

**STATEMENT OF ANGELA B. STYLES**

**TESTIFYING ON BEHALF OF THE DEFENSE INDUSTRY INITIATIVE ON  
BUSINESS ETHICS AND CONDUCT**

**BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS  
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE  
DECEMBER 9, 2015**

CHAIRMAN HANNA, CONGRESSMAN TAKAI, AND MEMBERS OF THE SUBCOMMITTEE, I appreciate the opportunity to appear before you today as the Coordinator of the Defense Industry Initiative on Business Ethics and Conduct (“DII”) to discuss ways to empower small businesses to comply with the multitude of requirements they are required to follow as contractors in the federal marketplace.

DII is a nonpartisan, non-profit 501(c)(3) association of U.S. defense companies who are committed to a culture and practice of ethics and integrity in all business dealings with the United States Department of Defense. In 1986, the Chief Executive Officers and senior officials of 18 defense contractors (please see Attachment A for a list of founding Signatories) led by Jack Welch from General Electric voluntarily met to create DII and draft self-governance principles. Mr. Welch and the other pioneering defense contractors were guided by the “The President’s Blue Ribbon Commission on Defense Management” for defense contractors to improve the defense acquisition process through greater self-governance. By July 1986, 32 major defense contractors had pledged to adopt DII’s core principles. Today, 76 defense contractors – including both small and large businesses – are Signatories to the DII principles (see current list of DII Signatories at Attachment B):

We, the members of the Defense Industry Initiative on Business Ethics & Conduct (DII), affirm our commitment to uphold the highest ethical standards in all our business dealings with the government, as expressed through the following principles:

(1) We shall act honestly in all business dealings with the U.S. government, protect taxpayer resources, and provide high-quality products and services for the men and women of the U.S. Armed Forces.

(2) We shall promote the highest ethical values as expressed in our written codes of business conduct, nurture an ethical culture through communications, training, and other means, and comply with and honor all governing laws and regulations.

(3) We shall establish and sustain effective business ethics and compliance programs that reflect our commitment to self-governance, and shall encourage employees to report suspected misconduct, forbid retaliation for such reporting, and ensure the existence of a process for mandatory and voluntary disclosures of violations of relevant laws and regulations.

(4) We shall share best practices with respect to business ethics and compliance, and participate in the annual DII Best Practices Forum.

(5) We shall be accountable to the public, through regular sharing and reporting of Signatory activities in public fora, including [www.dii.org](http://www.dii.org). These reports will describe members' efforts to build and sustain a strong culture of business ethics and compliance.

As part of its mission, DII provides resources and assistance to help train hundreds of thousands of defense-industry employees in ethics and compliance, with DII's website providing free access to ethics training, instructional videos, and webinars on emerging ethics issues for defense-industry companies. DII also holds regular meetings and conferences to share best practices. As well, DII mentors suppliers and new firms in how to comply with the laws and regulations that govern U.S. defense companies.

### **Small Businesses in the Federal Marketplace Lack Resources to Develop Compliance Programs**

In an ideal world, all businesses that participate in the federal marketplace would have the wherewithal to understand and comply with all of the obligations that go hand-in-hand with federal contracting. This is not an ideal world. The scope and complexity of regulations faced by contractors are enough to regularly challenge even the largest federal contractors with robust compliance and ethics programs.

With less resources (measured both by money and manpower) and less experience with government contracting, the hurdles faced by small businesses in even setting up compliance programs are monumental. As a result, the federal government is undoubtedly contracting with small businesses that do not know the full extent of the laws, regulations, or provisions with which they are supposed to comply (let alone understand them), are not monitoring their compliance against these requirements, and have no process to voluntarily disclose violations to the appropriate authorities.

Although there are numerous federal government agencies, centers, and offices that work with small businesses engaged in federal contracting, DII has *extensively* searched and has not found government sources that provide guidance to small businesses to aid in the adoption of codes of conduct or the establishment of broader compliance and ethics programs. Some offices, like small business development centers, which are administered by the Small Business Administration, provide management assistance to current and prospective small business owners, but have been statutorily tasked only in general terms with providing counseling and technology development for complying with environmental, energy, health, safety, and other federal, state, and local regulations. 15 U.S.C. § 648(c)(3)(H).<sup>1</sup> The statutes underlying other similar programs, like the Procurement Technical Assistance Centers and the Department of Defense “DoD” Office of Small Disadvantaged Business Utilization (also known as the DoD Office of Small Business Programs), do not speak to helping ensure small business compliance with laws at a high-level like this, let alone the establishment of ethics and compliance programs.

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<sup>1</sup> The Small Business Act provides that “Services provided by small business development centers shall include, but shall not be limited to – (h) maintaining current information concerning Federal, State, and local regulations that affect small businesses and counsel small businesses on methods of compliance. Counseling and technology development shall be provided when necessary to help small businesses find solutions for complying with environmental, energy, health, safety, and other Federal, State, and local regulations.” 15 U.S.C. § 648(c)(3).

## **DII's Past and Current Outreach to Small Businesses**

Because federal resources for assisting small business with ethics and compliance programing appears to be woefully lacking, DII recently undertook several significant initiatives to provide ethics and compliance resources to small business contractors. In 2014, DII published a Model Code of Conduct for suppliers, which I have provided to the Subcommittee as Attachment C. DII learned from a 2013 survey of its Signatories that such a code would be a helpful resource when dealing with supply chain integrity issues. DII's Model Code of Conduct includes such topics as compliance with laws, human rights, employment practices, anti-corruption, conflicts of interest, and information protection. For those already with a supplier code, this Code is a benchmarking tool. For Signatories as well as small suppliers without a code of conduct, the Code is capable of being adopted for use as-is or as a foundation to the creation of a new supplier code of conduct. Ideally, this Code will come to serve as common core code with company specific addenda and achieve the ultimate objective of limiting the number of codes flowed to common suppliers.

DII also undertook in 2014 to provide a Supplier Toolkit. The Toolkit's purpose is to provide helpful tips and guidance on how to put together an effective ethics and compliance program, support suppliers in becoming compliant with Federal Acquisition Regulation 52.203-13 Contractor Code of Business Ethics and Conduct requirements, engage the supplier community in the ethics discussion, and strengthen the defense industry. The Supplier Toolkit can be found on our website at [www.dii.org](http://www.dii.org)

Following the publication of DII's Model Code of Conduct and Supplier Toolkit, multiple suspension and debarment offices from agencies across the federal government invited DII to discuss difficulties faced by small businesses in understanding and complying with their

obligations as federal contractors. As a result of these meetings, DII has committed to provide additional resources specifically developed with small businesses in mind. To that end, DII has recently published a webinar on small business issues on its website; I have also provided today as Attachment D to my testimony the slides for this webinar.

Finally this spring, DII plans to launch a robust Small Business Toolkit, which will touch upon the following four features of a compliance program:

- Structure and organization of a compliance program – DII will provide examples of various models that can be used in building a compliance program;
- Code of conduct, policies & procedures – DII will develop models of the types of policies that small businesses which contract with the government should consider implementing;
- Training and communications – DII will publish sample training videos and other communications;
- Monitoring and auditing – DII will provide templates for small businesses to use to monitor the effectiveness of their compliance programs.

DII is also developing a mentor-protégé program for ethics and compliance issues that will provide names of companies and individuals that small contractors can contact as a resource.

DII is taking these steps in furtherance of its mission to help improve the defense acquisition process through greater self-governance and will be analyzing how best to conduct outreach to make these resources more broadly available to non-Signatory small businesses.

### **In Conclusion**

Given the scarcity of federal government resources dedicated to helping small businesses establish ethics and compliance programs, DII has committed to creating and making available resources to help small businesses understand and comply with federal contracting requirements. We are certainly hopeful that these education and training efforts can be done in coordination

with our Department of Defense and Small Business Administration colleagues. The small business advocates can play an important role in helping to ensure that small businesses have ethics and compliance programs and provide guidance on the resources available to develop them. Together, the public and private sectors should ensure that small businesses have the resources and tools to wisely, legally and ethically perform contracts for the federal government. This concludes my prepared remarks. I am happy to answer any questions you may have.



HOUSE COMMITTEE ON SMALL BUSINESS  
Witness Disclosure Statement  
Required by House Rule XI, Clause 2(g)

Your Name: <u>Angela Styles</u>		
1. Are you testifying on behalf of a Federal, State, or Local Government entity?	YES	NO <input checked="" type="checkbox"/>
2. Are you testifying on behalf of an entity other than a Government entity?	YES <input checked="" type="checkbox"/>	NO
3. Other than yourself, please list what entity or entities you are representing: <u>Defense Industry Initiative on Business Ethics &amp; Conduct</u>		
4. Please list any offices or elected positions held or briefly describe your representational capacity with the entities disclosed in question 3. <u>Coordinator</u>		
<i>(For those testifying on behalf of a Government entity, ignore these questions below)</i>		
5. a) Please list any Federal grants or contracts (including subgrants or subcontracts), including the amount and source (agency) which <u>you</u> have received and/or been approved for since January 1, 2013: <u>None</u>		
b) If you are testifying on behalf of a non-governmental entity, please list any federal grants or contracts (including subgrants or subcontracts) and the amount and source (agency) received by the <u>entities listed under question 3</u> since January 1, 2013, which exceeded 10% of the entities' revenues in the year received: <u>None</u>		
6. If you are testifying on behalf of a non-governmental entity, does it have a parent organization or an affiliate who you specifically do not represent? If so, list below:	YES	NO <input checked="" type="checkbox"/>

Signature: Angela B. Styles Date: 12/7/15



ORIGINAL SIGNATORIES (1986)

Aeronca Inc.  
Allied-Signal, Inc.  
American Telephone & Telegraph Co.  
Burroughs Corporation  
E-Systems, Inc.  
Eaton Corporation  
FMC Corporation  
Ford Aerospace & Communications Corp.  
General Dynamics Corporation  
General Electric Company  
Goodyear Aerospace Corporation  
Grumman Corporation  
Hercules Inc.  
Hewlett-Packard Company  
Honeywell Inc.  
Hughes Aircraft Company  
IBM Corporation  
Lockheed Corporation  
Martin Marietta Corporation  
McDonnell Douglas Corporation  
Northrop Corporation  
Parker Hannifan Corporation  
PneumoAbex Corporation  
Raytheon Company  
Rockwell International Corporation  
The Boeing Company  
The Singer Company  
Sperry Corporation  
TRW, Inc.  
Textron Inc.  
United Technologies Corporation  
Westinghouse Electric Corporation





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**SIGNATORIES**

3M Company	Humana Government Business, Inc.
ACC Health	Huntington Ingalls Industries
Advanced Electronics Company	IAP Worldwide Services
Aerojet Rocketdyne “A GenCorp Company”	IBM Corporation
Aerospace Corporation, The	Institute for Defense Analyses (IDA)
Agiltron	Intel Federal
AgustaWestland North America Inc.	Leidos
Allfast Fastening Systems, Inc.	Lockheed Martin Corporation
Alliant Techsystems, Inc.	ManTech International
Applied Research Associates, Inc.	MCR, LLC
AT&T Government Solution	Mission Essential Personnel
BAE Systems	MTS Systems Corporation
Boeing Company, The	Natel Engineering Company
Booz Allen Hamilton	North Florida Shipyards
BWX Technologies, Inc.	Northrop Grumman Corporation
CFM International	Orbital ATK
Chugach Alaska Corporation	Parker Hannifan Corporation
CNA Corporation	PGBA, A Celerian Group Company
Concurrent Technologies Corporation	Quantech Services, Inc.
Curtiss-Wright Corporation	Raytheon Company
Day & Zimmermann, Inc.	Rockwell Collins, Inc.
Decypher Technologies Ltd.	SAIC
Delex Systems, Inc.	SAP National Security Services, Inc.
DRS Technologies, Inc.	SENTEL Corporation
DynCorp International LLC	Serco Inc.
EADS North America	Siemens Government Services, Inc.
EG&G Technical	Sodexo Federal Services, Inc.
Elbit Systems of America	Solers, Inc.
Engility Corporation	SRA International, Inc.
Esterline Corporation	Supreme Group USA, LLC
Exelis Inc.	Teledyne Technologies Incorporated
Frequency Electronics, Inc.	Textron Inc.
General Dynamics Corporation	United Technologies Corporation
General Electric Company	URS Corporation
Georgia Tech Research Institute	Vectrus Corporation
Harris Corporation	Williams International
Health Net Federal Services, LLC	Wisconsin Physicians Serv. Ins. Corporation
Honeywell International, Inc.	Woodward, Inc

# *Defense Industry Initiative* MODEL SUPPLIER CODE OF CONDUCT



The members of the Defense Industry Initiative on Business Ethics and Conduct (DII) (hereinafter "we") are committed to upholding the highest standards in all our business dealings with the U.S. Government, protecting taxpayer resources, and providing high-quality products and services for the men and women of the U.S. Armed Forces and their allies. Complying with all laws and regulations and ensuring fair competition are fundamental to this commitment.

This Supplier Code of Conduct expresses the expectations we hold for suppliers throughout the aerospace and defense industry.



## General Disclaimer

*This Supplier Code of Conduct is in no way intended to conflict with or modify the terms and conditions of any existing contract. In the event of a conflict, suppliers must first adhere to applicable laws and regulations, then the contract terms, followed by this Supplier Code of Conduct.*

## I. Compliance with Laws

*We expect our suppliers to maintain full compliance with all laws and regulations applicable to their business. When conducting international business, or if their primary place of business is outside the United States, suppliers must comply with local laws and regulations.*

### A. Maintain Accurate Records

We expect suppliers to create accurate records, and not alter any record entry to conceal or misrepresent the underlying transaction represented by it. All records, regardless of format, made or received as evidence of a business transaction must fully and accurately represent the transaction or event being documented. When a record is no longer needed to conduct current business, records should still be retained based on the applicable retention requirements. Suppliers performing as US Government contractors (whether direct or indirect) must comply with the requirements in FAR 4.703. Suppliers that are performing or fulfilling a US Government role in their prescribed work must comply with the records requirements of the affected agency and any relevant National Archives and Records Administration (NARA) requirements that apply to that agency.

## II. Human Rights

*We expect our suppliers to treat people with respect and dignity, encourage diversity, remain receptive to diverse opinions, promote equal opportunity for all, and foster an inclusive and ethical culture.*

### A. Child Labor

We expect our suppliers to ensure that illegal child labor is not used in the performance of work. The term "child" refers to any person under the minimum legal age for employment where the work is performed.

### B. Human Trafficking

Suppliers must adhere to regulations prohibiting human trafficking, and comply with all applicable local laws in the country or countries in which they operate. Suppliers must refrain from violating the rights of others and address any adverse human rights impacts of their operations. Suppliers must educate employees on prohibited trafficking activities, discipline employees found to have violated the law or rules, and notify the contracting

officer of violations and action taken against employees. Specifically, suppliers will be prohibited from the following in all contracts.

- *Destroying, concealing, or confiscating identity or immigration documents;*
- *Using misleading or fraudulent tactics in recruiting;*
- *Charging employee recruitment fees or providing inadequate housing based on local standards, laws and directives;*
- *Failing to provide employment contracts and other documentation in the employee's native language;*
- *Failing to provide return transportation upon the end of employment for employees brought to the country for the purpose of working on a U.S. government contract or subcontract; and*
- *Failing to interview and protect employees suspected of being trafficking victims.*

## III. Employment Practices

### A. Harassment

We expect our suppliers to ensure that their employees are afforded an employment environment that is free from physical, psychological, and verbal harassment, or other abusive conduct.

### B. Non-discrimination

We expect our suppliers to provide equal employment opportunity to employees and applicants for employment, without regard to race, ethnicity, religion, color, sex, national origin, age, military veteran status, ancestry, sexual orientation, gender identity or expression, marital status, family structure, genetic information, or mental or physical disability, so long as the essential functions of the job can be competently performed with or without reasonable accommodation.

### C. Substance Abuse

We expect our suppliers to maintain a workplace free from illegal use, possession, sale, or distribution of controlled substances.

## IV. Anti-Corruption

### A. Anti-Corruption Laws

Our suppliers must comply with the anti-corruption laws, directives and/or regulations that govern operations in the countries in which they do business, such as the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act.



We require our suppliers to refrain from offering or making any improper payments of money or anything of value to government officials, political parties, candidates for public office, or other persons. This includes a prohibition on facilitating payments intended to expedite or secure performance of a routine governmental action like obtaining a visa or customs clearance, even in locations where such activity may not violate local law. Personal safety payments are permitted where there is an imminent threat to health or safety.

We expect our suppliers to exert due diligence to prevent and detect corruption in all business arrangements, including partnerships, joint ventures, offset agreements, and the hiring of consultants.

#### **B. Illegal Payments**

Our suppliers must not offer any illegal payments to, or receive any illegal payments from, any customer, supplier, their agents, representatives or others. The receipt, payment, and/or promise of monies or anything of value, directly or indirectly, intended to exert undue influence or improper advantage is prohibited. This prohibition applies even in locations where such activity may not violate local law.

#### **C. Anti-Trust**

Our suppliers must not fix prices or rig bids with their competitors. They must not exchange current, recent, or future pricing information with competitors. Our suppliers must refrain from participating in a cartel.

#### **D. Gifts/Business Courtesies**

We expect our suppliers to compete on the merits of their products and services. The exchange of business courtesies may not be used to gain an unfair competitive advantage. In any business relationship, our suppliers must ensure that the offering or receipt of any gift or business courtesy is permitted by law and regulation, and that these exchanges do not violate the rules and standards of the recipient's organization, and are consistent with reasonable marketplace customs and practices.

#### **E. Insider Trading**

Our suppliers and their personnel must not use material, non-publicly disclosed information obtained in the course of their business relationship with us as the basis for trading or for enabling others to trade in the securities of our company or those of any other company.

## **V. Conflict of Interest**

*We expect our suppliers to avoid all conflicts of interest or situations giving the appearance of a potential conflict of interest in their dealings with our company. We expect our suppliers to provide notification to all affected parties in the event that an actual or potential conflict of interest arises. This includes a conflict between the interests of our company and personal interests or those of close relatives, friends or associates.*

## **VI. Information Protection**

### **A. Confidential/Proprietary Information**

We expect our suppliers to properly handle sensitive information, including confidential, proprietary, and personal information. Information should not be used for any purpose (e.g., advertisement, publicity, and the like) other than the business purpose for which it was provided, unless there is prior authorization from the owner of the information.

### **B. Intellectual Property**

We expect our suppliers to respect and comply with all the laws governing intellectual property rights assertions, including protection against disclosure, patents, copyrights, and trademarks.

### **C. Information Security**

Suppliers must protect the confidential and proprietary information of others, including personal information, from unauthorized access, destruction, use, modification and disclosure, through appropriate physical and electronic security procedures. Suppliers must comply with all applicable data privacy laws. Suppliers shall assure extension of this requirement to all sub-tier sources they employ.

## **VII. Environment, Health, and Safety**

*We expect our suppliers to operate in a manner that actively manages risk, conserves natural resources, and protects the environment. We expect our suppliers to apply environmental management system principles in order to establish a systematic approach to the management of risks/hazards and opportunities associated with the environment, including potential risk from regulatory non-compliance, reputational loss, and opportunities for business growth through operational and product stewardship.*

*We expect our suppliers to comply with all applicable environmental, health and safety laws, regulations, and directives. Suppliers should protect the health, safety, and welfare of their people, visitors, and others who may be affected by their activities.*



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## VIII. Global Trade Compliance

### A. Security

When applicable, suppliers are encouraged to implement practices and procedures to ensure the security of their supply chains in accordance with the Customs-Trade Partnership Against Terrorism initiative of the United States Department of Homeland Security.

### B. Import

We expect our suppliers to ensure that their business practices are in accordance with all applicable laws, directives and regulations governing the import of parts, components, and technical data.

### C. Export

We expect our suppliers to ensure that their business practices are in accordance with all applicable laws, directives and regulations governing the export of parts, components, and technical data.

### D. Anti-Boycott

Our suppliers must not participate in, cooperate with, or further the cause of any unsanctioned foreign economic boycott, in accordance with the 1977 Export Administration Act and the 1976 Tax Reform Act.

### E. Conflict Minerals

Suppliers must adhere to federal laws and regulations requiring reporting companies to make specialized disclosure and conduct due diligence concerning their use of conflict minerals that may have originated in the Democratic Republic of the Congo (DRC) or an adjoining country. Conflict minerals include cassiterite, columbite-tantalite, gold and wolframite, or their derivatives (tantalum, tin, and tungsten). Under the Securities Exchange Act of 1934, reporting companies that manufacture or contract to manufacture products that contain conflict minerals must conduct due diligence on the source and chain of custody of the applicable conflict minerals, and file a report with the SEC by May 31, 2014. We expect our suppliers to develop due diligence processes to meet our obligations to ensure that all products are responsibly manufactured.

## IX. Quality

*Suppliers must take due care to ensure their work product meets our company's quality standards. We expect our suppliers to have in place quality assurance processes to identify defects and implement corrective actions, and to facilitate the delivery of a product whose quality meets or exceeds the contract requirements.*

### A. Counterfeit Parts

We expect our suppliers to develop, implement, and maintain methods and processes appropriate to their products to minimize the risk of introducing counterfeit parts and materials into deliverable products. Effective processes should be in place to detect counterfeit parts and materials, provide notification to recipients of counterfeit product(s) when warranted, and exclude them from the delivered product.

## X. Ethics Program Expectations

### A. Whistleblower Protection

We expect our suppliers to provide their employees with avenues for raising legal or ethical issues or concerns without fear of retaliation. We expect our suppliers to take action to prevent, detect, and correct any retaliatory actions.

### B. Consequences for Violating Code

In the event of a violation of any of the above expectations, we may pursue corrective action to remedy the situation. In the case of a violation of law or regulation, we may be required to report those violations to proper authorities. We reserve the right to terminate our relationship with any supplier under the terms of the existing procurement/purchasing contract.

### C. Ethics Policies

Commensurate with the size and nature of their business, we expect our suppliers to have management systems in place to support compliance with laws, regulations, and the expectations related to or addressed expressly within this Supplier Code of Conduct. We encourage our suppliers to implement their own written code of conduct and to flow down the principles of a code of conduct to the entities that furnish them with goods and services.

For questions/comments about the Code, please visit the Defense Industry Initiative website: [www.DII.org](http://www.DII.org). Send an email by selecting "Contact Us" under the "About Us" section.



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## Contracting with Small Businesses

Amy L. O'Sullivan  
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Crowell & Moring LLP  
October 2015

### Purpose of Training

- Large pool of contracts/revenue set aside for small businesses
- Understand key SBA programs, requirements, and how contracting relationship can impact size status
- Focus on affiliation issues and limitations on subcontracting
- Large business participation in SBA programs or working with small businesses = TENSION
  - Opportunities
  - Limitations
  - Risks

## Agenda

- Overview of various SBA programs, penalties
- What is a small business?
- Affiliation issues
- Limitations on subcontracting
- 8(a) business development program
- Mentor protégé program and joint ventures

## SBA Origins and Mission

- The SBA was created to ensure that: “a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government . . . be placed with small-business enterprises. . . .” 15 U.S.C. § 631(a).
- It is the “continuing policy and responsibility of the Federal Government to use all practical means to take such actions as are necessary” to foster the economic interests, growth, development, and competitiveness of small businesses. 15 U.S.C. § 631a.

## SBA/Contracting Agency Interaction

- SBA negotiates annual procurement preference goals with each agency and reviews results
- SBA is responsible for ensuring that the statutory government-wide goals are met in the aggregate
  - SB = 23%
  - SDB = 5%
  - WOSB = 5%
  - HUBZone = 3%
  - SDVOSB = 3%
- Individual agency goals meet or exceed 23% goal
- MORE TENSION!

## SBA's Focus on Enforcement

### False Certifications

- The Small Business Jobs and Credit Act of 2010 provides that an offeror's mere submission of a proposal for a small-business set-aside contract, or even its registration in a database to be considered for a set-aside, is to be considered an "**affirmative, willful and intentional**" certification that the offeror meets the small business size and status requirements
- Implemented in 13 C.F.R. § 121.108

### Size Protests

- Low threshold to file, short time frame to respond and response includes significant documentation and certified SBA Form 355
- Parallel/subsequent OIG investigations, suspension/debarment



## Size Misrepresentation Penalties

- The Small Business Act and implementing regulations provide for severe penalties for misrepresenting small business size status:
  - Fine of not more than \$500,000 or by imprisonment for not more than 10 years, or both
  - Subject to administrative penalties for Fraud
  - Suspension and debarment
  - Ineligibility to participate in any program or activity conducted by the SBA for up to 3 years
- May also be subject to:
  - Investigations
  - Civil or Criminal False Claims Act penalties

## Oversight and Enforcement – Risks for Large Businesses Too

- October 2011 Suspension of GTSI: the “Wake-Up Call” on Small Business Issues
- No prior warning – simultaneous with *Washington Post* headlines
- Suspension based on:
  - Adequate evidence of commission of fraud or criminal offense in connection with obtaining, attempting to obtain, or performing a contract or subcontract; and
  - Adequate evidence indicating lack of business integrity/honesty casting doubt on GTSI’s responsibility
- Key issue was compliance with limitations on subcontracting:
  - Prime contractors had little to no involvement (0-.5%) in set-aside contracts
  - GTSI concealed the extent of its involvement as a subcontractor
  - Suspension lifted only after removal of CEO, GC, and others, and agreement to turn over internal business documents to government
  - Subsequent suspensions of GTSI small business prime contractors

## What is a Small Business?

- Size requirements vary by industry to reflect differences (generally either based on number of employees or annual receipts)
- SBA developed a table of size standards to match the North American Industry Classification System (“NAICS”)
- NAICS code identified in the solicitation
- Offeror self-certifies in SAM it is small for the procurement
- SBA does not maintain a list of SBs
- Size status determined as of date contractor submits self-certification that it is small to the procuring agency as part of its initial offeror which includes price

## What is Affiliation?

- Size is based on employees/annual receipts of SB and its affiliates
- Generally, affiliation exists between entities when:
  - One controls or has power to control another or third party has power to control both
- A “totality of the circumstances” analysis
  - Ownership, management, previous relationships
  - Contractual relationships
- Affiliation may be:
  - Affirmative or negative control (*e.g.*, minority shareholder that can prevent quorum or otherwise block action by board or shareholders)
  - Direct or indirect (through a third party)

## How is Affiliation Determined?

- Several “stand-alone” tests, with certain exceptions
- “Totality of the circumstances” evidencing power to control
  - Case law provides guidance, but analysis is fact dependent
  - Focus on reality of control – substance over form
- Exceptions to affiliation coverage:
  - Most importantly, ANCs and mentor-protégé
  - Variety of other narrow exceptions

## What Does “Affiliation” Mean?

- Affiliation affects a concern’s size for SB purposes
  - Eligibility for award of SB set-aside contracts/revenue – affects entire team!
  - Lost opportunities (prime and sub) and/or potential penalties if wrong
  - Possible subject of investigations, criminal sanctions
- This where SBA devotes heightened scrutiny – don’t try to walk the line!!
  - “[SBA] will not close its eyes to the practical realities of business life, but will look to substance rather than form in determining the size of a concern. . . . Although no single factor alone may support a finding of power to control, consideration of all . . . factors together [may lead] to that conclusion.” *Size Appeal of Savini Construction Co.*, SBA No. 477 (1971).

## Affiliation Tests

- “Control” is construed broadly by the SBA and includes both affirmative and negative control
- Identity of interest
  - Business or economic interests
  - Family relationships
- Newly organized concern rule
- Ownership – several stand-alone tests
- Stock options, convertible securities, agreements to merge
- Common management
- Joint ventures (note key mentor-protégé exception)
- **Totality of the circumstances!!**

## Affiliation – Ostensible Subcontractor

- SBA looks at whether the large business subcontractor is really the prime
- Not just a percentage of the work determination – this is only one of many factors
- Frequent issue if incumbent prime has become large or incumbent large business sub wants new teaming relationship
- Requires some counter-intuitive proposal writing techniques
- More factors present, greater likelihood of affiliation
- **Mentor-protégé relationships avoid these concerns!!**

## Affiliation – Ostensible Subcontractor

- Evidence of unusual reliance on subcontractor:
  - Which party will manage the K?
  - Are there discrete tasks to be performed by each party or is there commingling of personnel?
  - What party performs the more complex and costly K functions?
  - Which party possesses the requisite background and experience to carry out the K?
  - What degree of collaboration was there on the bid or proposal preparation?
  - What is the amount of work performed by each party?
  - Which party chased the K?
- Other factors – incumbent team member; personnel transfer; lack of qualifications and/or experience; bonding or financial assistance
- More factors present, greater likelihood of affiliation

## Limitations on Subcontracting

- In order to be awarded full or partial SB set-aside or 8(a) K, SB must agree:
  - Services K: SB will perform  $\geq 50\%$  of cost of K incurred for personnel with its own employees
    - Includes direct labor costs and any overhead which has only direct labor as base, plus G&A rate multiplied by labor cost
    - Does not include supplies/materials
  - Supplies/Products K: SB will perform  $\geq 50\%$  of cost of manufacturing supplies or products (not including cost of materials)
  - General Construction: At least 15% of the cost of the contract with its own employees (not including the cost of materials)
  - Specialty Trade Construction: At least 25% of the cost of the contract with its own employees (not including cost of materials)
- SBA-approved JVs must comply with same requirements
- Similar requirements for SDVOSB and HUBZone set asides

## Limitations on Subcontracting

- If Sub, understand how the limitations on subcontracting are calculated
- Focus on what does NOT count:
  - **Services:** 49% of the cost of the contract incurred for personnel; materials; supplies; overhead that does not have only direct labor as its base
  - **Supplies:** 49% of the cost of manufacturing the supplies; costs not incurred in production of the end item; materials, off-the-shelf items; required special tooling or test equipment
  - **Construction:** 84% of the cost of the contract, materials
  - **Specialty Trade Construction:** 74% of the cost of the contract, materials
- Also consider non-manufacturer rule, if applicable
- Must still consider other affiliation factors – “totality of the circumstances”

## Proposed Regulatory Changes – Limitations on Subcontracting

79 Fed. Reg. 77955 (12/29/14) Proposed SBA Regulation

- Complete overhaul of formula for calculating compliance with limitations on subcontracting – intended to be easier
- Shift from cost-based formula to comparison of amount paid to prime versus other than “similarly situated” subcontractors at any tier (defined as small business that is qualified the same as prime for the type of set aside)
- New compliance certification and harsh fine (greater than \$500K or amount exceeding limitation on subcontracting )
- Affiliation: Exclusion for “similarly situated” contractors in application of ostensible subcontractor rule

## Proposed Regulatory Changes – Limitations on Subcontracting

- Questions and Challenges
  - “Subcontractor” is undefined – i.e., does it include 1099’s?
  - Will the cost of materials exclusion in current regulations be carried forward?
  - Exclusion for similarly situated subs “at any tier” requires more oversight by prime
  - For ID/IQ contracts, does calculation apply at contract or order level?
  - When will final regulations be issued? For SBA regulations and FAR? What about the interim between implementation in both SBA regulations and the FAR?

## 8(a) Business Development Program

- 8(a) versus SDB Programs:
  - 8(a) Program offers broad scope of assistance to socially and economically disadvantaged firms, but SDB certification strictly pertains to benefits in Federal procurement
  - Companies which are 8(a) firms automatically qualify for SDB certification
- 8(a) application and certification process
- 8(a) participation is divided into 2 phases over 9 years:
  - 4-year developmental stage
  - 5-year transition stage
- Benefits = set-asides (sole source and competitive); mentoring; subcontracting opportunities; other assistance
- Survival post-graduation is difficult
- SDB status extends longer

## 8(a) Program Eligibility

- Small business
- Unconditionally owned and controlled by 1 or more socially and economically disadvantaged individuals who are of good character and U.S. citizens
  - Socially disadvantaged: have been subjected to racial or ethnic prejudice or cultural bias because of their identity as members of a group. Social disadvantage must stem from circumstances beyond their control. Includes: Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and others if meet test.
  - Economically disadvantaged: ability to compete in the free enterprise system impaired due to diminished capital and credit opportunities. Individual's net worth, after excluding the individual's equity in firm and primary residence, may not exceed \$250K at time of application and \$750K after that. SBA also considers individual's average 2-year income, fair market value of all assets, access to credit and capital, and financial condition of applicant firm.
- Must demonstrate potential for success (does not apply to SDBs)
- Key limits on ownership interests by non-disadvantaged individuals

## 8(a) Program – Grounds for Contract Termination

- 8(a) contract (whether in base or option year) “must be terminated for the convenience of the Government” if :
  - Individual(s) on which 8(a) eligibility was based “relinquishes or enters into an agreement to relinquish” ownership or control of the 8(a) entity such that 8(a) entity would no longer be controlled or at least 51% owned by disadvantaged individuals; or
  - “The contract is transferred or novated for any reason to another firm”
- May be waived by SBA if meet limited exceptions
- **Important transactional consideration!**



## Important 8(a) Restrictions

- 8(a) entity may change its ownership or business structure so long as one or more disadvantaged individuals own and control it after the change, **AND** SBA approves the change in writing prior to the change
- Decision to deny request for change of ownership or business structure may be grounds for 8(a) program termination where change is made nevertheless
- Regulations do NOT provide that an 8(a) contract must be terminated if 8(a) entity is terminated from the program

## SBA's 8(a) Mentor Protégé Program

- Unique advantages for mentor and protégé (and effective bid strategy) – currently limited to 8(a) program
- Special requirements
  - Qualifications of mentor and protégé
  - Numerous (some counterintuitive) requirements for terms of agreements
  - Various levels of SBA approval
- Must comply with performance of work restrictions (both between JV members and also limitations on subcontracting)

## 8(a) Mentor Protégé Program – Key Benefits

- SBA's M-P Program as affiliation exception for JVs; large business can have shared responsibilities as prime contractor
- JV qualifies as small and 8(a) on set-asides and for subcontracts (can be used to meet subcontracting goals)
- Ability to form multiple JVs to exceed regulatory limit of 3 awards in 2-year period
- Mentor can have up to 40% equity interest in Protégé
- Assistance provided under M-P agreement is exempt from affiliation
- Mentors generally limited to 1 Protégé; prohibited from more than 3; multiple Protégés cannot be competitors
- Protégé benefits from true mentorship, increase awards due to JV combined capabilities

## SBA v. Other Mentor Protégé Programs

- Only SBA program provides exemption from affiliation for M-P joint venture
- Other agency-specific M-P programs with varying benefits; only exempt from affiliation for assistance provided between Mentor and Protégé if M-P program authorized by statute or SBA
- Differing approval process, benefits, eligibility, and reporting under other programs
- Most designed to operate when Protégé is acting as subcontractor to Mentor (*i.e.*, DoD)
- Other types of benefits: subcontracting credit; reimbursement for costs of assistance; evaluation credit; awards and recognition

## Mentor Protégé Practice Pointers

- Types of assistance offered under M-P agreement should be broad (umbrella to avoid affiliation consideration) but not over commitment
- JV should be formed before submitting offer
- Operating Agreement – no transfer of membership interests; resignation, withdrawal, dissociation of member requires consent and SBA approval; carefully tailor termination provisions; members obligated to ensure performance of K and complete performance despite withdrawal of member
- Leave adequate time for SBA approval!

## Proposed Regulatory Changes – Expansion of Mentor-Protégé Program

80 Fed. Reg. 6618 (2/5/15) – Proposed SBA Regulation

- Significant expansion of 8(a) M-P program to all categories of small businesses
  - Concern for how SBA can process influx of applications, even with set open/closed periods
  - Annual review to determine if M-P agreement should be allowed to continue another year
  - Limit on duration proposed at 3 years and a total of 2 M-P agreements for protégé (either with same or different mentor)
  - Same affiliation exemption for JVs extended

## Proposed Regulatory Changes – Expansion of Mentor-Protégé Program

- Relationship Limitations
  - Generally no more than 1 protégé per mentor; max of 3 but no adverse impact on protégé development
  - Protégé cannot also be mentor
  - Generally no more than 1 mentor per protégé; may have 2 if not competing/conflicting
  - Delete current size restrictions for 8(a) protégé for consistency
  - Prohibit non-profits from qualifying as mentor
  - Need to chose counterpart wisely in light of limitations – are there more opportunities (set asides) with a specific category of SB?

## Proposed Regulatory Changes – Expansion of Mentor-Protégé Program

- Joint Ventures
  - JV must be reduced to written agreement
  - Does not require JV to be separate legal entity – but SBA questions whether all JVs formed under M-P agreements should be separate legal entities
  - JVs cannot be populated with individuals to perform awarded contracts (for tracking and ensuring protégé is benefitting)
  - New certification on compliance with JV regs and JV agreement at multiple points in time with sanctions
  - New requirement to allow SBA to track award to JVs but SBA requesting guidance on how (separate DUNS, SAM)

## Proposed Regulatory Changes – Expansion of Mentor-Protégé Program

- Questions and Challenges
  - Greater incentives and authorization for SB alliances (teaming and JVs) – fewer competitors and stronger teams on set-asides and full and open competitions
  - More JVs and teams increase confidence in agency set-aside determinations – contributing to increase in percentage of annual spending/awards to small business
  - Explosion of JVs fueled by M-P expansion, but likely reduction in 8(a) M-P relationships
  - Need to invest in development of M-P JV templates – we can help!
  - Further backlog and delays within SBA – more M-P agreements and JVs to approve and more size protests
  - Disappearance of non-DoD agency-level M-P Programs?

## Questions?

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