REAVESCOLEY PLLC

Size and Status Recertification Under the SBA's New Rules

On November 16, 2020, the SBA's long-awaited Final Rule (the "Rule") amending various small business regulations across a wide variety of areas went into effect. One area of significant change is in the area of size and socioeconomic status recertification. Recertification is an area of immense importance to government contractors engaged in or contemplating merger and acquisition ("M&A") activity. Whether or not set-aside contracts critical to a small business's portfolio will still be able to generate revenue at predictable levels post-M&A can materially affect the valuation of a small business government contractor. Before discussing these changes and their potential impact, it is important to understand the background.

The general rule for small business set-aside contracts is that a concern's size for that contract is effective as of the date of its final offer (which includes price). The concern's size/status then carries through the entirety of contract performance. In other words, even if halfway through a 5-year contract a concern grows to be large under that contract's NAICS code, it can still perform the contract, and the contracting agency can still count the award toward its contracting goals. However, the SBA views M&A activity much differently (some might even say antagonistically). The SBA's rules require that after contract novation or M&A activity where no novation is required, the concern must recertify its size (i.e. report to the Contracting Officer that it is still small or that it is now other-than-small). Often times the recertification requires the contractor to report being other-than-small because of the newly combined average annual receipts or employee count. The SBA also has in place rules regarding recertification in other instances such as in long-term contracts (defined as longer than 5 years), when M&A activity occurs after offer but prior to award, and when the Contracting Officer has discretion to seek a size recertification in connection with task orders. In addition, similar rules apply to recertification of socioeconomic status under set-aside contracts for the different socioeconomic programs (i.e. 8(a), WOSB/EDWOSB, SDVOSB, & HUBZone). Therefore, unless stated otherwise, any required recertification or potential effect of having to report the concern's size status has changed is the same for a change in socioeconomic status after a merger or acquisition.

The key question that often arises when small businesses are considering merging with, acquiring, or being acquired by another business center on not just when recertification would be required under the rules but more importantly what will be the *effect* of an other-than-small recertification. These new changes offer some very different considerations for small business government contractors.

<u>The Effect of Size Recertification</u>

Under the Rule, the SBA made a slight wording change that could have a significant impact on small business government contractors. It has been long understood that a plain reading of the recertification rule rendered the effect of an other-than-small (or failure to continue to qualify for a certain socioeconomic category) recertification as only resulting in the contracting agency not being able to take further credit towards their small business goals. Otherwise, the agency could continue to exercise

option periods or award task orders to the concern. This understanding has been the subject of an administrative and regulatory tug-of-war over the last few years (largely between the SBA and the SBA's Office of Hearing and Appeals), and while there was always risk that the result of an other-than-small recertification could lead to performance under a set-aside contract being ended earlier than expected, it was somewhat safe to assume that despite some ambiguity in the rule, small business government contractors could count on future task orders and option years post-recertification.

Now, under the new Rule, the SBA included a revision to the recertification rule without even addressing it specifically in the rule's preamble commentary. This change arguably states (in more clear language), that the recertification requirements post-merger/acquisition or contract notification are complete exceptions to the general rule regarding size/status discussed above. Accordingly, based on the SBA's prior positions on the effect of a post-M&A activity recertification, it appears that this wording change could have the effect of prohibiting agencies from further awarding task orders or exercising option periods.

Still, confusion reigns in this area. The Federal Acquisition Regulation's (FAR) provisions governing recertifications (or "rerepresentations" as they are called under the FAR) do not necessarily reflect this aggressive SBA position (ineligibility for award of options and task orders after an "other than small" recertification), and it can be argued that this change is still not clear thus not having the SBA's intended effect. In short, Contracting Officers could continue to operate unchanged despite this revision to the Rule. Further, in public statements made after the announcement of the new Rule, certain SBA officials have stated that an other-than small recertification would only affect agency goaling and not eligibility for future options or orders (despite the SBA's previously articulated position). However, this elevated risk of potentially not being awarded future task orders or option periods *must* be considered by small business government contractors looking at a merger or acquisition whether on the buy or sell side, and regardless, this slight change and the history of uncertainty under this regulation should serve to prevent them from just assuming that set-aside work will stay in place unaffected post-transaction.

<u>Recertification After Offer but Prior to Award</u>

Most small business government contractors understand that the procurement process (i.e., from RFP to contract award) can be quite lengthy. This often times results in many months (and perhaps a year or more), between the submission of a final offer with price (i.e., when size/status is determined) and actual contract award. The historical recertification rule broadly required that if a merger/acquisition occurs after offer but prior to award of a set-aside contract, the concern must recertify its size/status.

Under the new Rule, however, the SBA has tried to take the potential for lengthy procurements into account. Rather than a blanket requirement in this scenario, the rule still requires recertification as before but states:

- If the merger/acquisition occurred *within* 180 days of the final offer with price and the concern recertifies as other-than-small, the concern will be ineligible for award.
- If the merger/acquisition occurred greater than 180 days after the final offer with price and the concern recertifies as other-than-small, the concern is eligible for award, but the agency cannot count the award as an award to a small business.

Recertification Rules for Joint Ventures

Currently, if a member company of a Joint Venture that is performing on a small business set-aside contract undergoes merger/acquisition activity, the Joint Venture itself must recertify its size. However, what has been unclear is whether just the affected member or all the members of the Joint Venture need to recertify. A fair reading of the historical rule indicates that all the members of the Joint Venture are required to recertify, which could lead to unfair results. For example, Company A and Company B are members of "A-B JV," which was eligible for a small business set-aside contract because both Company A and B are small under the applicable NAICS code. A-B JV won the small business set-aside contract, and in year 3 of the 5-year contract, Company A has grown organically to large (remember, this does *not* require any recertification under the general rule). Also, during this year, Company B is acquired by another business, which should require recertification. In this case though, Company B is still small, *but* because Company A is now large, A-B JV would be deemed other-than-small if Company A also has to recertify its size. Apparently, this was not the SBA's intent. Therefore, to avoid the example described here, the Rule now makes it clear that the Joint Venture's recertification need only be based on the member undergoing merger/acquisition activity. Going back to our example, under the new Rule, the Joint Venture would recertify itself as still being small because Company B is still small post-acquisition and Company A's size relates back to its final offer with price.

Conclusion

Size recertification can be a complex exercise, but it is often the most central question for small business government contractors either looking to merge with, acquire, or be acquired by another business. The SBA's new Rule offers some important clarifications and needed updates in this area, but there are still significant areas of uncertainty that need to be addressed on a case by case basis. It is vital that small business government contractors undergoing or contemplating any time of M&A activity review these changes closely before moving forward with their transactions to ensure compliance.

This article is for informational purposes only and does not constitute legal advice. For specific legal advice on any of the issues discussed above, please consider contacting ReavesColey government contracts attorneys Brad Reaves at brad.reaves@reavescoley.com and Paul Hawkins at paul.hawkins@reavescoley.com.