

# PRATT'S GOVERNMENT CONTRACTING LAW REPORT

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Editorial Office  
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862  
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# FAR Conformed to the “New” Limitations on Subcontracting Methodology at 13 C.F.R. § 125.6

*By Amy Laderberg O’Sullivan, Olivia L. Lynch, Michael E. Samuels, and Zachary Schroeder\**

*The authors of this article discuss a final rule that updates the methodology to calculate compliance with the limitations on subcontracting.*

The Department of Defense (“DoD”), General Services Administration (“GSA”), and National Aeronautics and Space Administration (“NASA”) published a final rule,<sup>1</sup> effective September 10, 2021, that finally updates the methodology to calculate compliance with the limitations on subcontracting.

## THE NDAA

Section 1651 of the National Defense Authorization Act (“NDAA”) for Fiscal Year (“FY”) 2013<sup>2</sup> revised and standardized the limitations on subcontracting, including the nonmanufacturer rule, that apply to small business concerns.

## IMPLEMENTATION IN SBA’S REGULATIONS

The Small Business Administration (“SBA”) implemented Section 1651 of the FY 2013 NDAA in a final rule<sup>3</sup> published at 81 FR 34243 on May 31, 2016, which became effective on June 30, 2016.

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\* Amy Laderberg O’Sullivan (aosullivan@crowell.com) is a partner at Crowell & Moring LLP and a member of the Steering Committee for the firm’s Government Contracts Group, focusing on litigation, transactional work, investigations, and counseling for corporate clients of all sizes and levels of experience as government contractors. Olivia L. Lynch (olynch@crowell.com) is a partner in the firm’s Government Contracts Group advising government contractors on navigating the procurement process, compliance and ethics, commercial item contracting, accessibility, supply chain assurance, and various aspects of state and local procurement law. Michael E. Samuels (msamuels@crowell.com) is counsel in the firm’s Government Contracts Group counseling and representing government contractors on a wide range of issues. Zachary Schroeder (zschroeder@crowell.com) is an associate in the firm’s Government Contracts Group.

<sup>1</sup> <https://www.govinfo.gov/content/pkg/FR-2021-08-11/pdf/2021-16364.pdf>.

<sup>2</sup> 15 U.S.C. 657s.

<sup>3</sup> <https://www.govinfo.gov/content/pkg/FR-2016-05-31/pdf/2016-12494.pdf>.

## **PROPOSED RULEMAKING TO UPDATE THE FEDERAL ACQUISITION REGULATION (“FAR”)**

DoD, GSA, and NASA published a proposed rule<sup>4</sup> at 83 FR 62540 on December 4, 2018, to implement regulatory changes made by the SBA.

### **KEY SET OF CHANGES MADE TO THE FAR**

The final rule updates the methodology for complying with the limitations on subcontracting. FAR 19.505 and FAR clause 52.219-14 provide that a small business concern subject to the limitations on subcontracting will pay no more than a certain percentage of the amount paid by the government for contract performance to subcontractors that are not similarly situated entities. As with 13 C.F.R. § 125.6, the relevant thresholds are set as follows:

- For a contract assigned a services North American Industry Classification System (“NAICS”) code, the small business concern must not pay more than 50 percent of the amount paid by the government for contract performance to non-similarly situated subcontractors;
- For a contract assigned a NAICS code for supplies or products (other than a procurement from a nonmanufacturer), the small business concern must not pay more than 50 percent of the amount paid by the government for contract performance, excluding the cost of materials, to non-similarly situated subcontractors;
- For a contract assigned a general construction NAICS code, the small business concern must not pay more than 85 percent of the of the amount paid by the government for contract performance, excluding the cost of materials, to non-similarly situated subcontractors; and
- For a contract assigned a special trade contracting NAICS code, the small business concern must not pay more than 75 percent of the amount paid by the government for contract performance, excluding the cost of materials, to non-similarly situated subcontractors.

As of September 10, 2021, FAR 52.219-14 largely became consistent with the SBA’s limitations on subcontracting methodology. Nonetheless, agencies like the DoD will apparently continue to rely on class deviations for FAR 52.219-14.

Indeed, on September 10, 2021, DoD published a new class deviation,<sup>5</sup> noting that it rescinds and supersedes Class Deviation 2020-O0008, Revision 2, issued on November 6, 2020 but that, starting September 10, 2021,

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<sup>4</sup> <https://www.govinfo.gov/content/pkg/FR-2018-12-04/pdf/2018-25506.pdf>.

<sup>5</sup> <https://www.acq.osd.mil/dpap/policy/policyvault/USA001770-21-DPC.pdf>.

contracting officers shall use the clause at Attachment 1, 52.219-14, Limitations on Subcontracting (DEVIATION 2021-O0008). This is because in 2019, SBA published another final rule (at 84 FR 65647)<sup>6</sup> regarding the limitations on subcontracting, including certain exclusions to the limitations on subcontracting for services contracts. FAR 52.219-14, Limitations on Subcontracting (DEVIATION 2021-O0008) reflects those exclusions in paragraph (e)(1).

To effect this methodology, FAR 19.001 has been updated to include the following definition of similarly situated entity, which comports with SBA's definition from 13 C.F.R. § 125.1: a first-tier subcontractor, including an independent contractor, that—(1) has the same small business program status as that which qualified the prime contractor for the award (e.g., for a small business set-aside contract, any small business concern, without regard to socioeconomic status), and (2) is considered small for the size standard under the NAICS code the prime contractor assigned to the subcontract.

As with 13 C.F.R. § 125.6(c), work that is not performed by the employees of first-tier similarly situated subcontractors will count as subcontracts performed by non-similarly situated entities. Per the commentary in the final rule, while prime contractors are supposed to be able to enjoy greater flexibility through use of similarly situated subcontractors, this scheme does require monitoring and oversight by the prime contractor to ensure the benefits flow to the intended recipients.

The final rule also makes the FAR's application of the limitations on subcontracting requirement consistent across the small business programs for all set-aside and sole source awards regardless of contract value with one exception. Now it is clear that the limitations on subcontracting apply:

- To small business set-asides and directed orders above the simplified acquisition threshold; and
- To all other set-aside and directed awards under FAR subparts 19.8 (covering the 8(a) Program), 19.13 (covering the HUBZone program), 19.14 (covering the Service-Disabled Veteran-Owned Small Business (“SDVOSB”) program), and 19.15 (covering the Women-Owned Small Business (“WOSB”) Program) regardless of the dollar value. Note, this includes awards to HUBZones where the price evaluation preference has not been waived.

### **ANOTHER KEY SET OF CHANGES MADE TO THE FAR**

The final rule also creates a new clause FAR 52.219-33, Nonmanufacturer Rule. When included in a contract, the clause requires a contractor to:

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<sup>6</sup> <https://www.govinfo.gov/content/pkg/FR-2019-11-29/pdf/2019-25517.pdf>.

1. Provide an end item that a small business has manufactured, processed, or produced in the United States or its outlying areas; for kit assemblers who are nonmanufacturers, *see* paragraph (c)(2) of this clause instead;
2. Be primarily engaged in the retail or wholesale trade and normally sell the type of item being supplied; and
3. Take ownership or possession of the item(s) with its personnel, equipment, or facilities in a manner consistent with industry practice; for example, providing storage, transportation, or delivery.

The prescriptive clause, FAR 19.507, instructs that insertion of the clause is not required when the SBA has waived the nonmanufacturer rule.

Even though the SBA's regulations at 13 C.F.R. § 121.406 no longer address kit assembly separately, FAR 52.219-33 nonetheless provides that: "When the end item being acquired is a kit of supplies, at least 50 percent of the total cost of the components of the kit shall be manufactured, processed, or produced in the United States or its outlying areas by small business concerns."

The final rule added a number of definitions to FAR 52.219-33, including:

- "Manufacturer" means "the concern that transforms raw materials, miscellaneous parts, or components into the end item." Consistent with 13 C.F.R. § 121.406(b)(2), the definition provides that "[c]oncerns that add substances, parts, or components to an existing end item to modify its performance will not be considered the end item manufacturer, where those identical modifications can be performed by and are available from the manufacturer of the existing end item."
- "Nonmanufacturer" means a concern, including a supplier, that provides an end item it did not manufacture, process, or produce.

The prescriptive clause at FAR 19.507(h) instructs contracting officers to insert FAR 52.219-33 in solicitations and contracts when (1) the item being acquired has a manufacturing or supply NAICS code, and (2) any portion of the requirement is either going to be set aside for small business and is expected to exceed the simplified acquisition threshold or set aside, or awarded on a sole-source basis in accordance with subparts 19.8, 19.13, 19.14, or 19.15, regardless of dollar value.

Separately, the clause is to be inserted when (1) the item being acquired has a manufacturing or supply NAICS code, and (2) use of the HUBZone price evaluation preference has not been waived.

### **INTERESTING TIDBIT FROM THE RULEMAKING**

Presumably in response to complaints about the length of time that passed between SBA's 2016 implementation of the new methodology and the 2021



update to the FAR, the Councils noted in commentary that beginning in 2019, the Councils have started working on proposed FAR rules after SBA publishes a proposed rule, instead of waiting for a final rule from SBA. Per the Councils: “This approach should allow more timely publication of FAR rules implementing SBA rules.”