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December 7, 2015

Ms. Brenda Fernandez  
U.S. Small Business Administration  
Office of Policy, Planning and Liaison  
409 Third Street, S.W.  
Washington, D.C. 20416

Subject: RIN: 3245-AG71, "Credit for Lower Tier Small Business Subcontracting"  
CODSIA Case Number 11-16

Dear Ms. Fernandez:

On behalf of the undersigned members of the Council of Defense and Space Industry Associations (CODSIA), we offer the following comments to the U.S. Small Business Administration (SBA) proposed rule entitled "Credit for Lower Tier Small Business Subcontracting" published as a proposed rule in the *Federal Register* on October 6, 2015.

At the suggestion of the Department of Defense, CODSIA was formed in 1964 by industry associations with common interests in federal procurement policy issues. CODSIA consists of six associations – the Aerospace Industries Association, the American Council of Engineering Companies, the Information Technology Alliance for Public Sector, the National Defense Industrial Association, the Professional Services Council, and the U.S. Chamber of Commerce. CODSIA acts as an institutional focal point for coordination of its members' positions regarding policies, regulations, directives, and procedures that affect them. Combined these associations represent thousands of government contractors and subcontractors. A decision by any member association to abstain from participation in a particular case is not necessarily an indication of dissent.

### **Introduction and Executive Summary**

The proposed rule implements section 1614 of the National Defense Authorization Act for Fiscal Year 2014 (FY14 NDAA or Act), Credit for Certain Small Business Subcontractors. The section significantly modified section 8(d)(6)(D) of the Small Business Act in two general areas. First, the Act now allows a prime contractor that has an individual subcontracting plan to receive credit towards its small business subcontracting goals for subcontract awards made to small businesses at any tier. Second, the Act adds significant new responsibilities large businesses must accept and implement in the oversight of subcontractors' small business plans.

As described in our comments that follow, CODSIA has a number of concerns with the proposed rule because it misapplies the statute; creates significant new performance, oversight and compliance risk; and is not scalable under the current federal subcontract

compliance and reporting frameworks. CODSIA recommends portions of the proposed rule be excluded from the final rule or be redrafted. There are also instances where the proposed rule fails to provide clear and consistent guidance to large businesses and CODSIA recommends the SBA expand or add information to clarify the rule.

CODSIA's initial comment is a disagreement with the SBA's regulatory impact analysis that "[t]he benefit and cost of the proposed rule are minimal." 80 F.R. 60301. The proposed rule should be considered more than minimal as it could provide the federal government a new breadth of information on the magnitude of small businesses performing work for the federal government. Equally, the cost and challenges of collecting this data are more than minimal. Large businesses will incur more than minimal new costs as the proposed rule places significant new responsibility and burden on large businesses. CODSIA also believes the government will have to modify the Electronic Subcontract Reporting Systems (eSRS) to properly implement the new rule, which will be a costly and lengthy endeavor. While CODSIA generally regarded section 1614 of the Act favorably as an interim step until data systems were funded and fielded by the government that allowed for the collection of the desired small business spend data at all tiers in the federal supply chain, this rule does not reflect a strategy, plan or investment in establishing the government's system improvements needed to streamline and gather accurate reporting. Many of the costs to government contractors will be collected and ultimately transferred back to the government and the taxpayer. CODSIA strongly recommends the SBA re-evaluate the potential benefits and costs of this regulatory action before publishing a final rule.

### **Industry Concerns:**

The following sections of this letter are comments to specific portions of the proposed rule; in many cases, the comments under a specific cite include multiple remarks related to different points of uncertainty for industry.

1. § 125.3(a)(1)(i)(C) ... *the contractor may receive credit for small business concerns performing as first tier subcontractors or subcontractors at any tier pursuant to the subcontracting plans requirement under paragraph (c)* ... The portion of the proposed rule mirrors the FY14 NDAA and SBA is accurately redrafting the policy in a regulatory form.

2. § 125.3(a)(1)(i)(C) *The actual subcontracting dollars are only reported once for the same award to avoid double counting the dollars notwithstanding the fact that a small business subcontract may be reported under more than one subcontracting plan.* The federal government has debated for years how to gain greater insight into the total impact a contract to a large business has on small businesses beyond the first tier. One of the more significant hurdles facing policy makers is how large businesses should count work performed by small businesses that support more than one prime contract. Large businesses regularly rely on vendors to support numerous prime contracts. The proposed

rule fails to provide large businesses any guidance or insight how to address the issue of double counting. CODSIA believes the SBA must clarify how large business contractors should allocate subcontracts that support numerous prime contracts. It is also fundamentally unclear how large business primes will be able to obtain the “credit” for acceptable lower tier large business subcontractor performance to their individual subcontracting plans (ISPs).

3. § 125.3(c)(1)(i) *Submitting and negotiating before award an acceptable subcontracting plan that reflects maximum practicable opportunities for small business in the performance of the contract as subcontractors or suppliers at all tiers of performance.* (emphasis added). CODSIA recommends this portion of the proposed regulation be excluded from the final rule.

CODSIA’s first objection is that this proposed change exceeds the scope of the statute. In section 1614, Congress did not modify the existing law or rule for negotiating a subcontracting plan on with the apparent successful offeror. Rather, Congress only modified the Small Business Act “[f]or purposes of determining whether or not a prime contractor has attained the percentage goals specified in paragraph (6).”

In addition, by pyramiding all the goals of all large business subcontractors at all tiers to the prime contractor, CODSIA interprets the proposed rule to mean that prime contractors would be responsible for the subcontractors at the various tiers of the chain to meet their small business goals. This adds a new, significant and unacceptable performance requirement.

Further, the proposed rule is simply not practical. Under the proposed rule, large businesses would be required to include small business goals and data from all potential tiers of large business subcontractors well before the prime or subcontracts are negotiated or awarded. CODSIA does not believe realistic negotiations of small business goals at the sub tiers can take place at the pre-award stage of the contracting process. The government acquisition process, which demands full and open competition at all tiers of the contracting process is unpredictable. Prime large business contractors estimate the amount and type of work it can perform in house and consequently the amount and type of work it will award to a subcontractor, either a large or small business. Below the first tier, information on future competitive awards represents only blurry estimates of work scope and is thus mainly unusable for purposes of inclusion in the prime contractor’s pre-award individual subcontracting plan (ISP) and inappropriate for good faith negotiations at lower tiers. The proposed rule demands data that does not exist in any consistent or reliable form.

CODSIA further notes that per current eSRS guidelines, the large business prime contractor’s small business performance reports may only include subcontract performance credit if such subcontracts were included in the goals established in the contractor’s ISP. As such, prime contractors may be denied the ability to take credits for

small business subcontracting that occurs outside of the scope of the ISP. This eSRS shortcoming must be fixed to avoid negative consequences for both the large prime and potential small businesses that could contribute to contract performance outside the scope of the ISP.

4. § 125.3(c)(1)(v) *The contractor must assign to the solicitation and the resulting subcontract the NAICS code and corresponding size standard that best described the principal purpose of the subcontract...* The proposed rule requires all subcontract solicitations to contain the applicable NAICS code and the small business size standard. It is unclear in the proposed rule under what basis a large business prime or subcontractor would decide which NAICS code should be applied to a subcontract as work flows through the supply chain. One single NAICS code may not prevail through the supply chain and thus it is reasonable to conclude that many different NAICS code decisions would have to be made on an ongoing and dynamic basis. This would continue throughout the pre-award process for each subcontract subjected to the rules. Furthermore, there is no dollar threshold or other limitation on this requirement. Aside from being extremely burdensome for large business primes and lower-tier subcontractors to accurately identify codes that comport with federal NAICS and size standards determinations, and make other dispositive product code decisions, it will almost certainly involve considerable and extensive manual effort for large business primes and subcontractors to affect consistent coding decisions. CODSIA recommends this portion of the proposed rule be deleted.

5. § 125.3(c)(1)(x) *The prime contractor... will review and approve subcontracting plans submitted by their subcontractors; monitor subcontractor compliance with their approved subcontracting plans; ensure that subcontracting reports are submitted by their subcontractors when required; acknowledge receipt of their subcontractors' reports; compare the performance of their subcontractors to subcontracting plans and goals; and discuss performance with subcontractors when necessary...* This portion of the rule reflects the statutory changes in the FY14 NDAA. SBA, however, fails to provide information or guidance to large business on how to implement these requirements. These comments reflect the challenges to large business and those areas where the SBA must further evaluate how to implement.

The Small Business Act and the FAR currently require large business primes to ensure that their first tier subcontractors who are not small businesses “adopt” their own small business plans as required in the operative subcontracting clauses in FAR Part 19 and 44. Prime contractors review first tier subcontractor plans to ensure they meet the criteria set forth in the clauses and also to ensure first tier subcontractors enter the required reports in the federally managed eSRS. But those understood duties are becoming increasingly more costly as more government-mandated detailed and complex data collection, disclosure and reporting requirements are levied by primes on their supply chains.

Large business cannot implement the proposed rule as presently written, in part because the eSRS database is insufficiently scaled and not technically capable of capturing all the small business subcontract performance data that may be required to comply with this rule and/or to flow that data upstream to a single prime large business without large risk of reporting error. The cost for primes to create the unique systems and collection capability to perform the functions envisioned in this proposed rule will be enormous across the federal contractor supply base and is inconsistent with ongoing government attempts to reduce compliance costs and to remove obstacles to the federal market.

Anecdotally, at least one large business prime has reported to CODSIA that previous attempts at lower-tier reporting on a large well-known program (estimated at over \$50 Million) resulted in significant administrative and program management activity and required four new full time employees to manage the process with all of the lower tier large businesses. A “firewall” also had to be put in place between those internal employees and other company contract/procurement personnel to ensure that there was no sharing of the lower tier’s “proprietary” data. The cost for this increased activity to meet the additional compliance requirements was estimated at over \$1,000,000 for project start-up and that activity did not apply to the lowest levels of the supply chain.

This lack of the government’s capability to collect the subcontract small business spend data is a fundamental flaw that CODSIA believes was anticipated at the outset by the drafters of the Act and, as set forth below, and should be the first step by the Government to act on, before implementing any proposed regulations on contractors.

CODSIA thus recommends that SBA delay implementation of the rule until an expanded version of eSRS (or other similar reporting capability) can be developed and fielded by the government that can be applied to the lowest levels of the supply chain and that such capability be instituted prior to, or concurrent with, the finalization of these SBA rules and the subsequent follow-on implementation of this rulemaking into the FAR.

The SBA should also recognize that under the proposed new duties in (c)(1)(x), large business primes are required to conduct small business program performance reviews with large business subcontractors with ISPs, in the same manner and depth as federal oversight agencies such as the DCMA or the SBA. These new duties require that large business primes perform a broad governance role to oversee their large business subcontractor’s performance to their ISP’s, including “discuss(ing) performance...when necessary to ensure their subcontractors make a good faith effort ...”, which implies that businesses at every level will be held responsible for applying subcontract remedies to under or non-performing large business and small business subcontractors.

Performing these oversight functions of large business subcontractors’ ISP performance is an extreme shift in the federal competition business model. Such monitoring of other large business performance could require that large businesses at every level have access to other companies’ subcontracting pricing, process and policy data, including strategic



information on salient business initiatives (the SBIR and Mentor-protégé programs among others), most of which is business proprietary to each respective company in the supply chain and often acts to differentiate offerors from one another in competitive environments. CODSIA recommends that the proposed rule be amended to clearly state that prime contractors and lower tier subcontractors are only responsible for obtaining information about lower tier subcontractor achievement of Individual Subaward Reporting (ISR) goals at a macro level and that no other information is required to be collected by or submitted to contractors further up the supply chain. Furthermore, the proposed rule should clarify that obtaining ISR goal performance, at a macro level, and requesting subcontractor performance against the goals without seeking detailed and potentially proprietary information should qualify as a good faith effort by the contractor to comply with the requirements set forth in any final rule resulting from this proposed rule.

Aside from possible competitive harm and increased costs from strict compliance to this rule, prime contractors, large or otherwise, do not generally have any legal rights to review, audit or have access to business or technically sensitive work-share proposals or to contract overhead or cost data of other contractors or have the right to unilaterally dictate terms to successive levels of large business subcontractors throughout the supply chain. The proposed rule thus ignores the cost and resources to police suppliers to the new enforcement framework of small business subcontract compliance. The new rules will almost certainly increase the risk for small and large contractors at all tiers, small and large, with access to such proprietary information or loss of subcontract credit within their own supply chain.

6. § 125.3 (c)(xi) *The prime contractor must recite the types of records the prime will maintain to demonstrate procedures which have been adopted to ensure subcontractors at all tiers comply with the requirements and goals set forth in the plan . . . .* (emphasis added). The SBA should clarify the term “recite”, and how that task is different from the other compliance duties enumerated in subsection (c)(1)(x). Aside from enumerating specific socio-economic categories for large business subcontracting attention at each lower tier, it appears that a large business prime now must also catalog and attest in their ISP to the form and content of any record keeping processes they intend to implement to fulfill the requirements in subsection (c)(1)(x) relative to a large business subcontractors’ efforts to subcontract with the named socio-economic categories. It is not clear, however, that the prime must factor in these specific category requirements in their ISP compliance plans or take other specific actions to insure that records reflect that objective.

#### **Additional Comments:**

- a. Large business primes currently have 30 days to enter ISR and Sample Summary Subcontracting Report data into eSRS. This requirement will need to be substantially expanded notionally to between 60-90 days to account for down and upstream delays and administrative processes to gather, analyze and report the

- data for successive layers of large businesses at the second, third or even fourth tiers. The government review cycle should also be expanded accordingly to between 60-90 days to validate the large business prime's SB subcontracting reporting.
- b. The final SBA rule should insure that contracting officer's authority to set small business subcontracting goals are limited to the prime contract, and allow the prime contractor to determine how to fulfill those goals at lower tiers in the supply chain.
  - c. Considering the increased scale of the small business subcontracting program in this rule, the SBA should clarify how lower tier large business subcontractor performance or non-performance to their ISP goals will be measured against prime large business contractor past performance ratings and how a mitigation process to address any erroneous ratings in Contactor Performance Assessment Reporting System (CPARS) will be implemented.
  - d. There is risk that the cost to large business primes and subcontractors to implement this rule as written could lead to less subcontracting to SBs because the burdens to LBs will certainly outweigh the costs to comply without additional incentives being available. Hence, implementation of the proposed rule should be postponed until eSRS and FSRS have proven to be effective at capturing data and reducing the administrative burden on large and mid-sized businesses. Additionally, DATA Act implementation is concurrently seeking to establish effective methods for tracking procurement spending at multiple tiers while also reducing contractors' reporting burdens. There is no evidence or discussion about how this proposed rule is taking those efforts into consideration.
  - e. The rule imposes higher levels of oversight between a large business prime contractor and lower tiered large businesses performing their small business subcontracting plan compliance obligations including, among other things, enforcing the requirements of those lower tiered subcontractors to make a good faith effort to meet their subcontracting plan commitments to further subcontract with small businesses and to ensure proper payment. Such obligations will undoubtedly create additional risk that affected subcontractors below the first tier will not comply with the assorted subcontracting duties flowed to them or be diligent where further lower tiered subcontracting creates novel or unique types of teaming arrangements that the prime cannot possibly police or have total visibility into and relies on the lower tiered subcontractors' assertions of compliance as the invoicing and payment requirements flow upstream. The SBA should clarify the extent to which any subcontractor at lower tiers can create False Claims Act liability for successively higher tiered contractors, including the prime contractor, for failing to meet their small business subcontracting duties or, in the alternative,

convene a conversation with industry and/or provide guidance about how to mitigate the potential risk of such occurrences taking place.

## **Conclusion**

The proposed rule creates significant new responsibility and work for the prime contractor but does not offer clear or sufficient new incentives, such as regulatory or cost relief or credit or added profit for performing these new functions. CODSIA recommends that SBA significantly revise the proposed rule based on the comments herein, the government take action to enhance the eSRS reporting requirements, and that SBA engage the Department of Treasury and OMB in discussions about how this proposed rule and implementation of the DATA Act will interact before publishing a final rule.

CODSIA looks forward to working with you to help build a robust industrial base inclusive of large, mid-sized, and small businesses and thanks you for consideration of these comments. Should you have any questions, or need further information, please contact Ron Youngs at the Aerospace Industries Association AIA, the CODSIA Case manager, at 703-358-1045 or via email at [ronald.youngs@aia-aerospace.org](mailto:ronald.youngs@aia-aerospace.org).

Respectfully,



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