

*2016 Government Contracts  
Breakfast Seminar Series*

**Small Business Set-Aside Programs**

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# Important Note

The contents of this presentation are intended for general information only and should not be construed or relied upon as legal advice nor as a legal opinion on any specific facts or circumstances.

# Agenda

- Small Business Set-Aside Programs
- Affiliation Issues
- Limitations on Subcontracting
  - Overview of SBA [Final Rule](#) (81 Fed. Reg. 34,243) (May 31, 2016)
- Challenges to Status and Size

# A Piece of the Pie

- \$90.7 billion in federal prime contract dollars to small business FY 2015 (25.75%)

Small Business Administration, FY2015 Small Business Procurement Scorecard, accessible at [www.sba.gov](http://www.sba.gov)

# Set Aside Programs

- 8(a)
- WOSB
- SDVOSB
- HUBZone

# Size Standards – What is “small”?

- SBA's size standards define whether a business entity is “small.” Size standards are based on type of industry under the North American Industry Classification System (NAICS).

13 C.F.R. §121.101

# Size Standards – What is “small”?

- By number of employees or annual receipts, as assigned to NAICS code. 13 C.F.R. §121.101
  - SBA looks to three year average to determine annual receipts
- *Employees* includes all individuals employed on a full-time, part-time, or other basis.
- Includes employees from a temporary employee agency.

13 C.F.R. §121.106

# General Principles of Qualification

- Size
  - Small
    - Affiliation Issues
- Profile of Owner
- Ownership
- Control



# 8(a) Business Development Program

- Profile of Owner (13 C.F.R. §124.101-104)
  - Must be “socially and economically disadvantaged”
  - Presumption per designated groups

# 8(a) Business Development Program

- Profile of Owner (13 C.F.R. §124.101-104)
  - Economically disadvantaged
    - Beginning Net worth < \$250,000, excluding:
      - Ownership interest in the 8(a) entity and equity in primary personal residence (except any portion of such equity which is attributable to excessive withdrawals from the entity)
      - IRA or other official retirement account
    - Continued eligibility: net worth < \$750,000

# 8(a) Business Development Program

- Profile of Owner (13 C.F.R. §124.101-104)
  - Economically disadvantaged
    - Beginning Eligibility adjusted gross income < \$250,000
    - Continued eligibility: adjusted gross income < \$350,000
    - 3 year measurement period

# 8(a) Business Development Program

- Profile of Owner (13 C.F.R. §124.101-104)
  - Economically disadvantaged
    - Initial Eligibility: fair market value of all assets < \$4 million:
      - House and Business Valuations included (IRA or 401(k) retirement account excluded)
    - Continued eligibility: < \$6 million

# 8(a) Business Development Program

- Ownership (13 C.F.R. §124.105)
  - “Direct” ownership
  - At least 51% “unconditionally” owned by one or more socially or economically disadvantaged individuals
  - Unexercised stock options or similar agreements held by non-disadvantaged individuals will be treated as exercised
  - Restrictions on immediate family members owning other 8(a) concerns

# 8(a) Business Development Program

- Ownership (13 C.F.R. §124.105)
  - Ownership restrictions for non-disadvantaged individuals and concerns
    - A non-disadvantaged individual or a non-Participant business concern with at least a 10% ownership interest in one Participant may not own more than a 10% interest (developmental stage) or 20% interest (transitional stage) in another Participant

# 8(a) Business Development Program

- Ownership (13 C.F.R. §124.105)
  - Ownership restrictions for non-disadvantaged individuals and concerns.
    - A non-Participant concern in the same or similar line of business or a principal of such concern may not own more than 10% (developmental stage) or 20% interest (transitional stage) of the Participant .
    - A former Participant or a principal of a former Participant may have an equity ownership interest of up to 20% (developmental stage) or 30% (transitional stage) in a Participant, in the same or similar line of business.

# 8(a) Business Development Program

- Control (13 C.F.R. §124.106)
  - Management and daily business operations must be conducted by one or more disadvantaged individuals.
  - Disadvantaged individuals managing the concern must have managerial experience of the extent and complexity needed to run the concern.



# 8(a) Business Development Program

- Control (cont.) (13 C.F.R. §124.106)
  - A disadvantaged individual must have ultimate managerial and supervisory control over those employees who possess required licenses or technical expertise.
  - *However*, where a critical license is held by a non-disadvantaged individual having an equity interest in the Participant, the non-disadvantaged individual may be found to control the firm.

# 8(a) Business Development Program

- Control (cont.) (13 C.F.R. §124.106)
  - Must be managed on a full-time basis by one or more disadvantaged individuals who possess requisite management capabilities.
  - Disadvantaged individual must hold the highest officer position (usually President or Chief Executive Officer).
  - He/She must devote full-time to the business.

# WOSB/EDWOSB

- EDWOSBs set-aside contracts:

NAICS Codes where women-owned small businesses are underrepresented (21 + 92)

- WOSB set aside contracts:

NAICS Codes where women-owned small businesses are *substantially* underrepresented (92)

- Commercial, industrial and institutional construction
- Manufacturing
- Transportation (land, sea) and warehousing
- Media, IT

# WOSB/EDWOSB

- Profile of Owner

- EDWOSBs

- Limitations on personal net worth (\$750,000)

- Excludes

- » Ownership interest in concern and equity interest in primary personal residence

- » IRA or other official retirement account

# WOSB/EDWOSB

- Profile of Owner

- EDWOSBs

- Other factors (personal financial condition, spouse's financial situation)

- SBA may consider spouse's financial situation in determining a woman's access to credit and capital. Transfers to a spouse within two years of certification will be attributed to woman.

# WOSB/EDWOSB

- Profile of Owner
  - EDWOSBs
    - Income
      - Adjusted gross income three year average < \$350,000
      - Excludes S corp or LLC income reinvested in EDWOSB or distributed to pay income taxes

# WOSB/EDWOSB

- Profile of Owner

- EDWOSBs

- Fair market value of assets < \$6 million

- Includes primary residence and value of the business concern)

- IRA or 401(k) retirement account excluded

- Transfers within two years

- Counted if to immediate family member or to trust that benefits immediate family member

# WOSB/EDWOSB

- Ownership (13 C.F.R. §127.201)
  - “Unconditionally” owned by one or more women or EDW
  - “Direct”
    - Ownership by the individual
    - Ownership by a revocable trust



# WOSB/EDWOSB

- Control (13 C.F.R. §127.202)
  - Woman or EDW control of management and daily business operations
    - LLC: Must be managing member
    - Corporation: Must control board of directors and own at least 51% of voting stock

# WOSB/EDWOSB

- Control (13 C.F.R. §127.202)
  - Must hold highest officer position and must have managerial experience of the extent and complexity needed to run the concern
    - However, if spouse possesses the required license and has an equity interest in the concern, he may be found to control the concern.
  - Limitation on outside employment

# SDVO SBC

- Profile of Owner (13 C.F.R. §125.8)
  - *Service-Disabled Veteran* means a veteran with a service-connected disability as determined by the VA

# SDVO SBC

- Ownership (13 C.F.R. §125.9)
  - SDVOSB must be at least 51% unconditionally and directly owned by one or more service-disabled veterans
  - “Direct”
    - Individual ownership.
    - Ownership can also be by a trust controlled by a veteran.

# SDVO SBC

- Ownership (13 C.F.R. §125.9)
  - Partnerships: 51% of every class of partnership interest
  - LLCs: 51% of each class of member interest
  - Corporations: 51% of the aggregate of all stock outstanding and at least 51% of each class of voting stock

# SDVO SBC

- Control (13 C.F.R. §125.10)
  - “Control by one or more service-disabled veterans means that both the long-term decisions making and the day-to-day management and administration of the business operations must be conducted by one or more service-disabled veterans (or in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran)”

# SDVO SBC

- Control (cont.) (13 C.F.R. §125.10)
  - The SDV must hold the highest officer position in the concern (usually President or Chief Executive Officer).
  - The SDV must have ultimate managerial and supervisory control over those who possess any required licenses or technical expertise.

# SDVO SBC

- Distinguish from VA's Veterans First Contracting Program!
  - VA has its own regulations governing qualification and participation of SDVOSBs (38 C.F.R. Part 74) for VA procurements only
  - Verification through Center for Veterans Enterprise ("CVE") and VetBiz Vendor Information Pages ("VIP Verification")



- *Kingdomware Technologies, Inc. v. United States, No. 14-916 (U.S. Sup. Ct. June 16, 2016)*
  - VA **must** apply the Rule of Two even when the VA will otherwise meet its annual minimum contracting goals
    - Rule of Two requires VA to award contracts to SDVOSBs or VOSBs when there is a “reasonable expectation” that at least two SDVOSBs or VOSBs will bid for the VA contract at “a fair and reasonable price that offers best value to the United States.” 38 U.S.C. 8127(d)

# HUBZone

- Historically Under Utilized Business Zones
  - Ownership (13 C.F.R. §126.103)
    - 51% by one or more persons each of whom is a US Citizen; or
    - By an Alaska Native Corporation (“ANC”), an Indian Tribal Government, Community Development Corporation (“CDC”), or small agricultural cooperative

# HUBZone

- Control (13 C.F.R. §126.202)
  - *Control* means both the day-to-day management and long-term decision-making authority for the HUBZone SBC.
- Key Requirement (13 C.F.R. §126.200)
  - Maintain a principal office located in a HUBZone and ensure that at least 35% of employees reside in a HUBZone
  - Must apply for HUBZone certification

# HUBZone

- Price Evaluation Preference for HUBZone SBCs
  - Add factor of 10% to all offers except HUBZone SBCs or otherwise successful offers from SBCs in an unrestricted procurement
  - A qualified HUBZone firm can win a competitive procurement even if its bid is up to 10% higher than an equally qualified large firm. 13 C.F.R. § 126.613

# Affiliation

- Why Affiliation Matters
  - An affiliate's average annual receipts or number of employees are counted with yours to determine if you are a small business for the applicable NAICS Code
- Affiliation is based on *control* (13 C.F.R. § 121.103)
  - Does one firm have the power to control another, or does a third party have the power to control both?

# Affiliation

- Bases for Affiliation (13 C.F.R. § 121.103)

Stock Ownership

Stock Options,  
Convertible  
Securities, and  
Merger Agreements

Common  
Management

Identity of Interest

Newly Organized  
Concerns

Joint Ventures

Ostensible  
Subcontractor  
Arrangements

Franchise and  
License  
Agreements

Totality of the  
Circumstances

# Affiliation

- *Stock Ownership*

- Individual or entity owns, controls, or has the power to control 50% or more of a firm's voting stock, or a block of stock that is large compared to other outstanding blocks
- Two or more individuals or entities own, control, or have the power to control roughly equal minority holdings of voting stock, and the aggregate of the minority holdings is larger than any other stock holding
  - Creates a rebuttable presumption that each such person holding a minority interest has the power to control the firm

# Affiliation

- *Stock Options, Convertible Securities, and Agreements to Merge*
  - “Present Effect Rule”: SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.
  - SBA will not give present effect when:
    - The agreement is merely to open or continue negotiations towards the possibility of a merger or sale at a later date
    - There are conditions precedent that are incapable of fulfillment, unenforceable, or extremely remote



# Affiliation

- *Common Management*
  - One or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns.

# Affiliation

- *Identity of Interest*<sup>\*</sup>
  - Relationships can create a rebuttable presumption of affiliation when two or more firms:
    - Are owned and controlled by married couples, parties to a civil union, parents, children, or siblings and
    - Conduct business with each other

*\* 13 C.F.R. § 121.103(f)(1) (amended by 81 Fed. Reg. 34,243) (May 31, 2016)*

# Affiliation

- *Identity of Interest*
  - Economic dependence <sup>\*</sup>
    - SBA will presume two firms are affiliated if one firm derives 70% or more of its revenue from the other firm over the previous three fiscal years (rebuttable presumption)

*\* 13 C.F.R. § 121.103(f)(1) (amended by 81 Fed. Reg. 34,243) (May 31, 2016)*

# Affiliation

- *Newly Organized Concern*
  - To prevent “spin-off” firms from circumventing the size restrictions
  - Rebuttable presumption (“clear line of fracture”)

# Affiliation

- *Joint Ventures*

- JV partners are affiliated for a specific contract.
- A JV qualifies as small as long as all joint venture partners qualify as small under the applicable NAICS code.\*

*\* 13 C.F.R. § 121.103(b)(9); (h)(3-4)(amended by 81 Fed. Reg. 34,243) (May 31, 2016).*

# Affiliation

- *Ostensible Subcontractor*
  - Affiliation based on a specific contract
  - A contractor and its “ostensible subcontractor” are treated as a JV and therefore are affiliated
  - Exception to ostensible subcontractor affiliation :
    - Similarly situated subcontractor\*

\* *13 C.F.R. § 121.103(b)(4) (amended by 81 Fed. Reg. 34,243) (May 31, 2016)*

# Affiliation

- *Totality of the Circumstances*

# Affiliation

## *SBA Mentor-Protégé Program*

- Affiliation exception (currently 8(a) Program only)\* for Joint Ventures with Large Businesses as long as the 8(a) qualifies as small and other JV requirements are met
- Mentor may acquire 40% ownership interest in Protégé
- SBA approval of Mentor-Protégé Agreement (MPA) and JV Agreement required
- Mentor's assistance under approved (MPA) does not create affiliation

\* *SBA proposed "Universal" Mentor-Protégé Program, 80 Fed. Reg. 6617 (February 5, 2015).*



# Performance Limitations

- *Limitation on Subcontracting* (13 C.F.R. § 125.6)\*
  - In order to be awarded a full or partial small business set-aside contract with a value > \$150,000, a small business concern must agree that:
    - Services: Concern will not pay more than 50% of the amount paid by the Government to firms that are not “similarly situated”
    - Supplies: Concern will not pay more than 50% of the amount paid by the Government to firms that are not “similarly situated” (not including the costs of materials)

- General Construction: Concern will not pay more than 85% of the amount paid by the Government to firms that are not “similarly situated” (not including the costs of materials)
- Construction by Special Trade Contractors: Concern will not pay more than 75% of the amount paid by the Government to firms that are not “similarly situated” (not including the cost of materials)

*\* 81 Fed. Reg. 34,243 (May 31, 2016)*

# Performance Limitations

- *Limitation on Subcontracting*

- Mixed Contracts 13 C.F.R. § 125.6(b)

- For a contract that provides both supplies and services, the limitations on subcontracting will only apply to the portion identified as the primary purpose of the contract.
      - *Primary purpose* means the component, either services or supplies, that has the greatest percentage of the contract value

# Performance Limitations

- *Exceptions to Limitations on Subcontracting*<sup>\*</sup>
  - Exception for a “similarly situated entity”
    - A *similarly situated entity* is a small business subcontractor that is a participant in the same small business program that the prime contractor is a certified participant which qualified the prime contractor to receive the award and is small for the NAICS code that the prime contractor assigned to the subcontract.

*\* 13 C.F.R. 125.1 (81 Fed. Reg. 34,261) (May 31, 2016).*

# Limitations on Subcontracting

- *Nonmanufacturer Rule* (13 C.F.R. § 121.406)

Exception to the limitations on subcontracting:

- A firm that is not a manufacturer may qualify as a small business on a supply contract if it:
  - Does not exceed 500 employees;
  - Is primarily engaged in the retail or wholesale trade and normally sells the type of item being supplied;
  - Takes ownership or possession of the item with its equipment, personnel or facilities as per industry practice; and
  - Will supply the end item of a small business manufacturer or processor made in the United States, or obtains a waiver of such requirement. 13 C.F.R. § 121.406(b)

# SBA Final Rule on Limitations on Subcontracting 81 Fed. Reg. 34,261 (May 31, 2016)\*

- Limitations on Subcontracting
  - Clarifying Services v. Supply Contracts
  - Similarly Situated Subcontractors
  - Nonmanufacturer Rule
  - Penalties
- Affiliation
  - Identity of Interest (familial relationships and economic dependence)
  - Joint Ventures
- Recertification: Mergers and Acquisitions

\* *Effective Date: June 30, 2016 (only SBA regulations not the FAR)*

# “Size” Protests at the SBA

1. Offerors self-certify that they are small
2. Who may protest an entity’s size:
  - Any concern that submits an offer for a set-aside contract that is not eliminated for reasons unrelated to size;
  - The contracting officer;
  - The SBA Government Contracting Area Director; and
  - Director, Office of Government Contracting, or designee. (13 C.F.R. §121.1001)
3. Where: with the Contracting Officer for the procurement, who must forward the protest to the SBA Government Contracting Area Office serving the area in which the headquarters of the protested concern is located (13 C.F.R. § 121.1003)

# “Size” Protests at the SBA

4. When: if by entities other than COs or the SBA –
  - Non-negotiated procurement: Received by the CO prior to the close of business on the 5<sup>th</sup> day, exclusive of Saturdays, Sundays, and legal holidays, after bid or proposal opening
  - Negotiated procurement: Received by the CO prior to the close of business on the 5<sup>th</sup> day, exclusive of Saturdays, Sundays, and legal holidays, after CO has notified protestor of identity of prospective awardee
5. What: A protest of size status must relate to a *particular procurement* and be specific (13 C.F.R. § 121.1007)
  - Affiliation issues
6. Size determinations by the SBA can be appealed to the SBA’s Office of Hearing and Appeals (“OHA”) (13 C.F.R. § 134.102) within 15 days after receipt of the formal size determination (13 C.F.R. § 134.304).



# “Status” Protests

## 1. What:

- Allege grounds for non-qualification other than that the entity is other than small
- Protests based on something other than size

## 2. Who: may protest status:

- If a contractor – must be an “interested party,” *i.e.*, the protester must have submitted an offer for the specific set-aside requirement

# “Status” Protests

## 3. When:

- Negotiated acquisitions: by close of business on the fifth business day after notification by the Contracting Officer of the apparent successful offeror.
- Sealed bid acquisitions: by close of business on the fifth business day after bid opening

# “Status” Protests

4. Where: to the Contracting Officer, who will forward to the appropriate SBA office according to the program
  
5. Appeals: Office of Hearings & Appeals (OHA)
  - Must file within 10 business days after protester receives status protest determination from the SBA

# Questions