December 28, 2018

(Submitted electronically at http://regulations.gov)

Mariana Pardo
Director, HUBZone Program
Small Business Administration
409 3rd Street SW
Washington, D.C. 20416

Re: Proposed Rules for the HUBZone Program, RIN 3245-AG38, Docket ID: SBA-2018-0005

Dear Ms. Pardo:

On behalf of the HUBZone Contractors National Council (Council), I am writing to submit the following comments regarding the Small Business Administration's (SBA's) above-referenced proposed rule regarding changes to the Historically Underutilized Business Zone (HUBZone) Program. According to the notice of this rulemaking in the Federal Register, these comments are timely if submitted by December 31, 2018. See 83 Fed. Reg. 54812 (Oct. 31, 2018).

The Council is a non-profit trade association providing information and support for companies and professionals interested in the SBA's HUBZone Program. The Council's members include HUBZone-certified small businesses, prime contractors, other small businesses, as well as service providers who support the HUBZone Program. The Council advocates on behalf of the HUBZone community as it relates to procurement and entrepreneurial policy and continues to seek needed modernization of the HUBZone Program.

The Council applauds the SBA for its efforts in proposing much needed changes to the Program, and believes the organization will incorporate and further enhance Congressional changes made to the Program in the 2017 National Defense Authorization Act (NDAA).

The Council appreciates SBA's effort to incorporate requests for reconsideration, clarify many of the definitions and regulations, and for its commitment to improving the HUBZone Program. The Council believes that these changes will streamline and strengthen the Program; however, as indicated in the response below, the Council does not agree with all of the proposed rule changes. The Council has concerns about the unintended consequences and impact on the HUBZone Program if there are not adequate resources allocated for oversight and implementation.

While the proposed changes will certainly assist small businesses with maintaining compliance, they fail to address a major underlying issue impacting the Program, which is the lack of contract efforts performed in HUBZone communities. The Council believes that it will take a change in acquisition philosophy to truly make an impact within these underserved communities. One potential acquisition philosophy change would be to encourage Contracting Officers to consider prioritizing solicitations to be performed at a contractor's facility as HUBZone set-asides. This model would embrace the true intent of the Program by fostering job creation and economic development within the HUBZone communities.

We appreciate the opportunity to comment on the proposed rule as follows:

Proposed Changes to the Definition of an "Employee"

I. *The proposed rule proposes to treat an individual as a HUBZone resident if that individual worked for the firm and resided in a HUBZone at the time the concern was certified or recertified as a HUBZone small business concern and he or she continues to work for that same firm, even if the area where the individual lives no longer qualifies as a HUBZone or the individual has moved to a non-HUBZone area.*

The Council requests some additional clarification on this proposed change because we believe that it could introduce additional complexities and unintended impacts on all phases of the Program. It is the Council's understanding from this proposed rule that if an area is re-designated and an employee continues to work for the HUBZone certified company, the individual will be considered an eligible HUBZone employee indefinitely. The Council believes that allowing employees to be designated as HUBZone residents indefinitely, even if the area no longer qualifies as a HUBZone or an individual moves out of the HUBZone, counters the Program's intent to bring jobs to distressed areas.

If not carefully structured, the proposed change could unintentionally allow skirting around the 35% residency requirement. For example, SBA should consider whether a company could ask an employee to temporarily establish residence in a HUBZone area and once certified or recertified, allow the employee to return to their permanent residence in a non-HUBZone area, while maintaining compliance. Although such action would certainly not comply with the spirit of the program, SBA would need to give clear guidance with respect to scenarios like this which we believe violate the program's fundamental policy, goals and compliance requirements.

Although we do not agree with the proposed rule as written, we understand that the intent behind the change is to mitigate a significant impact to HUBZone employees and/or the HUBZone area if the company has to release employees to remain compliant. To mitigate this risk, we encourage the SBA to consider alternatives to allowing the blanket HUBZone residency eligibility proposed in the rule. One possible alternative is to provide a one-year transition period from the date the employee moves out of the HUBZone to be considered a HUBZone eligible employee. The Council believes this will mitigate potential abuses and will provide companies time to address any HUBZone compliance issues that may arise due to an employee moving out of his/her HUBZone.

Another possible alternative that we believe is more in line with the intent of the Program is to consider HUBZone employees that do not move out of the area but are no longer HUBZone eligible due to area re-designation to remain HUBZone eligible as long as they remain an employee of the company and work at the Principal Office location. This option would keep the HUBZone company's investment dollars in the community.

II. *SBA requests comments on whether seasonal employees can or should be counted and still maintain the integrity of the eligibility requirements.*

The Council agrees with the SBA's stated concern and believes that seasonal employees and only employees on the firm's payroll should continue to be counted as employees. The Council recommends that changes associated with counting individuals other than owners not on the payroll as HUBZone eligible employees, should be prohibited.

III. *SBA proposes to amend the definition of the term "employee." The amended definition would count an employee as an individual that works at least 40 hours during the four-week period immediately prior to the relevant date— either the date the concern submits*

the HUBZone application to SBA or the date of recertification. Additionally, the proposed rule considers revising the requirement from 40 hours per month to 20 hours per week.

While the Council supports clarification of the definition of an "employee" from "a minimum 40 hour per month" requirement to "40 hours during the four-week period immediately prior to the relevant date of review", we strongly disagree with changing this requirement to a 20-hour work week. Not only will the increased cost adversely affect the HUBZone small businesses, it will also reduce the number of training and internship programs HUBZone companies have initiated to create additional jobs in the HUBZone area. A main priority of the HUBZone Program is to provide opportunities to those residing in underserved communities. Many companies provide training and education as well as other resources to those residing in the HUBZone to prepare them for future jobs.

One such example is a company called AboutWeb, located in Baltimore, Maryland. This firm hires one (1) HUBZone resident to participate in a training program for every two (2) technical billable consultants deployed. If the definition of what constitutes an employee is changed to require 20 hours per week, HUBZone companies would be hard pressed to offer internships and other skill training necessary to compete. HUBZone members have commented that their workforce would have to forego other assistance, such as childcare, if the required hours are doubled. In addition, companies who hire students through work study programs — 10 hours per week (or 40 hours per month) — would be adversely affected. These students are unlikely to work 20-hour weeks, but are able to manage working 40 hours a month.

In summary, the HUBZone Council recommends that the SBA not amend the definition of an "employee" to count only full-time employees. If the SBA decides to use full-time equivalents, we strongly encourage that the SBA provide guidance that a full-time employee for purposes of HUBZone eligibility equates to a minimum of 40 hours in a month.

IV. The proposed definition of "employee" clarifies that individuals who do not receive compensation and those who receive deferred compensation are generally not considered employees. The proposed definition further clarifies that individuals who receive in-kind compensation commensurate with the work performed will be considered employees.

The Council does not agree with the proposed definition change for in-kind compensation. We believe that to say individuals who receive in-kind compensation commensurate with the work

performed will be considered employees is too subjective. The Council points to the Internal Revenue Service's (IRS's) definition of employee compensation as the guideline to be used for compliance for this matter. In other words, if it is reported to the IRS as compensation, it counts; if not, it does not count. We suggest that companies wishing to provide in kind services could also offset the compensation for the market value of those items from the employees pay, thus avoiding another complex regulatory compliance issue.

V. *SBA also requests comments on how SBA should treat individuals who are employed through an agreement with a third-party business that specializes in providing HUBZone resident employees to prospective HUBZone small business concerns for the specific purpose of achieving and maintaining HUBZone eligibility*.

As long as the third-party business is an approved Professional Employment Organization (PEO) or a staffing agency that is in business to provide personnel resources to organizations that have defined staffing requirements, the Council does not have an issue with the use of a third-party business that provides HUBZone-resident employees to count for purposes of HUBZone compliance.

Proposed Changes to the "35%" Requirement

I. *SBA proposes to change its application of how SBA requires a firm to meet the 35% residency requirement when the calculation results in a fraction.*

The Council agrees with this change and believes that rounding up to the "nearest whole number" rather than rounding up in every instance, will simplify the calculation.

Proposed Changes to Recertification

I. The proposed rule would require only annual recertification rather than immediate recertification at the time of every offer for a HUBZone contract award. A firm would remain eligible for future HUBZone contracts for an entire year.

With the understanding that the annual recertification is an implementation of the HUBZone changes enacted in the NDAA, the Council believes the proposed rule will positively impact the Program. The Council believes that simplifying compliance on an annual basis as proposed would:

- Significantly reduce protests and increase HUBZone contracting opportunities
- Streamline and reduce complexities within the Program
- Reduce the compliance burden on the HUBZone small businesses

For several years, the Council has been suggesting a change to the current requirement that a HUBZone company must verify eligibility at both the time of bid and the award of a federal contract. Given the length of time a federal procurement can take from bid to award, HUBZone companies find this verification requirement burdensome and compliance difficult. SBA's proposal requiring annual recertification rather than at time of bid or award, would assist in giving the Program much needed stability. It would also give Contracting Officers more assurance that HUBZone contractors will still be eligible for award, even if the award occurs after the company was no longer eligible at time of recertification. We believe annual recertification, as proposed in the rule, will give HUBZone companies a more efficient path toward compliance.

As proposed in this rule, annual recertification largely overshadows the other proposed changes. We see it as a game changer for HUBZone certified firms. In the Council's opinion, an annual recertification mitigates the need for other suggested changes to the current regulations contained in this proposed rule. If the SBA considers firms to be in compliance on a yearly basis, the complexity of proving the "attempt to maintain" could be rendered largely unnecessary other than at the time of recertification. It seems to us that the simple standard of compliance on an annual basis per this proposed rule would eliminate with much of the current complexity of compliance, provide the Program more certainty, and address concerns regarding fraudulent practices.

The Council is concerned that bad actors could take advantage of the one-year eligibility by hiring employees at the beginning of the certification and laying them off until time for recertification. To the extent SBA can use its enforcement powers to ensure this provision is not misused, the Council supports efforts to change this onerous requirement. We urge the SBA to give extensive guidance and examples to HUBZone companies should the Agency adopt this change. We also recommend that SBA incorporate language addressing notification requirements of material changes impacting eligibility within the year.

II. *SBA proposes to amend § 126.501 to clarify that once certified, a HUBZone small business concern will remain eligible for HUBZone contract awards for one year from the date of certification. HUBZone status protests would also relate back to the date of initial certification or most recent annual recertification (except for protests against HUBZone joint ventures).*

The Council agrees that this clarification is necessary; however, the Council requests additional clarification on the implementation of the statement that a "HUBZone small business concern will remain eligible for HUBZone contract awards for one year from the date of certification." We encourage the SBA to revise the language and clearly state that if a company that submits a proposal within the one-year certification period and the contract award occurs after the recertification date, the company is still eligible for the award. We also encourage SBA to consider how Contracting Officers may interpret this change and clearly state how options, new task orders under IDIQ and Multiple Award contract awards will be treated if a HUBZone small business concern is awarded a contract and loses its HUBZone certification during the life of the contract.

Proposed Changes to "Attempt to Maintain"

I. *SBA proposes to amend the definition of "attempt to maintain" to clarify what happens if a HUBZone small business concern's HUBZone residency percentage drops too low. SBA is proposing to amend this definition to add that falling below 20% HUBZone residency during the performance of a HUBZone contract will be deemed a failure to attempt to maintain compliance with the statutory 35% HUBZone residency requirement.*

The Council believes that amending the definition of "attempt to maintain" by setting a floor of 20% residency is a good policy and is more in line with the intent of the HUBZone Program. The Council agrees with the SBA that that the current 0% floor for attempt to maintain potentially compromises the Program's impact in HUBZone areas. In addition, the Council is concerned that the continuation of the 0% floor for attempt to maintain in conjunction with the annual recertification will enable firms with HUBZone prime contracts to continuously remain eligible even with 0% compliance.

Although the Council agrees with raising the level from 0% to 20%, it is our understanding that with the SBA's other proposed rule changes associated with annual compliance and certification, the "attempt to maintain" provision would only be relevant at time of recertification. That said, the SBA's proposed definition indicates that a company must "always have at least 20% HUBZone employees once the hiring for contract is complete." With certification tied to the initial certification and/or recertification date, and as stated under the proposed rule "the HUBZone concern would not have to review and demonstrate its continued compliance with all HUBZone eligibility requirements throughout the year for each new contract that it seeks", the Council does not understand why it is necessary to address "attempt to maintain" outside of the recertification process.

While all HUBZone companies should strive to meet the 35% requirement, only companies performing on a HUBZone prime contract currently benefit from the flexibility under the "attempt to maintain" to drop below 35%. The Council believes that if "attempt to maintain" could be redefined to include all contracts under which the Agencies and large primes are claiming HUBZone credit, it would significantly benefit the Program and enable more firms to maintain compliance.

Proposed Changes to the Definition of "Principal Office"

I. SBA proposes to amend the definition of "principal office" to eliminate ambiguities in the regulation.

Given the complexity of SBA regulations with respect to the HUBZone Program, we support the need for additional clarification on factors determining a "principal office". The definition of "principal office" is the location where a majority of individuals, excluding those performing at job-sites, perform their work. The Council definitely agrees that business must be conducted at the principal office location in order to qualify for HUBZone certification. The Council welcomes the SBA's guidance in the form of examples.

In addition to clarifying the definition, the Council believes that providing additional stability for the investment in the principal office would also be a very beneficial change and aligns with the intent of the Program. The Council would like to propose a change for consideration that we believe would provide more business certainty and stability and not force a company to move their location out of the area as a result of the area losing its HUBZone designation. We propose that if a company has maintained a principal office in a location for more than a year, and the area loses its HUBZone designation, the company will continue to meet the principal office eligibility criteria as long as it maintains the location as its principal office.

Proposed Changes Related to Affiliation Determinations

I. *SBA proposes to continue to use its definition that employees of affiliates may be counted as employees of a HUBZone applicant or certified HUBZone small business concern if the totality of circumstances demonstrates that there is no clear line of fracture between the concerns.*

SBA also proposes to clarify § 126.204, in that a HUBZone small business concern may

have affiliates, but the affiliate's employees may be counted as employees of the HUBZone applicant/participant when determining the concern's compliance with the principal office and 35% percent HUBZone residency requirements. Proposed § 126.204 clarifies that where there is evidence that a HUBZone applicant/participant and its affiliate are intertwined and acting as one, SBA will count the employees of one as employees of the other.

The Council agrees that the SBA should continue to use its current definition with respect to employees of affiliates. We agree with SBA's rule issued earlier this year that permits HUBZone firms to be indirectly owned by U.S. citizens. The ability for entity-owned firms to participate in the HUBZone Program provides more flexibility in corporate structuring and investment options for HUBZone firms. This will be beneficial not only to HUBZone firms, but to the HUBZone Program overall and the HUBZone area in which the firms are located.

The Council seeks clarification on how the SBA will treat the employees of "sister" and "parent" companies for entity-owned HUBZone firms. SBA's rules state that HUBZone firms may have affiliates, and such sister and parent entities. SBA's rules further state that whether the employees of the affiliates are counted as part of the HUBZone firm's employees depends on the totality of the circumstances. In the Council's view, the fact that SBA rules now explicitly permit entity ownership of HUBZone firms should be taken into consideration. We believe the SBA's default approach should be to not count employees of parent and sister entities as part of the HUBZone subsidiary's employees, as long as the entities operate independently with shared resources, facilities, and personnel only insofar as would be typical and expected between parent and subsidiary entities. To adopt any other approach would defeat the purpose of permitting entity ownership. For example, a parent entity may provide typical parent company functions, such as shared accounting and legal support and a common office space, requiring the parent entity's employees to be counted with the HUBZone subsidiary's employees. It is possible that a HUBZone subsidiary is not sufficiently independent from the parent or sister company from an operational standpoint, and it may be appropriate to aggregate the employees of all firms in that scenario. However, if the entities are largely operationally independent and share services and personnel in a customary way for corporate families, we believe the SBA should look only at the employees of the HUBZone subsidiary in determining HUBZone compliance.

Proposed Changes to the Definition of "Reside"

I. *The proposed rule amends the definition of "reside" to remove the requirement to prove intent to live somewhere indefinitely. SBA proposes that "reside" means to live at a location full-time and for at least 180 days immediately prior to the date of application or date of recertification, as applicable.*

As previously mentioned, compliance with the 35% residency requirement can be complex and create unnecessarily, burdensome paperwork. The Council appreciates the SBA's acknowledgement of the difficulty of the definition of "reside" and its proposed solution. In the past, SBA has permitted firms to count employees who have lived in a HUBZone for less than 180 days if the employees can demonstrate an intent to live in the HUBZone indefinitely. The Council believes that it is unreasonable and overly restrictive not to be able to count an employee who has recently moved into the HUBZone within 180 days of the relevant date.

We recommend that the SBA revise the definition of "reside" by stating that "reside means to live at a location full-time with proof of residency on and beyond the date of application or date of recertification, as applicable. We believe that this change along with requiring supporting documentation, such as a lease, mortgage statement, notarized letter, driver's license or voter's registration card provides adequate assurance that the individual intends to remain in the HUBZone area.

In addition, we recommend the SBA consider an alternative definition for college students/interns, given that their residency is not year-round. These programs draw students into HUBZone areas and these much-needed employees are key to the success of HUBZone companies.

II. *SBA proposes that it will consider the residence located in the United States as that employee's residence if the employee is working overseas for the period of a contract.*

The Council agrees with the SBA's assertion that a greater number of small businesses are performing contracts overseas and the need for a solution regarding how to treat employees who reside in a HUBZone when in the U.S./U.S. territories, but are temporarily residing overseas to perform contract work. The HUBZone Program has always considered the U.S. residence of the employee when determining eligibility. The Council agrees with the proposed clarification for U.S. citizens that are employees; however, this change does not address the use of foreign nationals on overseas contracts. Many contracts operating overseas require that the contractor hire a certain

number of foreign nationals per the terms of the contract. The Council suggests excluding required foreign nationals used on overseas contracts from the definition of an employee, as well as from the total employee count when calculating the 35% residency requirement. According to the SBA, the mission of the HUBZone Program is to promote job growth, capital investment, and economic development in economically distressed communities. In our view, the policy of counting foreign nationals as employees does not support this mission. We encourage the SBA to issue guidance that specifically addresses the use of foreign nationals as it relates to the definition of employee.

Please do not hesitate to contact the undersigned at (240) 442-1787 if you have any questions about these comments.

Sincerely,

Shirley D. Bailey
President & Board Chair
HUBZone Contractor's National Council