Small Business’ Recertification Requirements Under Scrutiny
by Leslie H. Lepow, J. Alex Ward and Jessica Tillipman

Last November, we issued an advisory about the Small Business Administration’s final rule addressing small business recertification requirements for long term contracts. Specifically, the rule, effective June 30, 2007, requires small businesses to recertify their size status with respect to their contracts in excess of five years, including options. See 71 Federal Register 66434, November 15, 2006 (the “Recertification Rule”).¹ The Recertification Rule requires size recertification under several circumstances, including:

• Acquisation or Merger: Within 30 days after the closing of an acquisition or merger, a company must provide the SBA with notice of the event. Previously, contractors were required to recertify only after novation or change of name.

• At the End of the Fifth Year: Contractors must recertify 120 days prior to the end of the fifth year of a long-term contract. The rule is applicable to all contracts lasting longer than five years, including single-award, single-agency contracts.

• Options After the Fifth Year: Contractors must recertify on an option is exercised after the fifth year of a long-term contract.

• Contracting Officer Request: While contracting officers have always possessed the right to ask for a recertification, the preamble to the rule lists this as one of the circumstances under which a contractor may be required to recertify its size.

The preamble to the Recertification Rule makes clear that agencies are not required to terminate a contract if a contractor can no longer re-certify that it is small. This means an agency may continue to award tasks to a contractor that is no longer small. An agency is prohibited, however, from counting work under the contract toward its small business goals under these circumstances. The Recertification Rule expressly states that its effective date is June 30, 2007. It is, therefore, only applicable to triggering actions that occur after June 30, 2007.

In recent weeks there has been a flurry of activity, including a fair amount of media attention, regarding small business size certifications.² Much of this activity has stemmed from SBA’s efforts to implement the Recertification Rule.

On July 3, 2007, the SBA Administrator, Steven Preston, issued letters to the CEOs of major federal contractors regarding size recertification (the “Preston Letter”). In addition to summarizing the provisions of the Recertification Rule, the Preston Letter suggests that SBA may be taking steps beyond the rule’s express requirements.

Notably, the Preston Letter informs contractors that, for long-term contracts, SBA intends to extend the recertification requirements to past as well as future mergers and acquisitions. In a July 18, 2007 press release, the SBA likewise stated that it views the rule as applicable to long-term contracts held by firms that have been through a merger or acquisition even if the transaction occurred before the Recertification Rule’s effective date. See SBA Press Release, July 18, 2007 (“Press Release”).³ Unfortunately, the Press Release raises more questions than it answers.

Explaining SBA’s interpretation of the rule, the Press Release states:
The rule also applies to mergers and acquisitions that occurred before the June 30, 2007 implementation of the new rules. The new recertification policy prohibits government agencies from claiming small business status for contracts initially awarded to small businesses that have since been acquired by a large business, regardless of when that acquisition or merger occurred. The new recertification policy applies to all existing and future long-term (five years or longer) contracts. For example, if a large firm purchased a small firm with a 20-year federal government contract last year, the contracting government agency can no longer count that contract as small.

This language seems to suggest that the SBA is attempting to apply the Recertification Rule retroactively, which would raise serious legal questions. But SBA’s actual intent is less clear. Although the Preston Letter first states that contracting officers are modifying contracts to provide for recertification on any existing long-term contract held by a firm involved in a past merger or acquisition, the letter goes on to state that recertification will not be required until the end of the fifth year of the contract. As described above, the Recertification Rule requires recertification at the end of the fifth year of all long-term contracts, so stating that this requirement applies to firms that have undergone a pre-June 30, 2007 merger or acquisition does not appear to add anything. It remains to be seen how SBA and contracting officers will give effect to these pronouncements.

SBA also has addressed the effect of the Recertification Rule on short-term contracts. The Press Release states that, “[i]f a large firm acquires a small firm with existing short-term contracts, the contracts will be removed from the [small business] database when the next option is exercised.” SBA’s intent again is not entirely clear, but this requirement seems to apply only to firms that undergo mergers or acquisitions after June 30, 2007, which would be consistent with the Recertification Rule. If, however, SBA intends to require a recertification when an option is exercised under a short-term contract even where there has been no post-June 30, 2007 merger or acquisition, that would appear to go beyond the requirements of the Recertification Rule. It also would contradict the rule’s explanatory statement that “SBA has decided to limit applicability of the final rule to only long-term contracts.” Again, how these pronouncements will be implemented in practice remains to be seen.

In addition to giving effect to the Recertification Rule, SBA is asking contractors for voluntary assistance in “scrubbing” the small business database. The Preston Letter asks its recipients (i.e., large firms) to voluntarily identify all small business contracts held by those firms and to recertify short-term contracts with options greater than one year as “other than small.” No regulatory support for these requests has been cited by SBA either under the Recertification Rule or otherwise. The SBA’s apparent goal is to “scrub” virtually all large corporations out of the list of small business contracts before July 2008.”

Notably, despite SBA’s aggressive implementation measures, the Recertification Rule has provoked litigation contending that SBA must go even further. Some small business industry groups, such as the American Small Business League, believe the Recertification Rule does not go far enough in protecting the interests of small businesses. In a July 19, 2007 press release, the American Small Business League announced that it is filing its fourth federal lawsuit to overturn the rule. The League contends that the five-year recertification requirement is an intentional loophole that SBA created to falsify the government’s compliance with its small business contracting goals.4

Congress is also contemplating legislation that may require contractors to recertify on a more frequent basis. On May 10, 2007, the House passed H.R. 1873, the “Small Business Fairness in Contracting Act.” Section 303, titled “Recertification of Compliance with Size Standards and Registration with Central Contractor Registry,” amends Section 3(a) of the Small Business Act (15 U.S.C. § 632(a)), and imposes additional recertification and registration requirements on small businesses. First, if a small business is awarded a set-aside contract and is close to exceeding the size standard at the time of award, the Bill requires the business to recertify its size status annually after the date of the award. See Sec. 303(5)(A). This requirement will apply to new small business contracts only. The clause does not require recertification with respect to existing
small business contracts. In addition, if a small business is awarded a set-aside contract, the Bill requires the business to update its listing in the Central Contractor Registry on an annual basis. See Sec. 303(6).

On May 11, 2007, the Bill was referred to the Senate Committee on Small Business and Entrepreneurship. On July 18, that committee held a hearing titled “Increasing Government Accountability and Ensuring Fairness in Small Business Contracting.” During the hearing, Senator John Kerry expressed concern that six of the top small business government contractors are actually large businesses. In fact, during his opening statement, Senator Kerry displayed a large poster titled “Small Federal Vendors FY 2005 . . . At Least 6 of the Top 30 Small Vendors are Large Companies.” The poster provided the names of the following six companies: SAIC, General Dynamics, Lockheed Martin, L-3, BAE, and Northrop Grumman. Senator Kerry also expressed his disapproval of the SBA’s five-year recertification rule, stating “I know that the SBA has implemented a new rule that will give a business a five year grace period, but why should we allow big businesses to get small business set-aside contracts for one day let alone five years? We can do better.” The Senate expects to have additional hearings on small business matters as it begins reviewing H.R. 1873 and drafting its own version of the bill. Given Senator Kerry’s statements regarding contractor size status, we expect the Senate’s version of the bill to address recertification. We are continuing to monitor this legislation.

Contractors should be aware of the impact that these recent regulatory and legislative initiatives will have on their business practices and plans for growth. Companies that have engaged in recent mergers or acquisitions should consider the impact of the new rule and of the SBA’s recent correspondence on their activities. Similarly, companies (buyers, sellers or investors) contemplating a merger or acquisition involving a small business should also be aware of the impact this will have on their transaction and related issues such as diligence, structure, etc. These issues are obviously complicated and all of the implications raised by the new regulation and flurry of activity (legislative or otherwise) create a host of issues that go beyond the purview of an abbreviated client advisory. If you have any questions about the information contained in this advisory, please contact any of the following attorneys:

**Endnotes**

1 The regulation is available at [http://a257q.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-19253.pdf](http://a257q.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/E6-19253.pdf)

2 There have been numerous articles written in recent weeks about the new SBA rule and size certification issues in general. Especially troubling are articles addressing the issue of large contractors that are currently performing small business contracts as the result of an acquisition of a small business. See, e.g., Hire a small business: Perhaps Lockheed or SAIC... Industry giants still eligible for preferences—for now, FederalTimes.com (July 18, 2007), available at [http://federaltimes.com/index.php?S=2909018](http://federaltimes.com/index.php?S=2909018). Articles like this create a distorted impression that large contractors are engaging in fraudulent activity, while the reality is much more likely to be that large companies have made acquisitions consistent with then-existing regulations, which did not call for recertification.


5 We can make copies of the written testimony of all participants in this hearing available at your request.


For more information, please contact the following Jenner & Block attorneys:

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