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# OHA Sees Spike in NAICS Code Appeals

Contractors filed an increasing number of NAICS code appeals in 2023 and they were highly effective at obtaining relief.



BY STEPHEN L. BACON

The North American Industry Classification System (NAICS) is a standard used by federal agencies to classify businesses in different industries for purposes of statistical analysis. But in the context of small business set-aside procurements, NAICS codes have the power to establish the field of eligible competitors.

Every solicitation that is set aside for small businesses has an assigned NAICS code, which determines the applicable size standard for the procurement. If a contracting officer assigns an incorrect NAICS code, it can exclude offerors that do not qualify as “small” under the size standard associated with that NAICS code.

There is a specialized type of protest that a potential offeror can file directly with the Small Business Administration Office of Hearings and Appeals (SBA OHA) to challenge a solicitation’s NAICS code. Although NAICS code appeals are relatively rare, there was a notable increase in the number of appeals filed last year.

A review of those appeals showed that they were remarkably effective

at obtaining relief for the protester.

The increase in the number of appeals and their effectiveness suggests that contractors should seriously consider filing an appeal if they cannot compete under the solicitation’s assigned NAICS code and there are good grounds to challenge the contracting officer’s NAICS code selection.

## 2023 Statistics

The SBA OHA does not regularly publish statistics on the number and types of protests filed as the Government Accountability Office (GAO) does in its annual report to Congress. However, a one-time report covering fiscal years 2014 through 2016 found that there were approximately 20 NAICS code appeals filed every year during that timeframe.<sup>1</sup>

In 2023, however, there were 32 NAICS code appeals decided by the SBA OHA.<sup>2</sup> Of the appeals decided, five were granted, eight were denied, and 19 were dismissed. These statistics may suggest that NAICS code appeals were largely futile, but the 19 protests that were dismissed tell a very different story.

In 15 of the 19 appeals dismissed, the contracting officer took some form of corrective action. In nine appeals, the contracting officer voluntarily

changed the solicitation’s NAICS code designation in response to the appeal. There were six other appeals in which the contracting officer cancelled the solicitation after the NAICS code was challenged, opening the possibility that a new solicitation would be issued with the protester’s preferred NAICS code.

GAO’s report to Congress on bid protests identifies an “effectiveness rate” that encompasses all protests that achieved some form of relief, either as a result of voluntary agency corrective action or a sustained protest on the merits. This “effectiveness rate” hovers around 50% in most years for GAO bid protests.

By comparison, the analogous “effectiveness rate” for NAICS code appeals in 2023 was 62.5%, which includes five appeals granted and 15 appeals that spurred corrective action. These statistics suggest that the appeals process was well-utilized by protesters and that some contracting officers may need to pay greater attention to the NAICS code selection process.

## NAICS Code Selection

Contracting officers are required to assign the “the single NAICS code which best describes the principal purpose of the product or service being acquired.”<sup>3</sup> Every solicitation must contain only

one NAICS code and corresponding size standard. This rule applies to single-award contracts and to multiple-award contract (MAC) solicitations issued on or before October 1, 2025.<sup>4</sup>

After October 1, 2025, contracting officers for MACs will have the option to designate a single NAICS code to the entire MAC solicitation or designate different NAICS codes for “discrete categories” of work under the MAC.<sup>5</sup> The “discrete categories” may be divided by “Contract Line Item Numbers (CLINs), Special Item Numbers (SINs), Sectors, Functional Areas (FAs), or the equivalent” identifiers.<sup>6</sup> A single NAICS code must be assigned to each order issued against a MAC and that NAICS code must be the one that best represents the principal purpose of the order.<sup>7</sup>

The “principal purpose” of a procurement is determined by considering “the industry descriptions in the U.S. NAICS Manual, the product or service description in the solicitation and any attachments to it, the relative value and importance of the components of the procurement making up the end item being procured, and the function of the goods or services being purchased.”<sup>8</sup>

The 2022 edition of the NAICS Manual is the current operative version that is utilized for selecting the proper NAICS code for a solicitation.<sup>9</sup> In general, a procurement is “classified according to the component which accounts for the greatest percentage of contract value.”<sup>10</sup>

### The NAICS Code Appeal Process

If a potential offeror believes that a contracting officer has selected the

wrong NAICS code, it must act quickly to correct the problem. A NAICS code appeal must be served on the contracting officer and filed at OHA “within 10 calendar days after the issuance of the solicitation or amendment affecting the NAICS code or size standard.”<sup>11</sup>

The filing of an appeal results in a “stay” of the due date for offers.<sup>12</sup> After an appeal is filed, the contracting officer must amend the solicitation to inform other potential offerors that a NAICS code appeal has been filed so that they have an opportunity to participate in the proceedings.<sup>13</sup>

Under OHA’s rules, the appellant has the burden to show that the contracting officer’s NAICS code designation is based upon a clear error of fact or law.<sup>14</sup> OHA affords deference to the contracting officer’s designation. In OHA’s view, contracting officers are not required “to select the perfect code” and OHA will not reverse a contracting officer’s NAICS code designation “merely because OHA would have selected a different code.”<sup>15</sup> However, if OHA grants the appeal, the contracting officer must change the NAICS code in an amendment to the solicitation.<sup>16</sup>

A NAICS code designation can be challenged in a bid protest at the Court of Federal Claims (COFC), but only after the protester’s administrative remedies are exhausted.<sup>17</sup> This means that a NAICS code designation must be challenged in a NAICS code appeal at OHA first and, if the appeal is denied, the appellant may initiate an action at the COFC to contest OHA’s decision.

This was the path taken by Consolidated Safety Services, Inc. (CSS) to challenge a NAICS code designation used in a small business set-aside

solicitation issued by a division of the National Oceanic and Atmospheric Administration.<sup>18</sup> This recent case serves as an example of how to use the description of work in a solicitation’s Performance Work Statement (PWS) and the industry definitions in the NAICS Manual to effectively challenge the NAICS code assigned by the contracting officer.

### Consolidated Safety Services, Inc. v. United States

The agency issued a solicitation for scientific, technical, and administrative services to support the mission and goals of the National Centers for Coastal Ocean Science (NCCOS). The contracting officer assigned NAICS code 541620, Environmental Consulting Services, which had a corresponding size standard of \$19 million in annual receipts.

CSS was not eligible to compete under the applicable size standard, so it filed a timely NAICS code appeal at OHA. CSS argued that the correct NAICS code was 541715, Research and Development (R&D) in the Physical, Engineering, and Life Sciences (except Nanotechnology and Biotechnology). CSS’s preferred NAICS code had a 1,000-employee size standard under which it qualified as small.

The PWS identified tasks in seven main categories: (1) Administration, Management, Planning, Analysis, and Coordination; (2) Marine Science Data Acquisition; (3) Scientific Data Enterprise; (4) Geospatial, Statistical, and Modeling Analyses; (2.5) Publications, Communications, Outreach; (6) Program Execution and Analysis; and (7) NOAA Mission Support.

According to the solicitation’s



labor hour estimates, 90% of the work would be performed by environmental scientists, geospatial scientists, or social scientists, while the remaining 10% of hours were divided between program specialists, program analysts, communications analysts, and program managers.

CSS argued in its OHA appeal that the R&D code was correct because the PWS required the contractor to perform research tasks instead of advising the agency about research.<sup>19</sup> The contracting officer maintained that the consulting NAICS code was appropriate because the principal purpose of the procurement was collecting marine science data and this work related to providing advice and assistance to the agency.

OHA denied the appeal and affirmed the contracting officer's NAICS code designation. According to OHA, the tasks described in the PWS did not call for research and experimental development of new processes as the principal purpose of the services acquired.<sup>20</sup>

But the COFC disagreed with OHA and held that the contracting officer did not reasonably conclude that the NAICS code for Environmental Consulting Services "best describes the principal purpose" of the solicitation in accordance with 13 C.F.R. § 121.402(b). The COFC reached this conclusion after comparing the tasks described in the PWS to the NAICS Manual's definition for the protester's preferred R&D NAICS code.

The NAICS Manual indicates that the R&D code covers "research and experimental development" activities. It defines "research" as "original investigation undertaken on a systematic

basis to gain new knowledge," and "experimental development" as "the application of research findings or other scientific knowledge for the creation of new or significantly improved products or processes."<sup>21</sup>

The COFC found that "literally dozens of tasks in the Solicitation... naturally fit [these] definitions."<sup>22</sup> Moreover, the court noted that "astonishingly few" of the tasks in the PWS could be described as "providing advice" or "recommending solutions" within the NAICS Manual's definition of Environmental Consulting Services.<sup>23</sup> In sum, the court held that OHA's decision was "the very definition of arbitrary and capricious" because it ignored that the "lion's share" of the work under the solicitation involved "research" or "experimental development" tasks.<sup>24</sup>

### Conclusion

The assignment of a NAICS code to a small business set-aside solicitation can be an enormously consequential decision. To avoid errors that wrongfully exclude certain offerors, contracting officers must carefully consider the work involved and the industry definitions in the NAICS Manual to select the code that aligns with the solicitation's principal purpose.

Although NAICS code appeals are relatively infrequent, they are an essential tool that every small business must understand. If a solicitation identifies the wrong NAICS code, contractors must be prepared to promptly file a challenge to preserve their ability to compete. In some situations, a contractor's eligibility for award may depend on filing a successful NAICS code appeal. **CM**

*The views expressed in this article are those of the author and do not necessarily reflect the views of Rogers Joseph O'Donnell or its clients. This article is for general information purposes and is not intended to be and should not be construed as legal advice.*

**Stephen L. Bacon** is a shareholder in the Washington, D.C. office of the law firm Rogers Joseph O'Donnell, where he represents government contractors in bid protests, claims, investigations, and suspension and debarment proceedings. He frequently litigates cases at the Court of Federal Claims, the Government Accountability Office, the Boards of Contract Appeals, and the Small Business Administration Office of Hearings and Appeals. He also provides advice and counseling to clients on a broad range of contractual and regulatory compliance issues that confront government contractors.

### ENDNOTES

- 1 GAO-18-76, Small Business Contracting: SBA Efforts May Clarify the Assignment of Industry Codes, and Most Code Appeals Were Dismissed (Dec. 2017).
- 2 This data was gathered by the author after a review of NAICS code appeal decisions published on the SBA's website at <https://www.sba.gov/about-sba/oversight-advocacy/office-hearings-appeals/oha-decisions>.
- 3 13 C.F.R. § 121.402(b).
- 4 48 C.F.R. § 19.102(b)(2).
- 5 48 C.F.R. § 19.102(b)(2)(ii).
- 6 13 C.F.R. § 121.402(c)(1)(ii).
- 7 48 C.F.R. § 19.102(b)(3).
- 8 13 C.F.R. § 121.402(b)(1).
- 9 87 Fed. Reg. 59,240 (Sept. 29, 2022). The NAICS Manual is available at <https://www.census.gov/naics/>.
- 10 13 C.F.R. § 121.402(b)(2).
- 11 13 C.F.R. § 121.1103(b)(1).
- 12 13 C.F.R. § 121.1103(c)(i).
- 13 13 C.F.R. § 121.1103(c)(ii).
- 14 13 C.F.R. § 134.314.
- 15 Appeal of Veterans First Health Care, SBA No. NAICS-6212, at 4 (2023).
- 16 13 C.F.R. § 134.314(b).
- 17 13 C.F.R. § 121.1102.
- 18 Consolidated Safety Services, Inc. v. United States, 167 Fed. Cl. 543 (2023).
- 19 Appeal of Consolidated Safety Services, Inc., SBA No. NAICS-6203, at 6-9 (2023).
- 20 Id. at 15-17.
- 21 Consolidated Safety, 167 Fed. Cl. at 556.
- 22 Id.
- 23 Id. at 559.
- 24 Id. at 562. After the COFC remanded the case to OHA, the agency decided to cancel the solicitation. See Appeal of Consolidated Safety Services, Inc., SBA No. NAICS-6255 (2023).

CONTRIBUTED BY  
DENTONS US LLP

## KEY LEGISLATIVE UPDATES

### H.R. 2670, National Defense Authorization Act for Fiscal Year 2024

On April 18, 2023 Representative Mike Rogers (R-AL) introduced the National Defense Authorization Act (NDAA) for fiscal year 2024 (FY24 NDAA) (H.R. 2670). This legislation was signed into law on December 22, 2023.

The FY24 Defense Funding levels are as follows (in billions of dollars):

- ▶ Department of Defense (DoD): \$841.4
- ▶ Department of Energy: \$32.4
- ▶ Defense-related Activities: \$0.4
- ▶ NDAA Topline: \$874.2
- ▶ Defense-related Activities Outside NDAA Jurisdiction: \$9.5
- ▶ National Defense Topline: \$883.7

This legislation expands the list of munitions eligible for emergency and multiyear procurement authorities, with the addition of Israel and Taiwan to the program list, exempting these countries from cost and pricing data as well as other contracting requirements. This legislation also supports the use of multiyear contracting authority as a tool to improve industrial base stability and improves the timeliness of payments made to small business subcontractors.

The FY24 NDAA prevents the DoD and its contractors from using logistics systems owned or operated by the People's Republic of China, with an additional limit on DoD funding for institutions that contract with Chinese or Russian institutions that are linked to military or intelligence programs. Finally, the FY24 NDAA provides a 5.2% pay raise for the DoD civilian workforce.

Of note, Congress must still pass full spending bills for FY24 to fund the DoD and other agencies. Funding for military construction ended on January 19, 2023, and funds for the rest of the DoD expired on February 2, 2023.

## KEY REGULATORY & EXECUTIVE UPDATES

### FAR Final Rule on Use of Project Labor Agreements for Federal Construction Projects

On December 22, 2023, the DoD, General Services Administration (GSA), and National Aeronautics and Space Administration (NASA) (together the *FAR* Council) published a final rule to amend the *Federal Acquisition Regulation (FAR)* to implement Executive Order (EO) 14063 regarding project labor agreements (PLAs) in federal construction projects.

PLAs are pre-hire collective bargaining agreements negotiated between construction unions and construction contractors that establish the terms and conditions of employment for construction projects. The EO mandates that federal agencies require the use of PLAs for large-scale (\$35 million or more) construction projects, unless an exception applies. Additionally, federal agencies still have discretion to require PLAs for construction projects that do not meet the \$35 million threshold.

This rule went into effect on January 22, 2024. (88 Fed. Reg. 88,708 (Dec. 22, 2023)).

### DFARS Proposed Rule on Data Requirements for Commercial Products for Major Weapon Systems

On December 22, 2023, the DoD published a proposed rule amending the

*Defense Federal Acquisition Regulation Supplement (DFARS)* to partially implement section 803 of the NDAA for FY 2023. This rule clarifies the data to be provided for certain procurements related to major weapon systems.

This rule proposes to modify DFARS 234.7002 to clarify what data an offeror must provide when proposing a subsystem or component of a major weapon system or spare part for a major weapon system or subsystem as a commercial product. The proposed rule also modifies the solicitation provision at DFARS 252.215-7010.

Comments closed for this proposed rule on February 20, 2024. (88 Fed. Reg. 88,554 (Dec. 22, 2023)).

### Proposed Rule for Cybersecurity Maturity Model Certification (CMMC) Program

On December 26, 2023, the DoD published a proposed rule to establish requirements for a comprehensive and scalable assessment mechanism to ensure defense contractors and subcontractors implement required security measures to expand application of existing security requirements for Federal Contract Information (FCI) and add new Controlled Unclassified Information (CUI) security requirements for certain priority programs.

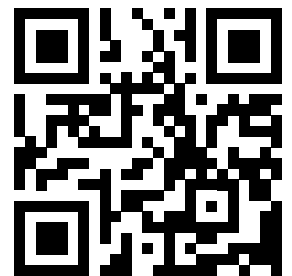
The CMMC Program provides the DoD a mechanism to verify that a defense contractor or subcontractor has implemented the security requirements at each CMMC Level and is maintaining that status across the contract period of performance.

Comments closed for this proposed rule on February 26, 2024. (88 Fed. Reg. 89,058 (Dec. 26, 2023)). **CM**



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