LEGAL ADVISOR

A PilieroMazza Update for Federal Contractors and Commercial Businesses

LABOR & EMPLOYMENT

Fair Pay Safe Workplaces Halted but Not Dead

By Nichole Atallah and Ambika Biggs

On October 24, on the eve of its implementation, the U.S. District Court for the Eastern District of Texas issued a nationwide order halting the implementation of the bulk of Executive Order 13673, Fair Pay Safe Workplaces, which imposes new reporting requirements on government contractors regarding labor law violations and prohibits them from entering into pre-dispute arbitration agreements for matters arising under Title VII of the Civil Rights Act and for torts based on sexual assault or harassment. Under the Executive Order, contractors bidding on government contracts that exceed $500,000 are required to represent whether any administrative merits determination, arbitral award or decision, or civil judgment has been rendered against them within the past three years for violations of 14 labor laws and Executive Orders, including the Fair Labor Standards Act ("FLSA"), the Occupational Safety and Health Act of 1970 ("OSHA"), the National Labor Relations Act ("NLRA"), the Family and Medical Leave Act (the "FMLA"), Title VII; the Americans with Disabilities Act of 1990 ("ADA"), and the Age Discrimination in Employment Act of 1967 ("ADEA"). The Executive Order was set to go into effect on October 25, but given the injunction, it is expected that the government will temporarily suspend implementation and appeal the ruling.

The FAR rule implementing the Executive Order and U.S. Department of Labor's ("DOL") Guidance (collectively, "New Rule") requires offerors to report information about labor law violations on the Federal Awardee Performance and Integrity Information System ("FAPIIS"), including administrative merits determinations–non-final determinations made by an agency–regardless of the severity of the alleged violation, whether a government contract was involved, and whether a hearing has been held or an enforceable decision has been issued. Under the Executive Order, contracting officers are required to consider the information provided by offerors to determine whether they were "a responsible source that has a satisfactory record of integrity and business ethics." The New Rule also requires offerors who report violations to demonstrate their efforts to mitigate them and/or to enter into labor compliance agreements, or else be subject to a range of penalties, including being denied a contract award, or being referred for suspension or debarment.

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PilieroMazza News

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FAIR PAY

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Texas and national trade associations, whose members regularly bid on and are awarded government contracts, brought action to enjoin implementation of the New Rule. They argued that their members would be irreparably harmed by the New Rule in exercising their Due Process and First Amendment rights, and brought to the court's attention many of the concerns that the public raised in the comment period to the proposed rules and guidance. In granting the plaintiffs' motion for preliminary injunction, the court focused on a number of issues:

1. The Executive Order is Preempted by Other Federal Laws and Abridges Due Process Rights. It held that the New Rule is preempted by other federal labor laws. The court held that in the NLRA, FLSA, OSHA, Title VII, ADEA and ADA, "Congress spelled out in precise detail what agency or court would be empowered to find a violation, how such a finding would be determined, and what the penalty or remedy would be. None of these laws provides for debarment or disqualification of contractors for violations of their provisions; none of them provides for such determinations to be made by unqualified, agency contracting officers or Agency Labor Compliance Advisors ("ALCA"), a position created by the new rules, and certainly none of these laws provides for such action to occur based on non-final, unadjudicated, 'administrative merits determinations.'" The court noted that in instances in which Congress has allowed suspension or debarment for labor laws that apply to government contracts, the statutes require a final adjudication of the alleged violations, which are subject to judicial review, with full protections of the contractors' due process rights.

By requiring contractors to publically disclose allegations of labor law violations, and then disqualifying them or require them to enter into "premature labor compliance agreements" based on nothing more than allegations, the New Rule departs from Congress' instructions regarding how to address labor law violations. In addition, the court held that the New Rule conflicts with all 14 of the labor laws they invoke because they permit disqualification based on "administrative merits determinations," which are merely allegations made by agency employees and not final agency findings of violations, and can be contested or settled without an admission of fault. The court held that the New Rule likely violated the plaintiffs' due process rights because it compelled them to report and defend against non-final agency allegations without being entitled to a hearing at which they could contest the allegations.

2. The New Rule Infringes on First Amendment Rights. The court found that the New Rule appeared to infringe on the plaintiffs' First Amendment rights because it "compelled speech" by requiring contractors to report any alleged violation of the labor laws, regardless of whether they occurred while performing government contracts or whether they had been adjudicated after a hearing or settled without a hearing. By compelling contractors to engage in public speech on matters that adversely affect their reputations, the New Rule infringed on contractors' First Amendment rights.

3. DOL Defined "Serious, Repeated, Willful, and Pervasive" Different from the Statutes. One of the major concerns contractors had with the New Rule concerned the definitions of "serious, repeated, willful, or pervasive violations" of the 14 labor laws, on which a responsibility determination would be based. The court noted that the DOL's Guidance defined those terms in a manner that differs from the labor statutes. This is important because the New Rule specified that the contracting officer, with the advice of the ALCA, a position requiring no specialized skill or training, would be charged with interpreting these terms which could compromise a contract award. It was unclear to the court how contracting officers and ALCAs would be able to review disclosures related to labor laws–in which neither the contracting officers nor ALCAs are trained–within three days, and concluded that the new system is likely to lead to delays and arbitrary and inconsistent results in assessing contractor responsibility.

4. The Federal Arbitration Act Overrides the New Rule. As for arbitration provisions, the court held that the Federal Arbitration Act required courts to enforce arbitration agreements according to their terms. There was no congressional command that overrode this requirement, and therefore it enjoined the portion of the New Rule that requires contractors to agree not to enter into any mandatory, pre-dispute arbitration agreements with their employees or independent contractors for matters arising under Title VII or for torts relating to sexual assault or harassment.

> **"The Executive Order was set to go into effect on October 25, but given the injunction, it is expected that the government will temporarily suspend implementation and appeal the ruling."**

5. The Government Failed to Support the Stated Need for the New Rule. The court noted that the defendants had not supported the purported basis of the regulation–that government contractors who fail to comply with labor laws are also poor performing government contractors–because they had not demonstrated that there was a relationship between unresolved *allegations* of labor law violations and performance on government contracts, but rather had relied on studies that involved "the most severe findings of labor violations by agencies and courts." In addition, the court noted that the new regulations were expected to impose additional costs on government contractors, but the government had not been able to quantify the benefits that would result from the New Rule as required by the Procurement Act, and that in fact the opposite appeared to be the case.

6. The Pay Transparency Rules Will Still Be Effective January 1, 2017. The court declined to suspend implementation of the pay transparency portion of the New Rule, which requires contractors to provide wage statements with specified information to employees and to provide exempt employees and independent contractors with notice of their employment status with the company. Federal contractors should be prepared to provide appropriate wage statements and notices to employees and independent contractors prior to January 1, 2017.

Although this decision is certainly a setback for the implementation of the New Rule, the New Rule is not dead. The Fifth Circuit has a long-standing reputation for being business friendly. A preliminary injunction simply hits the pause button on implementation until the case can be fully adjudicated. It is likely that the Obama administration will temporarily suspend implementation of the New Rule, but is considering its options to file an interlocutory appeal or amend the New Rule. While the injunction gives contractors some additional time to evaluate their track record of labor law compliance and, if need be, to come into compliance, the New Rule may well be implemented in some form and contractors should continue to prepare for that possibility.

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GOVERNMENT CONTRACTING

Recent Clarifications to SBA's Definition of Receipts

By Megan Connor

Over the summer, SBA published a final rule and size policy statement elucidating what is included in "receipts" for purposes of a size calculation. While SBA made clear that "all income" is to be included in receipts, it also clarified an important receipts exclusion for small businesses.

Specifically, SBA amended 13 C.F.R. § 121.104 to clarify that receipts "include all income," and the only exclusions from income are the ones specifically listed in paragraph (a) of that regulation. Small Business Government

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Contracting and National Defense Authorization Act of 2013 Amendments, 81 Fed. Reg. 34,243, 34,253 (May 31, 2016). This clarification was motivated by apparent confusion among contractors: "It was always SBA's intent to include all income, except for the listed exclusions; however, SBA has found that some business concerns misinterpreted the current definition of receipts to exclude passive income." Id. The amended regulation

The interaffiliate transaction exclusion arises for any properly documented transactions between a concern and its affiliates—even if the entities cannot file a consolidated tax return.

states: "Receipts means all revenue in whatever form received or accrued from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances." 13 C.F.R. § 121.104(a) (emphasis added).

The four discrete exclusions from receipts that the regulation provides are:

(1) net capital gains or losses;

(2) taxes collected for and remitted to a taxing authority if included in gross or total income, such as sales or other taxes collected from customers and excluding taxes levied on the concern or its employees;

(3) proceeds from transactions between a concern and its domestic or foreign affiliates; and

(4) amounts collected for another by a travel agent, real estate agent, advertising agent, conference management service provider, freight forwarder or customs broker.

Id. These are the "only exclusions from receipts" that SBA allows for size determination purposes. Id. All other items, such as subcontractor costs, reimbursements for purchases a contractor makes at a customer's request, investment income, and employee-based costs such as payroll taxes, may not be excluded from receipts. Id.

SBA also recently explained the third of these receipts exclusions for proceeds from transactions between a concern and its domestic or foreign affiliates, which are commonly referred to as interaffiliate transactions. In SBA Size Policy Statement No. 3, published on May 24, 2016, SBA stated the following: "SBA will not restrict the exclusion for interaffiliate transactions to transactions between a concern and a firm with which it could file a consolidated tax return. The exclusion for interaffiliate transactions may be applied to interaffiliate transactions between a concern and a firm with which it is affiliated under the principles in 13 CFR 121.103." Small Business Size Standards, 81 Fed. Reg. 32,635, 32,636 (May 24, 2016). In other words, SBA explained that the interaffiliate transaction exclusion arises for any properly documented transactions between a concern and its affiliates—no matter whether the entities are able to file a consolidated tax return under Internal Revenue Service guidelines. "The intent of this exclusion is to avoid counting the same receipts twice when determining the size of a particular concern." Id.

SBA explained that SBA Size Policy Statement No. 3 was necessitated by "[r]ecent SBA size determinations and decisions of the Office of Hearings and Appeals [that] have limited the exclusion by applying it only to transactions between affiliates that are eligible to file a consolidated tax return." One of these decisions was Size Appeal of Tenax Aerospace, LLC, SBA No. SIZ-5701 (2015), a case in which PilieroMazza represented the small business at issue. In that case, SBA's Office of Hearings and Appeals ("OHA") held that the interaffiliate transaction exclusions did not apply because the affiliates in question were not eligible to file a consolidated tax return and were not a parent and a subsidiary.

SBA published Size Policy Statement No. 3 while Tenax Aerospace, LLC was challenging OHA's decision in the U.S. Court of Federal Claims. In Size Policy Statement No. 3, SBA explained that the type of interpretation in Size Appeal of Tenax Aerospace, LLC, SBA No. SIZ-5701 (2015), was based on a former version of the regulations and the "current regulatory language is clear on its face." Id. In light of Size Policy Statement No. 3, the U.S. Court of Federal Claims remanded the matter back to OHA to reconsider whether Tenax Aerospace, LLC was a qualified small business. See Size Appeal of Tenax Aerospace, LLC, SBA No. SIZ-5747 (2016). OHA observed that Size Policy Statement No. 3 required a recalculation of Tenax Aerospace, LLC's size and, therefore, further remanded the case back to the SBA Area Office for a new size determination in light of SBA's clarification as to the applicability of the interaffiliate transaction receipts exclusion. See id.

Thus, SBA has made clear that it wants a concern's size calculation to include all income, including passive investment income. However, SBA will not double count receipts tied to properly documented transactions between a concern and its affiliate.

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Small Business Contracting Opportunities Abound Outside the Federal Marketplace

By Jackie Unger

Savvy small business contractors take advantage of the many federal contract set-aside opportunities arising out of the federal government's statutory goals for small business procurement. These goals aim to award 23% of government-wide contracts to small businesses, 5% of awards to small disadvantaged businesses (SDBs), 5% of awards to women-owned small businesses (WOSBs), 3% of awards to service-disabled veteran-owned small businesses (SDVOSBs), and 3% of awards to historically underutilized business zone (HUBZone) small businesses.

However, as small businesses seek to expand their customer base, they often remain focused solely on targeting contracts at the federal level, unaware of the myriad non-federal set-aside opportunities available to them. Indeed, many states and municipalities, as well as a multitude of private companies, establish their own goals or requirements to award contracts to small businesses and businesses that are owned and controlled at least 51% by minorities, service-disabled veterans, or women. With the highest target of any state, New York aims to commit 30% of its statewide contracting on minority and women-owned businesses, with an additional 6% of spending on disabled-veteran owned businesses. Maryland is close behind, with a 29% goal for small minority and women-owned businesses, and an additional goal to award 1% of state agency spending on veteran-owned small businesses.

While Washington, DC does not have a specific goal for minority or women-owned businesses, it does have a 50% small business enterprise target. Virginia aims to award 42% of its spending on small businesses, including minority-owned, women-owned, and service-disabled veteran-owned businesses. With these states spending billions of dollars per year, these amounts can add up to significant revenues for contractors that go through the effort of certifying for these different programs.

As each state determines its own set-aside goals, it also establishes its own criteria for qualifying as an eligible business concern for those set-aside contracts. Some states simply require that the business be certified for the comparable federal program. For instance, to qualify for VOSB set-aside contracts in Maryland, the business must be verified through the Department of Veterans Affairs (VA) Center for Verification and Evaluation. As long as a business is eligible for VOSB set-asides with the VA, it can qualify for similar contracts in Maryland. Likewise, many state minority business enterprise programs accept certifications from SBA or third-party organizations, which streamline the process for contracting in different states.

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Other states require that the contractor become certified through the state's own small or disadvantaged business program, which may impose either more or less stringent standards than equivalent federal programs. So, for example, California's Disabled Veteran Business Enterprise program requires that the disabled veteran upon whom eligibility is based must have at least a 10% service-connected disability, while the federal SDVOSB programs do not set a minimum service-connected disability rating that the majority owner must have. On the other hand, federal small business programs have strict limitations on subcontracting, requiring that the

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small business concern perform at least 51% of the work itself. In contrast, many states have only vague requirements that the small business concern perform a "commercially useful function" on the contract. However, state programs certainly are not without their downsides. Some states, such as California and D.C., only permit businesses principally located within the state to qualify for state set-aside contracts. And, because the requirements for qualifying as an eligible small business, WOSB, SDVOSB, or SDB are not uniform across states, contractors looking to expand in multiple states must carefully review each state's regulations and may need to go through a separate certification process for each state.

In addition to state and local contracting opportunities, many large companies have supplier diversity programs through which they earmark contracts for minority-owned, women-owned, and veteran-owned business enterprises. These companies may rely on federal certifications or certifications by independent third parties. The National Minority Supplier Development Council (NMSDC) is one such third-party certification organization that uses uniform standards nationwide and has over 460 corporate members—including large companies such as Apple, Microsoft, Verizon, and Wells Fargo, just to name a few—which recognize its certification. NMSDC uses similar procedures to public agencies, requiring the business to submit an application and supporting documents to the appropriate regional affiliate and go through a site visit. A similar standardized procedure is followed by the Women's Business Enterprise National Council (WBENC), which is the largest independent third-party certifier of women-owned businesses.

For federal contractors that are ready to expand their customer bases but have not yet made the leap, it makes sense to start local and identify available programs within the state and municipality where the business is principally located. For those contractors willing to explore commercial opportunities, both the NMSDC and WBENC provide an excellent way for minority-owned and women-owned businesses to forge new relationships with large businesses locally and across the country due to their standardized certification procedures.

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LITIGATION

The Corporate Designee in Commercial Litigation

By Paul Mengel

A corporate entity is regarded by the law as a "person" for purposes of standing to sue and be sued, but an organization, whether corporation, partnership, governmental organization, or other entity, can act only through its officers, directors or other agents. Accordingly, when a corporate entity becomes a party to a lawsuit, whether as a plaintiff or as a defendant, it will undoubtedly be required, at some point, to provide testimony at deposition in the course of the discovery phase of the case. Inasmuch as the statements of the representative at deposition become the admissions of the company and will be binding upon it at trial, the decision as to whom to speak for the company is not to be taken lightly. This article is intended to provide information and guidance to the corporate litigant in the selection and preparation for testimony of what is commonly known as the "corporate designee."

When a commercial case is brought in federal court, the obtaining of the testimony of the corporate entity

Much can be riding on the testimony of the corporate designee, therefore the choice of whom to select and how to prepare them is critical.

is governed by Federal Rule of Civil Procedure 30(b)(6). In fact, the corporate deposition has come to be commonly known as the "30(b)(6) deposition." Most state courts have adopted rules governing corporate designee depositions that are either modeled on, or otherwise similar to, Rule 30(b)(6), so for ease of reference in this article, corporate designee depositions, whether in state or federal court, will be referred to as 30(b)(6) depositions. If your company is involved in state court litigation, your trial counsel must be familiar with that jurisdiction's variations, if any, on Rule 30(b)(6). With regard to the right of a party to depose a corporate entity, Rule 30(b)(6) provides as follows:

> *In its notice or subpoena, a party may name as the deponent a public or private corporation, a partnership, an association, a governmental agency, or other entity and must describe with reasonable particularity the matters for examination. The named organization must then designate one or more officers, directors, or managing agents, or designate other persons who consent to testify on its behalf; and it may set out the matters on which each person designated will testify. A subpoena must advise a nonparty organization of its duty to make this designation. The persons designated must testify about information known or reasonably available to the organization. This paragraph (6) does not preclude a deposition by any other procedure allowed by these rules.*

When a person is deposed in his or her individual capacity, no advance notice of the subject areas of testimony need be given to the deponent. By contrast, the 30(b)(6) notice of deposition must state the subject areas of the deposition with "reasonable particularity." This enables the company being deposed to select the individual(s) it believes is best qualified to testify on its behalf on those subjects. Note that the Rule requires that the person(s) designated to testify are required to do so as to information "known or reasonably available to the organization." Thus, the corporate designee(s) need not have personal, first-hand knowledge of the facts and events about which they are to testify, but he or she must be prepared to testify about the designated subject areas, irrespective of how the knowledge was obtained. The deponent can be an officer, director, employee or even a former employee, as long as the witness possesses knowledge responsive to the deposition notice. Failure to produce an individual that is prepared to provide testimony in the subject areas listed in the notice of deposition can lead to serious adverse consequences for the company in the litigation, so careful selection and thorough preparation of the corporate designee is critical.

Generally speaking, much can be riding on the testimony of the corporate designee, therefore the choice of whom to select and how to prepare the deponent is critical. The deponent, aside from having knowledge of the subject areas, should be the type of person that presents well and will be effective in conveying the company's position. Since there is no requirement that the company put forth the individual with the most personal knowledge of an area, it may be best to put forth a credible-appearing, effective and personable witness who is able to gather the knowledge from sources within the company, rather than a witness who might be more familiar with the facts, but about whom the company has reservations as to how he or she will hold up in questioning from counsel. It may take longer to prepare the witness in that scenario, but the benefit of doing so could well outweigh the burden of the extra time spent.

Since the corporate designee is speaking for the company, he or she should not only be familiar with the facts and circumstances listed in the designated areas of testimony, but should also be familiar with, and ready to address, the company's position on the issues. Your counsel should ensure that the company's designee takes whatever preparation time is necessary which, depending on the subject areas of the deposition, may involve review of the relevant documents in the case, interviews with other individuals familiar with the facts and review of other deposition transcripts.

In sum, when engaged in litigation, the decision of whom should be the voice of the company, whether to either support the case that the company is advancing, or to address the allegations against which the company is defending, is critical. It is hoped that this article has shed some light on this area of the discovery process in litigation, and will provide some guidance when your company is making the important decision of selecting its corporate designee.

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