Testimony of

Damien Specht
Special Counsel
Jenner & Block, LLP
Co-Chair, Government Contracts Corporate Transactions Practice Group

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SUBCOMMITTEE ON CONTRACTING AND WORKFORCE

Regarding "Action Delayed, Small Business Opportunities Denied:
Implementation of Contracting Reforms in the FY 2013 NDAA"

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Chairman Hanna, Ranking Member Meng and Members of the Subcommittee, thank you for the invitation to appear today. It is a privilege to share my views on the issues facing small business government contractors with all of you. Before I begin, let me state that my comments are my own and I am not speaking on behalf of my law firm or any specific client.

My name is Damien Specht, and I am a government contracts attorney with the law firm of Jenner & Block here in Washington, D.C. My practice focuses on corporate transactions and compliance counseling for large and small government contractors. Because of my broad-based practice, I have the opportunity to work with businesses ranging from 8(a) program participants, whose company is just beginning to take off, to large prime contractors that have tens of thousands of employees. As I am sure you all are aware, all of these businesses are keenly interested in the small business policies pursued by this body and the Small Business Administration.

When the 2013 National Defense Authorization Act was enacted a year and a half ago, the small business community immediately took notice. The initial reaction from my clients, and the opinion I share, is that the legislation is a "mixed bag" for small government contractors, but that much will depend on how the legislation is implemented by the SBA.

In my limited time, I would like to address three reforms presented, but not yet fully implemented, from the 2013 NDAA.

SBA's Mentor-Protégé Programs

From my perspective, the most important change in the 2013 NDAA relates to SBA's mentor-protégé program.

One of the major benefits of SBA's mentor-protégé program is that it closes the gap between customer needs and small business capabilities. Many of the small contractors I work

with report difficulty convincing large prime contractors or government customers that they can successfully perform technically challenging or large-scale work. Even when they are successful in capturing a large award, small firms face challenges in quickly creating the contract administration, supply chain and compliance infrastructure required to comply with government contracts regulations.

Those facts likely sound familiar to the members of this subcommittee. There is, however, another aspect to this problem. With the increasing pressure to meet small business subcontracting goals and achieve strong past performance reviews, large business contractors are constantly pursuing reliable small business subcontractors. These large contractors report difficulty finding the advanced capabilities and track record of success they need in a key small business subcontractor. After all, it is not enough merely to put a small business subcontractor on your team: Successful contract performance by that subcontractor is vital.

That is where SBA's mentor-protégé program is invaluable. Partnering mentors with 8(a) small businesses gives the small business the chance to leverage the mentor's experience and understand what infrastructure is needed to reach the next level. Mentors benefit by gaining a trusted small business partner that, in time, can be used for more sophisticated work. The ability of the mentor and protégé to pursue contracts together as a joint venture is a necessary ingredient to cementing the benefits for both parties.

Currently, these benefits are limited to a very narrow group of small businesses. For a small business to qualify as a protégé under the SBA mentor-protégé program, it must be an 8(a) concern that (1) is in the developmental stage of program participation; or (2) has never received an 8(a) contract; or (3) has a size that is less than half the size standard corresponding to its primary NAICS code.

Because I believe that the SBA mentor-protégé program has been a success, I was pleased to see language the Small Business Jobs Act of 2010 expanding the program to the Service Disabled Veteran-Owned, HUBZone, and Women-Owned Small Federal Contract Business Programs and, in Section 1641 of the 2013 NDAA, authorizing expansion to include all small business concerns. Although SBA has stated that it will make it a priority to issue regulations establishing the three newly authorized mentor-protégé programs set out in the 2010 Small Business Jobs Act, I am not aware of any public statement from SBA that it will exercise the 2013 NDAA's authority to further expand the program. This has led significant uncertainty in the contracting community as to whether the expansion will ever happen.

SBA's delay may be the result of a number of difficult issues it must address. For example, does SBA have the resources it needs to administer a significantly larger program? More specifically, will application processing times increase or oversight be weakened by expansion? Because contractors face hard deadlines for proposal submission, an extended wait for application processing would hamstring potential mentor-protégé joint venturers and undermine the program. Weakened oversight raises its own concerns and may limit the benefit of the program to small businesses.

In addition, the NDAA states that the expanded program "shall be identical to the mentor-protégé program" for 8(a) concerns. But, as discussed earlier, the current mentor-protégé program is limited to a small subset of 8(a) concerns that is in the earliest stages of the program, has not been awarded an 8(a) contract or is half the size of its applicable size standard. Obviously, these criteria cannot be applied to other small businesses that are not 8(a) firms. As a result, SBA faces a choice: Should it allow all small businesses to participate in the expanded program, which would be inconsistent with the current program's focus on only the smallest

firms, or should it limit the expanded program to early-stage small businesses as measured by some other yardstick? My own view is that the program was designed for early-stage businesses, so limiting protégés to firms that fall below half of their relevant size standard would be a good way to expand responsibly while focusing on businesses that will benefit the most. If that effort is successful, SBA can revisit further expansion in future years.

Another issue is the fact that the current program is time-limited because 8(a) firms are ineligible for mentor-protégé benefits after they graduate. Because the graduation concept is inapplicable to other small businesses, will SBA impose a time limit or size cap on protégés?

Large and small business are also eager to understand how SBA will handle subcontracting from a mentor-protégé joint venture. Under the 8(a) program, a large business mentor can perform 60 percent of the set-aside work awarded to a joint venture, but this conflicts with the FAR's subcontracting rules requiring the small business to perform the majority of the work. Whether it does it as part of this rulemaking or another, this inconsistency should be addressed by SBA.

In short, SBA will have a very challenging task implementing these changes. These are not questions with easy answers, and the position that the agency takes will be critical to the future health of what is now an excellent program.

Other Mentor-Protégé Programs

As effective as I believe the SBA Mentor-Protégé program is, I do not think there is sufficient information available to judge the efficacy of other agency mentor-protégé programs. As you are aware, a number of agencies have created their own mentor-protégé programs that offer to compensate large contractors for assisting small businesses and have other benefits, such

as allowing mentors to apply assistance given to a protégé against small business subcontracting performance.

In my experience, few clients are aware of agency mentor-protégé programs. Some that are aware of these programs confuse them with the SBA's far more robust program. This can be a fatal error because only the SBA's mentor-protégé program offers an affiliation exemption for a large mentor and small protégé bidding together as a joint venture. As a result, a situation could arise where a protégé is ineligible for set aside award because it incorrectly believes that another agency's mentor-protégé program provides a joint venture affiliation exception.

Because of this confusion, I welcome the 2013 NDAA's effort to increase uniformity among these programs and assess how they relate to the SBA's mentor-protégé program. In SBA's implementation of this legislation must address a number of policy issues:

- The SBA currently imposes a limit on the number of protégés a large business can have and the number of mentors a small business can have. Will these limits apply across all mentor protégé programs or will the limits be applied for participants in each program? Given the difficulties of tracking all mentor and protégé relationships, I would suggest that any limit be imposed on an agency by agency basis. After all, ensuring every willing protégé has a mentor for different aspects of its business can only be beneficial.
- The SBA also limits the number of contracts that the mentor and protégé can pursue as a joint venture. If the same mentor and protégé participate in multiple programs, should that limit apply to all of their awards? If mentor-protégé joint ventures will be allowed in other agency programs, imposing such a limit does not make sense. A higher, cross-program limit could be considered or the three-contract limit could be imposed on a per agency basis.

- Should the joint venture affiliation exception for the SBA mentor protégé program apply to other agency programs? If so, what is the scope of the exception? In my experience, this exception is one of the most attractive parts of the program. Expanding the exception would limit confusion and encourage participation in all agency programs, but that should be coupled with aggressive oversight to ensure that the program does not become vulnerable to abuse that will, in the long term, undermine its credibility.
- Similarly, SBA must decide whether other mentor-protégé program benefits should be available across all agencies. For example, some agency programs offer small business subcontracting credit for costs spent assisting the protégé. This encourages the mentor to follow through on its commitments, so I would argue that such efforts should be adopted across the government and added to SBA's program. However, the more uniform the program benefits, the more questions are raised as to why we have separate agency programs at all.
- As discussed above, SBA must also decide who can be a protégé in these programs. Many agency mentor-protégé programs are available to all small businesses while SBA's program is currently limited to 8(a) concerns. This is part of the larger debate I discussed earlier, but I would suggest that having different eligibility criteria for each agency's program is confusing and unnecessary.

As these issues highlight, we are at a key moment in the future of the mentor-protégé program at SBA and across the government. The goal of this effort should be expanding access and increasing clarity with regard to the benefits of entering into a mentor-protégé relationship. In doing so, however, we cannot forget that administration and oversight of these programs will require resources for each agency with a program.

Limited Safe Harbor

As I noted earlier, not all the provisions of the 2013 NDAA are helpful for small businesses. One of the areas where the NDAA falls short is with regard to the safe harbor for size misrepresentation. Although Section 1681 of the NDAA required the creation of a safe harbor for good-faith reliance on a written size opinion from SBA, SBA has only recently issued a proposed rule on this topic. More frustrating than the delayed rulemaking, however, is the extremely limited scope of the safe harbor.

As you know, the Small Business Jobs Act of 2010 increased the penalties for concerns that misrepresent their size or status to receive the award of a federal contract to the total amount expended by the government under the contract, subcontract, grant or cooperative agreement.

Although the penalty is harsh, it seems easy enough to comply with this rule: Don't misrepresent your size. However, having litigated size protests in front of SBA's Office of Hearings and Appeals, I can tell you that size cases are very fact specific and SBA's affiliation rules allow for different good-faith interpretations.

For example, the Office of Hearings and Appeal has held that a concern was other than small because it was 18 percent-owned by a large business, which was more than the next largest shareholder at 8 percent.[1] That case is published, so small businesses are, at least in theory, on notice that this specific fact pattern is not acceptable. But what if we change the facts so that the large business is a 15 percent shareholder? Or what if the next largest shareholder holds 11 percent? How is a small business to predict how the Office of Hearings and Appeals would decide that case? Is it appropriate to impose a penalty of the entire contract value – potentially trebled – if the small business guesses wrong?

[1] *Size Appeal of Novalar Pharms., Inc.*, SBA No. SIZ-4977, at 17-19 (2008).

Without an effective regulatory safe harbor to control for situations like this, we are asking small businesses to bet their company on the accuracy of each and every size representation they make. As a practical matter, that risk is prejudicial to the very constituency this subcommittee and the SBA seek to help. The tremendous risk associated with an incorrect representation is also a barrier to entry for small firms in the government contracts marketplace. Why would small business owners pursue federal business when they could lose their business based on a regulatory nuance? For those small government contractors who are successful, an ineffective safe harbor limits the value of their companies, as possible investors will have to factor in the potential for business-crushing losses.

The 2013 NDAA added a safe harbor for small businesses that misrepresent their size in "good faith reliance on a written alert opinion from a Small Business Development Center . . . or an entity participating in the Procurement Technical Assistance Cooperative Agreement Program. . ." Unfortunately, SBA's recent proposed rulemaking raises real doubt as to whether this safe harbor will provide any real benefit to the small business community.

The most fundamental concern I have about this safe harbor is that it may never actually be implemented. Although the NDAA lists the entities that can issue advisory opinions, it goes on to say that "nothing in this Act shall obligate either entity to provide such a letter . . . ." In its rulemaking, SBA emphasizes this point by giving each individual Small Business Development Center (SBDC) or Procurement Technical Assistance Center (PTAC) the individual choice whether to offer advisory opinions. Moreover, the rule confirms that no additional funding will be provided to offices that offer advisory opinions. Given the additional work involved, it is not clear what incentive individual SBDCs or PTACs will have to issue opinions, thus rendering the safe harbor moot. Even if some offices choose to issue these opinions, it is not at all clear what

this patchwork of advisory opinion resources will mean for small businesses that are outside the regions generally served by a particular office.

Further, even if an SBDC or PTAC chooses to issue advisory opinions, neither SBA's proposed rule nor the 2013 NDAA includes a time limit for issuing those opinions. In my experience, size determinations often take months. If advisory opinions are handled in a similar manner, small businesses that want to rely on this safe harbor may be forced to endure an open-ended delay in submission of proposals and may miss out on procurement opportunities.

In addition, although SBA's rule provides for a 10-day review of advisory opinions by its Office of General Counsel (OGC), the proposed rule does not allow a contractor to appeal an adverse SBDC, PTAC or OGC decision. Given that size determinations are regularly overturned by SBA's Office of Hearings and Appeals, small businesses plainly need an appellate forum. The rule's failure to provide an appeal mechanism puts substantial risk on the small business community for possible errors at the SBDC or PTAC level, which a 10-day review by the OGC is unlikely to resolve.

In sum, it is essential that small government contractors – and small businesses considering entering the federal space – have the certainty of a safe harbor from the presumed loss rule. Without significant revision, however, the currently proposed safe harbor is unlikely to meet that need.

Conclusion

In conclusion, I would like to emphasize that large and small government contractors need regulatory certainty to plan for the coming years. Whether they consider the 2013 NDAA to be a positive, negative or a mixed bag, the government contracts community is looking

forward to working with this subcommittee and the SBA to implement these provisions as quickly and effectively as possible.

Thank you for your time and I look forward to your questions.