

ALERT

# SBA Final Rule Attempts to Prevent the Use of “Bait and Switch” Tactics with Small Business Subcontractors

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The U.S. Small Business Administration (SBA) recently issued a final rule requiring large business prime contractors to notify the contracting officer in writing if they fail to utilize a small business included in their bid or proposal or make late or reduced payments to a small business subcontractor. 78 Fed. Reg. 42391 (July 16, 2013). The rule is viewed as a step in the right direction by small business subcontractors as a way to prevent prime contractors from touting robust small business subcontracting participation in their proposal for evaluation purposes, only to toss the small businesses aside when the work actually begins. Questions remain, however, regarding the precise circumstances in which the new reporting requirements will apply and how (or if) the rule will be enforced.

**New Reporting Requirements.** The final rule implements provisions of the Small Business Jobs Act of 2010, Pub. L. No. 111-240 (2010), and applies to all prime contracts that require a small business subcontracting plan. Prime contractors performing such contracts are now required to submit written reports to the contracting officer when they fail to use a small business subcontractor “used in preparing the bid or proposal during contract performance.” The phrase “used in preparing the bid or proposal” is defined quite broadly, to include any situation in which:

(i) the offeror references the small business concern as a subcontractor in the bid or proposal or associated small business subcontracting plan;

## Authors

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John R. Prairie  
Partner  
202.719.7167  
jprairie@wiley.law

## Practice Areas

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(ii) the offeror has a subcontract or agreement in principle to subcontract with the small business concern to perform a portion of the specific contract; or

(iii) the small business concern drafted any portion of the bid or proposal or the offeror used the small business concern's pricing or cost information or technical expertise in preparing the bid or proposal, where there is written evidence (including email) of an intent or understanding that the small business concern will be awarded a subcontract for the related work if the offeror is awarded the contract.

Under the final rule, a prime contractor is also required to notify the contracting officer in writing if it "pays a reduced price to a small business subcontractor" or if payment to a small business subcontractor is more than 90 days past due under the terms of the subcontract. "Reduced price" means a price that is less than the price agreed upon in a written, binding contractual document. The prime contractor must include the reason for the reduction in payment or failure to pay a small business subcontractor in the written notice.

The final rule makes clear that contracting officers are responsible for monitoring and evaluating a prime contractor's compliance with its small business subcontracting plan as part of the prime contractor's overall performance evaluation. The contracting officer's review must include, among other things, an evaluation of the prime contractor's written explanation for (1) failing to utilize a small business subcontractor used in preparing the prime contractor's proposal, and/or (2) any reduced or late payments to small business subcontractors. Notably, if the contracting officer finds that the prime contractor "has a history of unjustified untimely or reduced payments to subcontractors," the contracting officer must record the identity of the contractor in the Federal Awardee Performance and Integrity Information System (FAPIS).

**Unclear Effect.** Despite the broad scope of the new reporting requirements and other restrictions imposed by the final rule, it is uncertain how effective the rule will be in preventing large businesses from using "bait and switch" tactics with small business subcontractors. While the rule contains no affirmative enforcement mechanism, it does permit contracting officers to consider a prime contractor's compliance with its subcontracting plan when conducting performance evaluations. This could impact a prime contractor's past performance evaluation and potentially result in the imposition of liquidated damages under FAR 19.705-7 to the extent that the contracting officer determines that the prime contractor has not acted in good faith. To the extent that these enforcement mechanisms are actually used by agencies, however, they could have the unintended result of reducing small business subcontracting participation. Prime contractors concerned about having to report a failure to use a small business subcontractor identified in their proposal, and potentially be subjected to liquidated damages, may choose not to enter into teaming arrangements with small businesses or name them in the proposal.

Questions also remain concerning the precise circumstance in which the reporting requirements will apply. For example, the rule requires prime contractors to notify the contracting officer if they do not use a small business subcontractor for which "there is written evidence (including email) of an intent or understanding that the small business concern will be awarded a subcontract for the related work if the offeror is awarded the contract." One can easily imagine circumstances in which the "intent or understanding" of a prospective small business subcontractor does not precisely align with that of the offeror. Contracting officers will now be

required to adjudicate such disputes in the evaluation of the prime contractor's compliance with its small business subcontracting plan.

The late/reduced payment reporting obligation raises similar concerns. There are any number of legitimate reasons a prime contractor might make a "reduced payment" to a subcontractor. Under the final rule, however, prime contractors would be required to report any situation in which it paid a small business subcontractor "a price that is less than the price agreed upon" in the parties' agreement. It will be left to contracting officers to determine whether the reduced payment was justified. Since the rule prohibits prime contractors from barring their small business subcontractors from communicating directly with the contracting officer about such issues, unhappy subcontractors will be free to raise any payment dispute with the prime contractor's customer. Although this may be an effective means of ensuring that small business subcontractors receive the payments to which they are entitled, it may also unnecessarily insert contracting officers into payment disputes between private parties.

Notwithstanding the uncertainty as to the effectiveness and scope of the final rule, it is clear that the SBA is serious about curbing the perceived exploitation of small business subcontractors in the procurement process. Both large and small businesses should familiarize themselves with these new requirements to inform their pre-proposal teaming discussions as well as their post-award rights and obligations in the negotiation of subcontracts.