LEGAL ADVISOR

A PilieroMazza Update for Federal Contractors and Commercial Businesses

Woman-Owned Small Business

NOW'S THE TIME FOR SBA TO EXPAND WOSB-ELIGIBLE INDUSTRIES

By Megan Connor

On May 1, 2015, the U.S. Small Business Administration issued a proposed rule to amend its regulations to implement Section 825 of the National Defense Authorization Act for Fiscal Year 2015 (2015 NDAA). Section 825 is most widely known for creating sole source authority for women-owned small businesses (WOSBs) and economically-disadvantaged women-owned small businesses (EDWOSBs), and the purpose of the proposed rule is to implement this authority. However, Section 825 also moves up the deadline for the SBA to conduct a study to determine the industries in which WOSBs are underrepresented, from January 2, 2018 (in the 2013 NDAA) to January 2, 2016 (in the 2015 NDAA). In order to comply with this requirement, SBA proposes revising the definitions of "underrepresentation" and "substantial underrepresentation" in 13 C.F.R. § 127.102 to provide SBA with flexibility to allow it to conduct a reliable and relevant study by the new, sooner deadline imposed by Congress.

Notably, the proposed rule does not describe the study SBA intends to undertake beyond the requirement that it use "reliable and relevant methodology." However, SBA's proposed changes signal a potential distancing from the 2007 Kauffman-RAND Institute for Entrepreneurship Public Policy (RAND) Study. Specifically, SBA proposes eliminating the RAND Study's disparity ratios from the definitions of "substantial underrepresentation" and "underrepresentation" (less than 0.5 for substantial underrepresentation and between 0.5 and 0.8 for underrepresentation). Such a move is warranted as the RAND Study methodologies and data sets have been criticized, and its results too narrowly construed by SBA.

Depending on the methodology selected, the RAND Study showed widespread underrepresentation by women in federal contracting, or no underrepresentation at all. And when originally interpreting the RAND Study and choosing which methodology to follow, the SBA acknowledged that it had selected the more "conservative approach" that could understate the availability of women-owned firms. See *Women-Owned Small Business Federal Contract Program*, 75 Fed. Reg. 62,258, 62,260-61 (Oct. 7, 2010). The SBA's conservative approach to the RAND Study made only 300+ six-digit NAICS codes available to the WOSB Program. As the WOSB Program is the only set-aside program that is not available for all 1,000+ six-digit NAICS codes, the SBA should adopt a more inclusive approach in establishing the "reliable and relevant methodology" it proposes to use.

Fortunately, the SBA has more data available now concerning WOSBs than it did when the RAND Study was published. At that time in 2007, only 3.32% of federal spending went to WOSBs. No doubt thanks in part to other recent changes to the WOSB Program, including the lifting of dollar caps, that percentage increased to 4.68% for fiscal year 2014. Federal agencies, therefore, have more data on hand concerning WOSBs because they are already doing business with them.

Because of this potential wealth of data, the SBA should consider directing each federal agency to perform its own analysis of WOSB representation. The SBA should then use the agency-specific data to develop a list of industries available for WOSB set-asides at each agency. Adjusting the list of available industries on an agency-by-agency

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basis would maximize each agency's ability to meet their WOSB goal. Under the current system, some agencies will have difficulty ever meeting the WOSB goal because their predominant procurements do not fall within the 300+ available NAICS codes. For example, the Department of Energy (DOE) does a significant amount of spending in the remediation services and environmental remediation services industries under NAICS code 562910, which is not one of the available industries for the WOSB Program. Not surprisingly, in fiscal years 2013 and 2014, DOE fell well short of the WOSB goal. Presumably, a DOE study would find underrepresentation of WOSBs in remediation services. The SBA could then use such a study to make NAICS code 562910 available to DOE for WOSB set-asides.

Importantly, the SBA does not need a legislative fix to involve agencies to determine the industries in which WOSBs are underrepresented. Both the existing law and the implementing regulations permit the SBA to determine underrepresentation of WOSBs based on input from each federal department and agency. See 15 U.S.C. § 637(m)(6) (giving the SBA the ability to request each agency provide "such information as the [SBA] determines to be necessary to carry out the [WOSB Program]"); see also 13 C.F.R. § 127.501(b) ("In determining the extent of disparity of WOSBs, SBA may request that the head of any Federal department or agency provide SBA, data or information necessary to analyze the extent of disparity of WOSBs.").

In light of the fast-approaching January 2, 2016 deadline, the SBA should use its authority under the law to require each agency to perform its own analysis, which the SBA could then use to develop a list of NAICS codes available for WOSBs at each agency. This would best serve the intent of the WOSB Program by increasing the tools each agency can use to maximize WOSB participation in their procurements.

The time is now to open the WOSB Program to more industries and more participants, and the SBA has the means to do so.

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PilieroMazza News

PilieroMazza is pleased to announce the opening of our first satellite office in Boulder, Colorado. Our goal is to make our legal services more accessesible to our mid-west and west coast clients. Peter Ford, who will manage the office, is one of our experienced government contracting and corporate lawyers. He will be available for in-person consultations and will be co-hosting several seminars and training sessions with our Washington, D.C., attorneys starting this fall.

Government Contracting

8(a) APPLICANTS: UNLOCK YOUR POTENTIAL TO SUCCEED

By Peter B. Ford

There are many issues that can trip up a small business applying to the SBA 8(a) Business Development Program (8(a) Program), and one of the most common and least understood is "potential for success." An added challenge with this eligibility criterion is that a denial decision based at least in part on a negative finding of potential for success is not appealable to SBA's Office of Hearings and Appeals and is the final decision of SBA. This means that you need to take more care with your application (and, potentially, your request for reconsideration) to make sure you understand and adequately demonstrate potential for success.

To demonstrate reasonable prospects for success, you must meet several criteria, including length of time in business, financial capacity, and managerial and technical expertise. While SBA will examine other factors as part of its analysis, these three are usually weighted heaviest and can make or break your ability to show potential for success.

Length of Time in Business

As a general rule, to demonstrate potential for success a firm must show that it has conducted business within its primary industry for a full two-year period immediately prior to the date of its 8(a) Program application. This is commonly known as the "two-year rule" and can be satisfied through the submission of tax returns showing that the firm has been

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generating revenues for two years. The revenue generation component of the two-year rule is key to meeting the length of time in business requirement. A firm formed two years prior to the date of application that does not generate any revenues during the first six months of opening its doors falls short of satisfying the rule.

That said, a firm with a limited operating history (i.e., less than two years) can request a waiver of the two-year rule. To do so successfully, the following five waiver criteria must be satisfied: (1) the individual or individuals upon whom eligibility is based have substantial business management experience; (2) the applicant has demonstrated technical experience to carry out its business plan with a substantial likelihood for success if admitted to the 8(a) BD program; (3) the applicant has adequate capital to sustain its operations and carry out its business plan as a participant; (4) the applicant has a record of successful performance on contracts from governmental or nongovernmental sources in its primary industry; and (5) the applicant has, or can demonstrate its ability to timely obtain, the personnel, facilities, equipment, and any other requirements needed to perform contracts as a participant.

The fourth criterion – a record of successful performance on contracts – is the one that most newly formed firms struggle to satisfy. While there is no magic number in terms of how many contracts must be performed successfully, in our experience you need at least one or two. Moreover, regardless of the number of contracts performed, you should always consider supplementing the waiver request with letters from current or former customers attesting to your successful contract performance.

Financial Capacity

Potential for success also requires a firm to demonstrate that it has adequate financial capacity. SBA's examination of this factor focuses largely on the applicant firm's financial statements, such as the balance sheet and income statement, for each of the three preceding fiscal year-end periods and for the interim period for the year in which the application is submitted.

In reviewing financial statements, SBA pays particular attention to the firm's working capital, net worth and net income. Again, there is no magic number for the working capital, net worth and net income values but, at the very least, these figures should all be positive. That said, if, for example, your interim financial statements look good but a review of the year-end financial statements reveals a downward (or disturbing) trend, SBA may question whether the figures on the interim financial statements paint a true picture of the firm's future economic viability. If a downward trend or sustained loss is attributable to atypical circumstances, you should be prepared to explain the nature of those circumstances to SBA and, more importantly, why the downward trend or sustained loss will not jeopardize the firm's ability to sustain business operations going forward.

SBA's examination of financial capacity extends beyond financial statements. SBA will take into account existing credit lines and other sources of financing in determining whether an applicant firm has the potential to succeed. For a firm with limited working capital, this presents an opportunity to demonstrate that the good outweighs the bad. In other words, access to a strong credit line can sometimes overcome SBA's concern with financial statements that reflect a weak working capital position.

Managerial Experience and Technical Expertise

With the managerial and technical expertise factor, the focus of SBA's potential for success analysis shifts from the firm itself to the individual owners, officers, managers and employees. These individuals must possess sufficient technical knowledge to operate the firm in its primary industry and have the management experience of the extent and complexity needed to run its day-to-day business operations. In addition, employees of the applicant firm must hold all requisite professional licenses.

Although the potential for success factor applies to the applicant firm as a whole, in practice, SBA is predominantly concerned with the experience and expertise of the socially and economically disadvantaged owner(s). SBA will critique the disadvantaged owner's résumé to determine whether he/she possesses the professional and educational background, in addition to any relevant licenses and certifications, needed to successfully run the business. For this reason, it is critical that the résumé of the disadvantaged owner be drafted to highlight not just his/her current management duties and responsibilities, but also prior work and/or educational experiences relevant to the business of the applicant firm. If you have a limited number of years of relevant experience, providing SBA with letters of referral or recommendation is a must.

In closing, demonstrating potential for success is a critical aspect of your application to the 8(a) Program, and knowing how to adequately address this eligibility issue can be the difference between gaining admission and getting denied.

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GUEST COLUMN

The Guest Column features articles written by professionals in the services community. If you would like to contribute an original article for the column, please contact our editor, Jon Williams at jwilliams@pilieromazza.com.

THE "TRICKLE DOWN" AUDIT

How OIG Audit Findings Influence GSA's Overall Compliance Efforts on Multiple Award Schedules

by Hope Lane, Partner, Aronson LLC

When working with clients who have received notice that they are being audited by the GSA Office of Inspector General (OIG), the first question I am often asked is what they did wrong that caused them to be selected. In reality, being chosen for an OIG audit is more often an indication that a company is doing something right – at least as far as contract sales volume is concerned.

GSA's OIG only does 40-50 pre-award audits annually and generally selects contracts that are up for renewal and fall in the top 5% of sales for all contractors on that particular Schedule. For example, in fiscal 2013, the OIG conducted 51 pre-award audits, but those contracts accounted for over 20% of total schedule revenues for that year. This makes sense because, when only a small sample can be audited in any given year, the OIG will choose contracts that offer the most "bang for the buck" in terms of potential recoveries and future cost avoidances.

Companies with more modest sales on their schedule contracts should not take the unlikelihood of an OIG audit as an invitation to stick their heads in the sand when it comes to managing GSA compliance issues. In fact, all schedule contract holders are well-advised to pay close attention to the major findings from OIG audits, as these recurring problems frequently become the basis for "trickle down" compliance efforts across the GSA Schedules as a whole.

Fortunately, you do not have to be psychic or have insider connections to learn what the OIG has been up to. Since 2011, the OIG has published an annual audit memorandum entitled 'Major Issues from Multiple Award Schedule Preaward Audits.' This report, which is available through the OIG's website (www.gsaig.gov), summarizes the recurring problem areas identified across the audits conducted in the prior year and provides historical data on the prevalence of these findings across fiscal years.

This year's audit memorandum identified three primary issues, the (1) use of unqualified labor on GSA task orders, (2) submission of Commercial Sales Practices (CSP) that are not current, accurate or complete, and (3) failure of sales tracking systems to capture and report all GSA sales. These problems are the focus of increasing scrutiny on all GSA contracts during the negotiation of contract awards and modifications as well as part of the Contractor Assessment compliance review program, which has recently increased in scope and frequency.

Current schedule holders have probably already noticed the growing emphasis on verifying the qualifications of people who are performing work on GSA task orders. GSA now requests a sampling of resumes corresponding to the personnel billed on selected task orders during Contractor Assessments (formerly Contractor Assistance Visits). The GSA analyst is then comparing the resume to the awarded position description for the labor category under which each employee was billed.

If the analyst finds that a person fails to meet the minimum requirements, *this is considered an overcharge and the contractor must reimburse the ordering agency the difference between the billed category and the position that person actually qualifies for.* Since having to refund customers is not a great PR strategy, GSA contractors need to implement processes to verify the education and experience of all people performing on GSA orders, including subcontractors, and periodically update the resumes they have on file.

Now let us consider the CSP. A CSP serves as the basis for GSA pricing negotiations to establish the contract's Basis of Award and it is therefore imperative to have a system in place to ensure CSP submissions are current, accurate, and complete. When is a contractor required to submit a new CSP? Clearly, one must be submitted with a new offer or the addition of products and services, but also within 15 days of a change to the discounting and/or terms and conditions extended to the Basis of Award customer. Beyond that, the GSA eMod System now asks contractors whether they need to revise their CSP upon the submission of any pricing modification.

eMod makes it exceptionally easy for contractors to state that there have been no changes to their CSP, even when that may not actually be the case. You may wonder why failing to revise the CSP to include changes to non-Basis of Award sales practices matters.

Every GSA Schedule contains GSAR 552.215-72 *Price Adjustment – Failure to Provide Accurate Information*. This clause gives GSA the right to unilaterally reduce contract prices if, at the time of award of the contract or a modification, it finds the contractor failed to provide pricing information that was current, accurate, and complete.

In other words, GSA is entitled to price decreases not only when the Basis of Award customer receives them, but also if the contractor fails to properly disclose information that would have been material to the *pricing negotiations* of the contract award or any modification of the contract. The GSA analyst will review invoices for Basis of Award customers during the Contractor Assessment. If he finds substantial anomalies in this pricing, it can be grounds for a directed OIG audit. Taken in the context of an OIG audit or qui tam False Claims case, the potential consequences for improper disclosure can be dire.

Keep in mind that the Multiple Award Schedules (MAS) Program is not funded by Congress; instead, the GSA gets all the money for the MAS from the Industrial Funding Fee (IFF) paid by ordering agencies. GSA has a vested interest in ensuring that contractors are reporting sales properly in order to maximize the amount of IFF it collects.

To that end, GSA actively monitors all contractors' sales tracking systems via Contractor Assessments. Contractors must be able to demonstrate that they can identify GSA orders and then track these orders in their accounting system in such a way that allows for the segregation of GSA orders and subsequent quarterly reporting GSA sales by Special Item Number (SIN). The system does not need to be sophisticated, it just needs to work. Schedule holders should be prepared to demonstrate their system at the Contractor Assessment.

Despite the fact that the majority of GSA contract holders will never be subject to an OIG audit, the compliance burden associated with the contract is heavily influenced by the issues identified in such audits. GSA uses findings from OIG audits to inform and direct program-wide compliance efforts, and major recurring deficiencies often become the impetus for new Contractor Assessment directives, such as the addition of resume reviews to these visits. Failure to meet these requirements can result in corrective actions, such as repayments, or even a directed audit. As goes the OIG, so goes GSA's primary compliance focus, and smart contractors will pay close attention to which way the winds are blowing.

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Business & Coporate Law

DRAFTING VALID LIQUIDATED DAMAGES PROVISIONS

By Ambika Biggs

When parties enter into agreements with each other, they want assurance that the other party to the agreement will perform its obligations under the agreement, or at the very least in the event of non-performance they can easily recover damages for the breach. In some instances, the parties realize measuring the damages that could result from a breach will be extremely difficult, if not impossible. In these instances, parties often include a liquidated or stipulated damages provision in their contract.

Liquidated damages are a set amount that a party agrees to pay to the other party to a contract in the event of a breach. Non-compete and non-disclosure agreements, leases and real estate contracts are examples of agreements that often include liquidated damages provisions. Government contracts also often contain liquidated damages provisions that enable the government to recover a set amount if the contractor does not meet certain performance deadlines or other requirements.

Parties may favor liquidated damages provisions because they provide a set amount that will be awarded in the event of a breach, without the non-breaching party having to prove the amount of damages it has incurred as a result of the breach. Liquidated damages provisions also are helpful to the breaching party because they set a limit on the amount it will have to pay if it breaches the agreement. By establishing a set amount for damages, liquidated damages provisions are intended to simplify the resolution of a breach of contract.

Unfortunately, even when a party breaches a contractual term to which a liquidated damages provision applies, the parties still could end up in litigation or arbitration. If the liquidated damages provision provides for the payment of a large sum, a breaching party may argue that the provision is unenforceable. A court can hold a liquidated damages provision to be unenforceable if it considers the amount of damages provided in it to be a penalty or punishment to the breaching party. The purpose of contractual remedies is to compensate the non-breaching party for its losses, not to punish or penalize the breaching party. A court will hold a liquidated damages provision to be an unenforceable penalty when the amount set forth in the liquidated damages provision is more than the amount of damages that the parties reasonably could have anticipated would result from a breach at the time of contract formation.

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In addition, a court may hold a liquidated damages provision invalid if the non-breaching party's intention in including the provision is to coerce performance by making a breach so expensive the other party feels forced to abide by the terms of the contract. Naturally, parties to a contract usually feel compelled to perform their obligations under the contract because they are exposed to potential liability if they do not, regardless of whether a contract contains a liquidated damages provision. However, when a liquidated damages provision contains damages so large that a party is coerced into performance, a court may hold the provision an unenforceable penalty.

Although each case is different and any liquidated damages clause must be drafted to suit the particular circumstances the parties are facing and the applicable law of the jurisdiction, the following is a list of terms that should be included in a liquidated damages provision to increase the chances of it being held enforceable:

- A sum certain to be paid in the event of a breach;
- The parties agree the amount represents reasonable compensation for the damages the parties anticipate will result from the breach;
- The parties agree to the stipulated remedy in the event of a breach;
- The liquidated damages are not a penalty, nor intended to punish a party for breaching the agreement;
- The liquidated damages are not intended to induce performance under the agreement; and
- Damages are limited to the amount set forth in the agreement (if the party wants to make the liquidated damages the exclusive remedy for breach).

Since one of the main reasons for including a liquidated damages provision in an agreement is to set damages for breach so the parties do not have to litigate, parties must be careful to craft liquidated damages provisions that are likely to be held enforceable and less likely to be challenged. Otherwise, a party may find itself subject to protracted litigation regarding whether the damages provision is an invalid penalty, and if so, what the actual damages are, which may be difficult to calculate.

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