Construction Bills

Recent Changes to Construction Laws

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Changes to the Limitations on Subcontracting for Small Business Set-Asides

The Small Business Administration (SBA) has proposed new regulations in order to implement provisions of the National Defense Authorization Act for Fiscal Year 2013 (NDAA).[1] The SBA issued a notice of proposed rulemaking on December 29, 2014, and the extended comment period closed April 6, 2015. The new regulations aim to clarify limitations on subcontracting under the 8(a) Business Development (8(a) BD), Historically Underutilized Business Zones (HUBZone), Service-Disabled Veteran-Owned (SDVO), Women-Owned Small Business (WOSB), and Economically Disadvantaged Woman-Owned Small Business (EDWOSB) programs, and full and partial government set-aside contracts, as well as provide additional guidance concerning affiliation and joint ventures. The SBA hopes that these regulations, if adopted, will promote the federal government's policy of preserving contracting opportunities for small businesses, while ensuring that those small businesses are actually performing and benefiting from the work that is done under the terms of the contract.

The new regulations first call for changing the current "performance of work" requirement to a "limitations on subcontracting" evaluation criteria. Under the new rules, 8(a) BD, HUBZone, SDVO, WOSB, EDWOSB, and full and partial government set-aside contracts will be "evaluated based on the percentage of the overall award amount that a prime contractor spends on its subcontractors."[2] This is a shift of focus from the amount of work a prime contractor is required to perform to a focus on the value of subcontracts. Under the new regulation, no more than a set percentage of the total contract awarded to a qualifying prime contractor may be paid to a subcontractor that is not a "similarly situated entity." In order for a subcontractor to be considered a "similarly situated entity," that subcontractor must participate in the same SBA program used by the prime contractor to qualify for the award of the prime contract, whether that program is the 8(a) BD, HUBZone, WSOB/EDWSOB, SDVO, or other small business set-aside program.The permitted subcontractor percentage varies based on the type of contract, with no more than 50 percent of the award going to subcontractors for service and supply contracts, 85 percent for general construction contracts, and 75 percent for specialty trade construction contracts. Small contracts valued at less than $150,000 are exempt from the new limitations on subcontracting.

Similarly situated entities are exempt from the new limitations on subcontracting, and therefore participating prime contractors may contract any amount they choose to qualifying "similarly situated" subcontractors.

Prime contractors must certify compliance in their application and also must identify any similarly situated subcontractors in their offer. The prime contractor must also notify the SBA of any later changes that may result in noncompliance with the new regulation. Failure to notify the SBA will result in a fine of the amount spent in excess of the allowed amount on nonsimilarly situated subcontractors or $500,000, whichever is greater.

The second change under the proposed regulations is how small businesses determine whether they are "affiliated" with another business. The SBA proposes a bright-line rule: if a firm derives 70 percent or more of its business from another entity, there is a rebuttable presumption that the firms are affiliated. Further, the SBA has clarified that a presumption of affiliation exists for firms that conduct business with one another and where the persons controlling the firms are married, in a civil union, parent–children, or siblings. This addition adds clarity where before no specificity was provided as to the relationships that presumptively create an affiliation.

Finally, the proposed regulations will allow small businesses that form joint ventures to compete on projects as a single small business, as long as each firm separately qualifies as a small business under its North American Industry Classification System (NAICS) designation. The firms need not be affiliated to form such a venture. The SBA hopes

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that this change will encourage more businesses to create joint ventures to compete for larger contracts and help align joint venturing requirements with the new limitations on subcontracting previously described.

Small Business Administration to Create New Mentor-Protégé Program

The SBA has proposed additional regulations to implement provisions of the NDAA relating to a new small business mentor-protégé program.[3] The SBA issued a notice of proposed rulemaking on February 5, 2015, and the extended comment period closed May 6, 2015. These regulations would establish a new, government-wide mentor-protégé program open to all small businesses and would have goals similar to the existing 8(a) Business Development Mentor-Protégé program. The regulations also propose changes to the current 8(a) program that change the qualifications for both mentors and protégés, in order to be consistent with the new program.

The biggest change to come from these regulations is the proposed creation of the Small Business Mentor-Protégé Program, designed to replace the separate mentorship programs based on small business classification authorized by the Small Business Jobs Act of 2010. Under the new program, any small business, including Historically Underutilized Business Zones (HUBZone), Service-Disabled Veteran-Owned (SDVO), Women-Owned Small Business (WOSB), and Economically Disadvantaged Woman-Owned Small Business (EDWOSB) businesses, would be eligible to create a joint venture as part of a mentor-protégé arrangement in order to compete for small business set-aside contracts. The 8(a) program would continue to operate and be administered by the SBA's Associate Administrator for Business Development, while the new program would be administered by the SBA's Director of Government Contracting.

The rule also clarifies that while a joint venture does not need to be a formal separate legal entity, such as an LLC, there needs to be a written agreement between the mentor and protégé establishing the responsibilities of each party to the joint venture. Further, parties to a joint venture must annually certify compliance with SBA joint venture regulations and the specific provisions of the individual joint venture agreement, and such joint ventures may not last for longer than three years. The SBA will use these annual certifications to deter fraud and will use administrative remedies such as suspension and disbarment, as well as applicable civil and criminal prosecutions, in order to deter such conduct.

If a joint venture is created as a separate legal entity, that entity must remain unpopulated, except for administrative staff. It may not be populated with any individuals intended to perform contracts awarded to the joint venture, which is a change from the current rules that allow unpopulated joint ventures, populated joint ventures with administrative personnel only, and populated joint ventures with persons that will complete work on the contract itself. The SBA believes that unpopulated joint ventures will help ensure that protégé firms directly benefit from and control the joint venture created with a large mentor firm.

The rule also proposes changes to the 8(a) BD program in order to make qualifications and requirements more uniform between this program and the newly proposed program. Under the new regulations, any for-profit going concern that wants to assist a small business may be approved as a mentor by the SBA. Nonprofits will no longer be allowed to act as mentors for the 8(a) BD program in order to keep the two programs consistent and to follow the definition of "mentor" found in the NDAA.

There is also a change in the way firms qualify as protégés for the 8(a) BD program to maintain consistency between the two programs. Currently, an 8(a) BD applicant must be smaller than half the standard size for its primary NAICS designation, or be in the developmental stage of its program, or have not yet been awarded an 8(a) BD contract. To make the two programs consistent, the SBA proposes to eliminate the existing 8(a) BD qualifiers. In their place, an applicant must qualify as a small business under its primary NAICS designation in order to participate as a protégé in either the new program or the existing 8(a) BD program.

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Consistent with current 8(a) BD regulations, a protégé in the new program may not become a mentor to another small business and maintain its protégé status. Additionally, mentor firms in the new program would be permitted to own up to a 40 percent stake in the protégé firm in order to help the protégé firm attract investors and raise any necessary capital.

As part of the goal of broadening access to mentor-protégé relationships for small businesses, HUBZone program participants will be allowed to partner with non-HUBZone mentors to create joint ventures that compete for HUBZone contracts. This is a change from previous rules, which restricted HUBZone participants from forming joint ventures with firms not already participating in the HUBZone program to compete for HUBZone contracts.

The new mentor-protégé program would potentially replace small business mentorship programs operated by other government agencies, with the exception of the mentor-protégé program operated by the Department

of Defense. The regulations propose that other agencies operating small business mentorship programs initially seek approval from the SBA to continue their programs, and later submit to an annual review by the SBA.

The proposed rule also addresses changes specific to the 8(a) program that are unrelated to the new mentorship program. These changes include a change to the way an individual must establish social disadvantage for the purposes of the 8(a) program, changes to the way the size of tribally owned and Native Hawaiian Organizations is determined, and revisions to the way the primary industry classification under NAICS is determined.[4]

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Florida Enhances Contractor's Right to Receive Notice of Construction Claims in Attempt to Reduce Litigation

On June 16, 2015, Florida's governor, Rick Scott, signed HB 87 into law, modifying the existing procedure requiring claimants to file a notice of a construction defect prior to resorting to litigation.[5] The amended bill, which passed the Florida House 112 to 0, took effect on October 1, 2015.

Florida law already requires a person who intends to sue for a construction defect to notify the contractor, subcontractor, supplier, or design professional (hereinafter, the "contractor") of a defect claim at least 60 days before filing any action. At least 120 days' notice must be provided for a potential defect claim by an association representing 20 or more parcels. That notice must be followed by an opportunity for the contractor to correct the defect.

The new legislation changed the law as follows, "[t]he notice of claim must describe ~~the claim~~ in reasonable detail ~~sufficient to determine~~ the ~~general~~ nature of each alleged construction defect and, if known, ~~a description of~~ the damage or loss resulting from the defect~~, if known~~."[6] As a result of the changes, now a claimant must provide notice to the contractor of the location of each claimed defect, based on at least a visual inspection, with enough detail to allow the contractor to locate the alleged defect without an undue burden. The claimant, however, need not complete destructive testing or other testing to provide a sufficient notice. In addition, the claimant must provide the contractor with an opportunity to examine the defect.

Under the new law, the timing of notice is moved up. A notice of claim need only be provided upon "completion of a building or improvement."[7] Under old law, "completion of a building or improvement" was defined as "issuance of a certificate of occupancy for the entire building or improvement."[8] HB 87 defines "completion of a building or improvement" as the "issuance of a certification of occupancy, whether temporary or otherwise, that allows for occupancy or use for the entire building or improvement, or the equivalent authorization to occupy or use the improvement, issued by the governmental body having jurisdiction."[9] The statute makes no change where no certificate of occupancy or equivalent is issued.

The new law adds the requirement that the contractor's response be written and is still due within 15 days of receipt, or within 30 days if the claim involves an association representing 20 or more parcels. The contractor's written response to the notice of claim must indicate whether the contractor disputes the claim and whether the contractor is willing to make repairs, settle the claim through a monetary settlement, or both. If repairs are proposed, the contractor must provide a description of the proposed repairs and a timetable for completion. The notice also must identify whether the contractor's insurer will cover the claim.

During the presuit process, either party may request an exchange of the following information related to the alleged construction defect:

- design plans, specifications, as-built plans;
- any documents detailing the design drawings or specifications;
- photographs, videos, and expert reports that describe any defect upon which the claim is based;
- subcontracts; and
- purchase orders for the works claimed as defective or related materials.[10]

The new law requires further disclosure by the claimant of "the maintenance records and other documents related to the discovery, investigation, causation, and extent of the alleged defect identified in the notice of claim and any resulting damages."[11] The claimant need not disclose documents, records, and information protected or privileged under Florida law, and the requesting party must offer to pay the reasonable cost to reproduce the requested documents.

If the parties are unable to come to a resolution within the time provided, the claimant may then proceed with litigation.

Based on the legislative findings that it is beneficial to have an effective alternative dispute resolution mechanism for construction defect claims, the Florida legislature passed HB 87 in an attempt to reduce litigation by providing a mandatory process to resolve construction defect disputes prior to filing of a lawsuit. The process is similar to the method for notice and resolution required in other areas of Florida law

including medical negligence, claims against nursing homes, and eminent domain.

The Florida legislature went on to make findings that the contractor's insurer should also be given an opportunity to resolve defect claims; therefore, the new law adds insurers to the list of entities that should receive notice of a defect and permits insurers to participate in "confidential settlement negotiations" to allow for resolution of defect claims prior to filing of a lawsuit and ending the need for further legal process. But the new law confirms that providing a copy of the notice of claim to an insurance company does not constitute a "claim" for insurance purposes unless the contractor's insurance policy so defines "claim." The new law does nothing to relieve the contractor of its duty to comply with the terms of its insurance policy; the statute confirms that the language of the insurance policy still controls a contractor's claim.

In addition to modifying the procedure for construction defect claims, HB 87 revises Florida law such that a "temporary" certificate of occupancy will constitute adequate completion of construction to start the three-year warranty period for condominiums and cooperatives.[12]

Note

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Endnotes

1. Proposed Changes to Small Business Government Contracting Pursuant to the National Defense Authorization Act of 2013 Amendments, 79 Fed. Reg. 77955 (proposed Dec. 29, 2014) (to be codified at 13 C.F.R. pts. 121, 124, 125, 126, 127).
2. *Id.*
3. Proposed Changes to Small Business Mentor-Protégé Program and Government Contracting Programs Pursuant to the National Defense Authorization Act of 2013 Amendments, 80 Fed. Reg. 6618 (proposed Feb. 5, 2015) (to be codified at 13 C.F.R. pts. 121, 124, 125, 126, 127, 134).
4. *Id.* at 6624–25.
5. Fla. Stat. § 558.001 (2015) et seq.
6. Fla. Stat. § 558.004 (additions shown underlined and deletions shown in strikethrough).
7. Fla. Stat. § 558.003.
8. Fla. Stat. § 558.002 (2013).
9. Fla. Stat. § 558.002 (2015).
10. Fla. Stat. § 558.004.
11. Fla. Stat. § 558.002.
12. Fla. Stat. § 718.203 (2015).

