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A New DCAA Low for Taking Advantage of Small Businesses

By Robert L. Eldridge, Director

In our last newsletter, we focused on some of the unnecessary obstacles small businesses face in the regulatory environment and areas where, in our opinion, Government auditors, particularly DCAA, misinterpret regulatory guidance in their efforts to question costs. We particularly expressed our concerns related to the application of the credits clause to PPP loan forgiveness and the detrimental impact on small businesses with flexibly priced government contracts. Sadly, DCAA's misinterpretations and efforts to take advantage of small contractors have gotten even worse since our last newsletter!

Now, at least in the Central Region, DCAA has gone totally off the rails and is claiming that not only is the government entitled to a credit for the forgiveness received, but that 100% of the expenses forming the basis for the forgiveness credit must be included in the indirect allocation bases because in DCAA's opinion that would result in an improper "fragmentation of the allocation base" under the provisions of FAR 31.203(d). Effectively, DCAA is treating the credit as if it represents an unallowable cost.

This interpretation results in a total inconsistency in the application of the guidance. DCAA is demanding a credit to expenses on the basis that because the loan was forgiven, contractors receiving forgiveness did not really incur the expense and then taking a different interpretation for allocation base purposes and saying that the total expense was incurred and must be included in applicable indirect allocation bases to avoid fragmenting those bases. DCAA, effectively, wants to interpret the credits both ways, treating the forgiveness as a reduction of incurred expenses for direct contract cost and indirect cost pool purposes but treating it as fully incurred expenses for allocation base purposes.

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DCAA wants it both ways. If the loan forgiveness is not a reduction of contract costs, then the credit clause cannot apply because there was no rebate or credit due to the Government. If the loan forgiveness is considered a rebate or credit of contract costs, then the related contract costs were in effect not incurred and the related credit should be appropriately reflected in the allocation bases.

DCAA not only wants small businesses to lose any benefit of the PPP loans and related forgiveness as we believe was intended by Congress, they want to punish small businesses for receiving the forgiveness by not only taking away the amount of the forgiveness but also by charging the small business for indirect fringe benefits, overhead, and G&A. The lack of DCAA understanding of regulatory requirements, basic accounting rules, and any kind of common sense is truly mind blowing!

According to this approach by DCAA, a small business can now owe the Government more money than it actually received in PPP loan proceeds and forgiveness. DCAA apparently believes small businesses should be penalized for using the PPP loan forgiveness provisions! Clearly a new DCAA low!

Additional details related to the application of credits and their relationship to the indirect allocation base are provided in the article below.

DCAA Misapplication of Credits Related to PPP Loans in Rate Development

By Kimberly Basden, Managing Consultant

Recently, our office has become aware of a few instances of auditors misunderstanding the DCAA Headquarters' guidance pertaining to the treatment of credits associated with PPP Loan Forgiveness. Specifically, it is the position of the Defense Pricing Center (DPC) and DCAA that any forgiven loan amounts should be treated as credits in accordance with FAR 31.201-5 which states that "the applicable portion of any income, rebate, allowance or other credit relating to any allowable cost and received by the contractor shall be credited to the government as a **cost reduction**…"

There is a difference between a cost reduction and cost that is unallowable or voluntarily disallowed. Unallowable or voluntarily disallowed costs implies the costs were incurred and should participate in all allocable cost burdens. As an example, the incurrence of unallowable labor would bear all allocable indirect cost (e.g., fringe benefits) the same as allowable labor. Since the labor itself is unrecoverable, the allocable indirect costs would likewise be unrecoverable by the contractor. Therefore, the unallowable costs are included in the base when calculating indirect rates.

A cost reduction because of a credit is a different matter entirely. Credits result in the elimination of costs. Therefore, a credit would be a reduction of the pool and base depending on the type of costs that received the credit. If direct labor was forgiven, then it would not be included in the base of the indirect rate calculation or the allocation base for G&A. Credits for material scrap are generally posted to the material handling pool, credits for insurance rebates or proceeds from the sale of manufacturing equipment is credited to the account in an overhead pool, reducing the costs. These credits are not added back to the allocation base for G&A. In short, the accounting for the forgiveness part of the PPP credit is the same, it is as if the costs never existed, and the result is that there are no allocable indirect costs associated with amounts credited, nor is the forgiven cost (e.g., credit) included in the allocation bases as the cost has been effectively removed from the claimed cost.

For those of you familiar with the ICE model, the proper place to record credits because of PPP loan forgiveness is in the GL column of the applicable schedule, not the adjustment column. The credits that result from PPP loan forgiveness are NOT adjustments related to the cost being unallowable rather it is simply a reduction to cost going into the ICE model.

We have prepared and reviewed many ICE models; I will say presenting credits because of PPP loan forgiveness is not entirely intuitive. The fact that there has been some confusion amongst various DCAA auditors in the presentation is not surprising. We just hope DCAA HQ can remedy this confusion soon through additional guidance to their auditors or encourage field auditors to read the applicable regulation and DCAA memos released during 2020.

Other consultants agree with our position. Click here to view the guidance provided by Aronson LLC.

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DFARS Business System Reviews

By Robert L. Eldridge, Director

As DCAA has caught up on its incurred cost audits, we have seen a significant increase in the number of DFARS Business System Audits performed. We are also seeing a significant increase in DCMA CPSR effort and a renewed emphasis on adequate Business Systems in Government Solicitations such as the recent CIO-SP4 solicitation.

In some cases, such as the Estimating System, in the CIO-SP4 solicitations, the Government is allowing a letter from a CPA firm regarding the adequacy of the system design and not requiring a full Government audit. However, in most cases, to meet the solicitation requirements or to increase a bidder's "point score" for having an adequate Business System, an audit by DCAA or DCMA is required. Not to go off on a tangent, but language for "approved" or "adequate" business systems, such as Estimating, Accounting and Purchasing appear to be the new normal for solicitations, even when the award is intended as a small business set-aside. We hate to break it to Procurement Officers, but the thresholds for a formal review or audit by DCAA or DCMA for systems such as Estimating and Purchasing do not allow for small businesses to be considered for these type of audits (See subsequent article for more clarification). We find the disconnect to be both frustrating and unfortunate. To compound matters, contractors do not have control of when or if DCAA or DCMA performs these audits, and they will not be performed unless requested by the Contracting Officer. The only thing worse than not having the audit (making a contractor potentially ineligible for the points or for meeting solicitation requirements) is having an audit performed by DCAA or DCMA that results in an inadequate system determination. Accordingly, it is very important that contractors, even those not subject to DFARS Business System rules, ensure they have adequate policies, procedures, and practices in compliance with the DFARS criteria for each applicable system.

As needed, Redstone GCI can assist with that effort by assessing current policies and procedures against the DFARS criteria and recommending changes as necessary for compliance, developing new policies, procedures, templates, or manuals as needed, and performing mock audits of your practices to help ensure compliance before a DCAA or DCMA audit. Where value added, we can also perform assessments and provide letters regarding the adequacy of the design of the system for compliance with the DFARS criteria.

What Purchasing Policies do Smaller Contractors Need?

By John C. Shire, Director

When does the USG perform CPSRs?
Defense Contract Management Agency (DCMA) Contractor Purchasing System Review (CPSR) Guidebook dated June 14, 2019, provides a CPSR is conducted when a contractor's annual sales to the Government are expected to exceed $50M in a 12-month period. Government sales include all Government contracts/subcontracts except competitive firm-fixed-price, competitive fixed-price with economic price adjustment, and commercial items under FAR part 12. Ultimately, the ACO determines the need for a CPSR based on risk. Based on this it is not likely that most small businesses and service contractors are going to get an ACO willing to request a CPSR be performed.

What a relief – right?
While not having to invest the resources to support a CPSR is a benefit, there are other risks and concerns. One of the biggest concerns is missing out on potential points or advantages under Government competitive solicitations – e.g., The National Institutes of Health Acquisition and Assessment Center (NITAAC) released a Request for Proposal (RFP) for the Chief Information Officer – Solutions and Partners (CIO-SP4) program providing points (used to evaluate the bidders for award) for several business systems. As for risk, DCAA auditors have questioned material cost based on documentation such as sole source justification documentation missing from supporting purchase order files.

So, what is a contractor to do?
Smaller contractors are not likely to have much they can do to get the points for an adequate purchasing system and the resources and effort to get the system infrastructure in place may simply not be worth it. The good news there is that the other small businesses you are competing against are in the same predicament and also very unlikely to have these approved systems, meaning they too will not obtain these points in a proposal evaluation. When it comes to protection from having low hanging fruit for DCAA to question, a full

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blown CPSR is not needed and having a limited number of policies and supporting documentation may be worth the investment.

What is the minimum to hold the DCAA dogs at bay?
We recommend having policies addressing the following areas:

- Prior Consent and Advance Notification, 10 U.S.C. 2306(e), FAR 44.201, FAR 52.244-2, DFARS 252.244-7001(c)(1);
- Competition in Subcontracting, DFARS 252.244-7001(c)(7), (8), and (21);
- Only one Offer, DFARS 252.215-7008;
- Sole Source Selection Justification, DFARS 252.244-7001(c)(4), (5), (9), and (10);
- Cost Analysis, FAR 15.404-1(c)(2);
- Price Analysis, FAR 15.404, DFARS 252.244-7001(c)(8), (9), (10), (16), and (22);
- Determination of a Fair and Reasonable Price, FAR 15.402 and DFARS 252.244-7001(c)(10);
- Documentation, DFARS 252.244-7001(c)(4), (5), and (15);
- Commercial Item Determination, FAR 2.101, FAR Part 10, DFARS 244.303, DFARS 244.402(a), DFARS 252.244-7000, DFARS 252.244-7001(c)(5);
- Market Research, FAR Part 10.

We also recommend at least one member of compliance or accounting staff be trained in the expectations of purchasing under Government contracts and be involved in all purchases, even if only to review purchase order files.

Cost/Price Analysis – Timely Performance

By Lynne Nalley, Director

DFARS 252.215-7002 requires an acceptable estimating system include "procedures that ensure subcontract prices are reasonable based on a documented review and analysis provided with the prime proposal, **when practicable** (emphasis added)." Completing timely cost/price analyses and including them in their proposal is one of the more difficult tasks a prime contractor must deal with when preparing and submitting a proposal. DCAA views a contractor that is not consistently completing cost/price analyses prior to coming to the negotiation table with the Government as having an estimating deficiency. Prime contractors must wait for subcontractors to submit the proposal before the analyses can even be performed. There are additional issues that may be encountered once a subcontract proposal requiring a cost/price analysis is received such as:

- Inadequate subcontract proposals hindering the cost/price analysis,
- Denied access to subcontract rates and other data,
- DCAA refusing to perform a contractor's request for support when denied access to subcontract data,
- Relying on the results of an assist audit without performing its own analysis utilizing the audit assistance,
- Untimely the receipt of requested assist audits,
- DCAA unsupporting the costs,
- Significant FAR 15 noncompliance's in DCAA reports without enough information for the prime to address, and
- Government reduction in acquisition time.

Prime contractors that submit proposals requiring certified cost or pricing data (exceeding $2M and an exception does not apply), are required to follow the instructions in FAR 15.408. FAR 15.408 Table 15-2A Material and Services requires the prime to conduct price analyses of all subcontractor proposals and conduct cost analyses for all subcontracts when certified cost or pricing data are submitted by the subcontractor. It goes on to specifically require the prime to include these analyses as part of its own certified cost or pricing data submissions.

When the solicitation requires the submission of certified cost or pricing data, the contracting officer will include the DFARs provision 252.215-7009, Proposal Adequacy Checklist for the contractor to complete and include in its proposal. The Proposal Adequacy Checklist includes the following question 17. related to price/cost analysis:

- Is there a price/cost analysis establishing the reasonableness of each of the proposed subcontracts included with the proposal?
- If the offeror's price/cost analyses are not provided with the proposal, does the proposal include a matrix identifying dates for receipt of subcontractor proposal,

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completion of fact finding for purposes of price/cost analysis, and submission of the price/cost analysis?

The proposal adequacy checklist allows for a matrix, which implies that the proposal is adequate if cost/price analyses completed are included along with a matrix with realistic dates for the ones that are not completed. Sounds like a good deal, if you are under a time crunch to submit the proposal to the Government with completed and open price/cost analyses.

But not so fast. In DCAA Memorandum for Regional Directors (MRD) 17-PSP-007, Audit Alert on Requirement for Prime Contractor Cost and Price Analyses, dated September 6, 2017, DCAA addressed the matrix in the Question & Answer (Q&A) section indicating that the inclusion of a matrix does not overcome the inadequacy of the prime contractor to submit the cost/price analyses with the proposal, nor does the request of an assist audit relieve the prime of its responsibility. But it does state that this inadequacy alone does not result in the audit team's inability to proceed with the audit.

Then DCAA issued MRD 18-PSP-006, Audit Guidance on Revised Treatment of Incomplete or Inadequate Prime Contractor Cost or Price Analyses, dated November 27, 2018, which supersedes the previous MRD 17-PSP-007. In that updated memo, DCAA is silent in the Q&A section on the inclusion of the matrix on outstanding cost/price analyses in the proposal.

In fact, DCAA has changed their guidance of classifying 100% of subcontract costs as unsupported when a cost/price analysis is not completed/included with the proposal. DCAA is now required to perform a variety of alternative procedures such as:

- Create a decrement based on purchase order history,
- Establish a decrement based on other relevant information (e.g., comparisons of prior subcontract proposals to historical cost or price analyses or negotiated amounts), or
- Coordinating with the subcontract audit team and request a DCAA assist audit based on a risk assessment.

When DCAA performs alternate procedures on a subcontract proposal and there is sufficient evidence, the guidance states the auditors will not classify the remaining costs as unsupported. Sufficient evidence is based on the auditor judgment of the procedures and tests they perform so it can vary by auditor. DCAA will still list the subcontract in an Exhibit called FAR 15 Noncompliance and inform the Contracting Officer of the contractor's scheduled completion date and that the analyses should be submitted to the CO prior to the prime contract negotiations. If DCAA is unable to obtain sufficient evidence by performing the alternative procedures, they will classify the costs as unsupported and cite a FAR 15 noncompliance and a scope limitation. If an assist audit is outstanding, DCAA will classify the costs as unresolved. Applying professional judgment to determine if the alternate procedures are sufficient evidence, is subjective and will be dependent on the training and experience of the audit staff and may still result in significant costs being classified as unsupported.

So, what should a contractor do if they are in a pickle and cannot perform the cost analysis due to time constraints, denial of access to subcontract data, waiting for assist audits, etc.? We recommend contractors include the evidence of what cost/price analyses was able to be performed in the proposal and include a matrix with realistic due dates of when additional action is due. This makes the matrix an important tool to include documentation of when subcontractor data will be received, dates assist audits were requested along with the follow-up dates and conversations with the auditors on estimated completion dates. Not keeping the matrix current or documenting the efforts taken to obtain data, gives the appearance that the dates are not realistic. Performing some of the alternate procedures that DCAA is using (historical decrements, etc.) and including this information in the proposal along with the matrix would also be a good practice. On significant proposals, ensure the ACO and PCO are briefed on the effort in which you are awaiting from Government resources and the potential impact on the determination of a fair and reasonable subcontract price.

When a prime contractor is denied access to subcontractor rates or data, the contractor should request the Government perform an audit as soon as possible, directly through the DCMA ACO at the subcontractor location. DCAA will not perform contractor requested assist audits, so they will either return the request to the prime contractor or coordinate with the Government to see if there is a need, which delays the start of the audit. DCMA performs Field Pricing Assistance when contractors are denied access. While DCMA does not

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perform audits, they do evaluate the proposal and provide a quick turnaround depending on their workload. DCAA performs audits under generally accepted Government auditing standards but will usually prioritize audits requested by the Government over contractor requested audits through the Government. When the audit is complete, contractors cannot simply use the assist audit in place of a cost/price analysis; but instead, are expected to perform its analysis of the subcontract proposal using the results from the audit and any other information available for determining price reasonableness.

Preparing and including the matrix in the proposal, continuously updating and documenting the matrix for follow-up with subcontractors and government auditors and performing alternate procedures similar to those mentioned by DCAA should provide the government assurance that you are being a responsible contractor.

Recent GAO and Court Decisions

By Guest Author: Jerome S. Gabig, Attorney, Wilmer & Lee

Raytheon Fought Back Against DCAA/DCMA Mischief Challenging Costs as Unallowable

Appeals of by contractors of DCAA/DCMA disallowing costs are often successful. Recently, Raytheon decided to push back on DCAA/DCMA mischief that aggressively disallowed costs. The government claimed the contractor had claimed unallowable costs for lobbying, corporate development, patents, travel, and recruitment. The board found that for the vast majority of its claims, the government had not met its burden of proof in establishing that the costs were unallowable. However, the Armed Services Board of Contracts Appeal ("ASBCA") did find that the contractor had wrongly claimed some unallowable costs for promotional materials given out at job fairs.

Raytheon Company and its business segments have several contracts with the federal government. Each year, Raytheon and its segments submit costs proposals to the government to recover indirect costs on its government contracts. This case concerned final indirect cost proposals that Raytheon and its subsidiary, Raytheon Missile Systems, submitted for 2007 and 2008.

The Defense Contract Audit Agency ("DCAA") audited those proposals and determined that some of the costs claimed were unallowable and that some were even expressly unallowable and thus subject to penalties under FAR 42.709(a)(1). Based on these audits, the Defense Contract Management Agency (DCMA) issued ten final decisions asserting claims against Raytheon for various unallowable costs—including costs for lobbying, patents, travel, corporate development costs, and recruitment. Raytheon appealed to the ASBCA.

Government's Burden of Proof

The board reviews a contracting officer's decision that costs are unallowable and subject to penalty *de novo*. The government bears the burden of proving that a contractor submitted expressly unallowable costs. To meet that burden, the government must show that it was unreasonable under all circumstances for a person in the contractor's position to conclude that the costs were allowable.

Lobbying Costs

Under FAR 31.205-22, costs incurred to influence federal or state legislation are not allowable. Raytheon had a government relations office, which spent significant time lobbying. Raytheon relied on times reported by its government relations lobbyists to determine the amount of unallowable lobbying activity. Raytheon established a ratio to determine the amount of unallowable lobbying costs. The numerator was the total number of unallowable costs reported by its lobbyists. The denominator was the total number of hours worked by those lobbyists. Raytheon then applied this factor to the total of its government relations expenses to determine the costs associated each year for lobbying activities.

DCMA alleged that for 2007 and 2008, Raytheon's claimed lobbying costs were all unallowable and that the company had not provided any meaningful support for the claimed costs. DCMA further alleged that Raytheon's lobbying estimates and allowability calculations were flawed. DCMA claimed that Raytheon's lobbyists had not been properly trained on which lobbying costs were recoverable, and that there had been no oversight regarding the lobbyists' estimates of their unallowable time.

The board found that the government had not met its burden of proof concerning the lobbying costs. Contrary to the government's contentions, the evidence showed that Raytheon's lobbying personnel received annual in-house and

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outside training, and that the company had an internal Lobbying Policy and guidelines for unallowable costs. Raytheon's policies required employees who spend more than 25% of their time on lobbying activity to keep records of their lobbying activity. Accounting for labor costs as function of time paid, rather than time worked, is a common industry method.

The board found that DCMA's arguments regarding the lobbying costs were based on general beliefs and speculation. The government had not met its burden of proof. The board sustained the Raytheon's appeals regarding the lobbying costs.

Corporate Development Costs

Under FAR 31.205-22, costs associated with corporate organizations and reorganizations—e.g., mergers and acquisition—are not recoverable. Raytheon had an office of corporate development that focused on strategic transactions like acquisitions and divestitures. Raytheon's policy was that unallowable corporate development costs began with the submission of an indicative offer—i.e., when the company made a decision to buy or sell a company.

DMCA alleged that Raytheon charged the government for expressly unallowable corporate organizational costs. DCMA claimed that Raytheon failed to support with the time it submitted for corporate development and failed to maintain accurate time sheets to demonstrate its compliance with cost principles.

The board, however, found that Raytheon's "bright line" practice—i.e., treating all costs incurred after an indicative offer as unallowable—sufficiently segregated unallowable organization costs from allowable market planning costs. DCMA had not carried its burned by a preponderance of the evidence to show that Raytheon had improperly claimed corporate organization costs.

Patent Costs

FAR 31.205-30 allows a contractor to recover costs in connection with the filing and prosecution of a patent where title or a royalty-free license will be conveyed to the government. Raytheon had an Invention Disclosure Policy by which it reviewed the technical and economic merits of inventions and determined whether to seek a patent or treat the inventions trade secrets. Raytheon would only seek to recover the costs incurred in this process for patents that Raytheon was seeking as part of a government contract, which Raytheon called "subject inventions."

DCMA alleged that Raytheon had sought costs that were not specifically required by a government contract and thus were unallowable. The board reasoned that the amount that DCMA had disallowed may well have included costs for "subject inventions" and for non-patent invention disclosures that were allowable. But the board could not determine from the record what the proper amount of unallowable costs should have been. The board concluded that this was a failure of proof by the government, which lead to a sustain of the appeal on the claim for patent costs.

DCMA also asserted a claim against Raytheon for $120,000 the company incurred from outside legal counsel preparing patent applications. DCMA argued that Raytheon had to prove that these costs were a literal line item requirement of a government contract. The board, however, found that the relevant FAR provision, 31.205-30, did not specify that there be a line item link to a government contract. Rather, the board found that Raytheon was permitted to seek these legal costs as indirect costs under the Cost Accounting Standards.

Airfare Costs

At the times relevant to Raytheon 2007 and 2008 cost proposals, FAR 31.205-46 provided that airfare costs in excess of the lowest customary standard, coach, or equivalent airfare offered during normal business hours are unallowable. Costs in excess of the standard may be allowable for travel during unreasonable hours, excessively long travel, or when coach travel was not otherwise available to meet mission requirements.

DCMA alleged that Raytheon had sought recover costs of premium airfare costs that did not fall into the exceptions listed by FAR 31.205-46. Additionally, DCMA alleged that in situations where premium airfare was available at a price less than coach, Raytheon simply charged the government with the premium fare without determining whether it satisfied the exception in FAR 31.205-46. Thus, DCMA claimed, the government was subsidizing Raytheon's premium travel.

Once again, the board determined that the government had not met its burden of establishing unallowable costs. By its plain language, the applicable version of FAR § 31.205-46 did not make premium class travel unallowable per se. Rather, it

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imposed an allowability limitation on airfare costs that exceed the lowest customary standard for coach. Raytheon reasonably interpreted this as a baseline of standard coach fare available to the public. Thus, as long as Raytheon's airfare costs did not exceed what was charged to the public, they were allowable. Raytheon had represented that it had never charged the government with more than available coach fare. The government had not rebutted this allegation. The board sustained the appeal on airfare costs.

Recruitment Costs

FAR 31.205-34 allows for recovery of certain travel costs of applicants for interviews. DMCA disallowed over $50,000 claimed for interviewees traveling to Tucson for interviews with Raytheon Missile Systems. DCMA claimed these costs contained duplicate tickets for the spouses of the interviewee, and that Raytheon had failed to provide adequate support showing that these interviewees had actually interviewed for a position. But the board noted that Raytheon ultimately agreed to withdraw the costs for spouses and guests of interviewees. As to the other travel-related costs, the board found that the government had failed to meet its burden of proof in demonstrating that these costs were unallowable.

Souvenirs

FAR 31-205-1 states that generally costs of promotional materials are not allowable. DCMA claimed that Raytheon had sought to recover costs of promotional materials like mouse pads, pens, pencils, coffee mugs, and To-shirts, which Raytheon handed out a job fair. Raytheon alleged these items were recoverable as public relations costs. The board, however, agreed with the government, reasoning that these items were effectively souvenirs. The government statute, 10 U.S.C. § 2324(e)(1)(I) provides that memorabilia and mementos are unallowable promotional items.

Attached is a copy of the ASBCA's Raytheon decision.

The SBA's Rule of Two:
Often Overlooked as a Business Development Tool

The SBA's Rule of Two cannot be traced to a statute, however, it is older than the Federal Acquisition Regulation (FAR). The rule states:

> The contracting officer shall set aside any acquisition over the simplified acquisition threshold for small business participation when there is a reasonable expectation that-
>
> (1) Offers will be obtained from at least two responsible small business concerns; and
> (2) Award will be made at fair market prices. Total small business set-asides shall not be made unless such a reasonable expectation exists (see 19.502-3 for partial set-asides).

FAR § 19.502-2(b).

The U.S. Court of Federal Claims has explained that:

> The Rule of Two is part of a larger framework in the FAR established to benefit small businesses. All that is required is a reasonable expectation. The threshold for meeting the criteria of the Rule of Two is purposefully low and is counterbalanced by FAR provisions that provide direction in the event of a failed set-aside.[1]

This larger framework is for government agencies to meet their small business goals. These small business goals consist of 23% of the yearly federal contracting budget being set-aside for small business contracts. There are also smaller goals for Women-Owned Small Businesses (5%), Small Disadvantaged Businesses (5%), HUBZone Small Businesses (3%), and Service-Disabled Veteran-Owned Small Businesses (SDVOSB) (3%).

The expanse of the SBA's Rule of Two is not abundantly clear. It has been enforced against the VA as to SDVOSBs even when the VA had exceeded its goal for award to SDVOSBs.[2] Although not mandatory for GSA Federal Supply Schedules, FAR § 8.405-5 authorizes contracting officers to use the Rule of Two to limit quotations from only small businesses. Similarly, FAR § 19.502-4 states multiple award task order contracts (MATOCs) are not required for follow the Rule of Two although contracting officers have discretion to do so. However, recently the U.S. Court of Federal Claims has held that before deciding to proceed under a MATOC, a contracting officer must abide by the Rule of Two.[3]

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1 *Dynamic Educational Systems, Inc. v. United States*, 109 Fed. Cl. 306, 328 (2013).

2 *Kingdomware Technologies v. United States*, 136 S. Ct. 1969 (2016).

3 *The Tolliver Grp., Inc. v. United States*, 151 Fed. Cl. 70 (2020).

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One of the factors in establishing the Rule of Two is that small businesses are often hesitant to invest bid and proposal resources to compete with large-business contractors for work in an unrestricted competition.[4] It is also noteworthy that the term "fair market prices" as used in FAR § 19.502-2(b) does not mean the lowest possible price.

Needless-to-say, large businesses generally do not appreciate being deprived of an opportunity to compete. Anecdotally, for some NAICS codes the set-asides for small businesses are so prevalent that large businesses are almost excluded from the market. Although the Small Business Act mentions the term "a fair proportion of the total purchases and contracts for goods and services of the Government," large businesses have not been successful in challenging small business set-asides by contending more than a fair proportion of the work is going to small businesses for a particular NAICS code.[5]

Some contracting officers regard the Rule of Two as merely guidance which can be circumvented when desired. Those contracting officers risk being taught a lesson by the GAO. The GAO inquiries into whether a contracting officer actually made reasonable efforts to ascertain if there was a likelihood of obtaining offers from two small businesses. The GAO has sustained protests where the decision not to set aside was either unreasonable or based on outdated/incomplete information. For example, in *Fire Risk Management*, B-411552, Aug. 20, 2015, the GAO sustained a challenge to a contracting officer's decision not to set aside an acquisition for small businesses because the contracting officer's decision of no reasonable expectation of receiving offerors from two or more small businesses was not supported by the record.

A lesson can be learned from the GAO's decision in *Information Ventures, Inc.*, B-294267, October 8, 2004 where the GAO sustained a protest involving a contracting officer's decision not to set aside a procurement where the contracting officer did not consider the responses of some small businesses to the pre-solicitation notice. To have the best chance at having a procurement set aside, small businesses should try to influence the contracting officer's decision as early as possible. Hence, when an agency disseminates information on a proposed contractual action under FAR Subpart 5.1 (such as a sources sought), small businesses should fully respond and accentuate their small business status.

There is no prohibition to alerting a small business competitor (AKA as a "frenemy") of a sources sought and encouraging the frenemy to similarly respond thus increasing the probability of the Rule of Two being put into play. However, it would be imprudent to go much further. Anything further dialog might create an appearance of collusive bidding—something the Government does not (and should not) tolerate.

In summary, the SBA's Rule of Two is an often-overlooked tool of business development. Eliminating large business competitors before the solicitation is issued can greatly enhance the likelihood of a small business's proposal being selected for award. Small businesses should not be bashful about reminding contracting officers of their responsibility under the Rule of Two.

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[4] *Delex Sys., Inc.*, B–400403, October 8, 2008.

[5] *Management & Training Corporation v. United States*, 118 Fed. Cl. 155 (2013).

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Our Company's Mission Statement: Redstone GCI enables contractors doing business with the U.S. government to comply with the complex and challenging procurement regulatory provisions and contract requirements by providing superior cost, pricing, accounting, and contracts administration consulting expertise to clients expeditiously, efficiently, and within customer expectations. Our consulting expertise and experience is unparalleled in understanding unique challenges of government contractors, our operating procedures are crafted and monitored to ensure rock-solid compliance, and our company's charter and implementing policies are designed to continuously meet needs of clients while fostering a long-term partnership with each client through pro-active communication with our clients.

In achieving government contractor goals, all consulting services are planned and executed utilizing a quality control system to ensure client objectives and goals are fully understood; the right mix of experts with the proper experience are assigned to the requested task; clients are kept abreast of work progress; continuous communication is maintained during the engagement; work is managed and reviewed during the engagement; deliverables are consistent with and tailored to the original agreed-to scope of work, and; follow-up communication to determine the effectiveness of solutions and guidance provided by our experts.

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