Federal Contractors' Guide to Small Business Administration Set-Aside Contracts, Size Standards, Size Protests, and Affiliation

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This publication answers key questions about SBA (small business procurement and contracts:

- What is a federal small business set-aside procurement and how does the SBA define procurement size standards?
- What happens if an entity misrepresents its size status for a small business set-aside procurement?
- How do SBA size protests work?
- How can a small business use size protests to its advantage, and conversely, how can a small business protect itself from size protests filed by a competitor?
- What is the SBA concept of affiliation and how can it be avoided by small businesses?

Supplemental Information

Federal contractors may also benefit from Doug's previous publications on Small Business issues contracting:

SBA Size Protests: Powerful Tool to Challenge Competitor's Contract Award; How to Minimize Risks When Targeted

Limitations on Teaming Arrangements in Small Business Set-Asides

I. INTRODUCTION TO KEY SMALL BUSINESS ADMINISTRATION CONCEPTS

The purpose of this guide is to educate federal contractors on the following issues and concepts:

- SBA Set-Aside Procurements, Set-Aside Contracts, and Size Standards;
- The parameters and purposes for SBA size protests, how they are filed, and how contractors can avoid and defend against such protests; and
- The parameters of SBA affiliation, which contractors can use to their advantage to challenge Large Businesses masquerading as small business concerns (also referred to as "SBCs" or small business "concerns" throughout this article), and, as importantly, to protect themselves from being adversely affected by a finding of affiliation at the hands of a size protest.

This Guide is divided into the following Sections:

Section I introduces key small business concepts;

Section II defines Set-Aside Procurements and Size Standards, and discusses when an entity qualifies to compete for and receive a Set-Aside Contract award;

Section III addresses the penalties that may apply if an entity misrepresents its small business size in relation to a Set-Aside Procurement;

Section IV provides an overview of the SBA size protest process;

Section V defines the concept of SBA affiliation and the circumstances under which the SBA may find that affiliation exists between two or more entities. Further, this section details how evidence of affiliation can be used to form the basis of an SBA size protest, and how a SBC can protect itself from actual or perceived affiliation to avoid being the victim of a successful size protest; and

Section VI concludes with takeaways.

The federal government sets aside a significant portion of its procurement dollars each year for purchasing goods and services from small businesses. In Fiscal Year 2016, federal agencies awarded approximately $99.7 billion – nearly 25 percent of federal procurement dollars – through small business contracts. Small business set-aside procurements and small business contract awards ("Set-Aside Procurements" and "Set-Aside Contracts," respectively) provide substantial opportunities for certified SBCs to compete for and perform federal contract work.

However, SBCs awarded Set-Aside Contracts are frequently subjected to size protests filed with the U.S. Small Business Administration ("SBA") by disappointed competitors looking to challenge the awardee's size, and if successful, to disqualify the awardee from the procurement. A successful size protest demonstrates that the Set-Aside Contract awardee exceeds the designated Size Standard applicable to a particular Set-Aside Procurement, and is therefore not eligible for the Set-Aside Contract award. The SBA regulations require agencies to disqualify purported SBCs from Set-Aside Procurements if the awardee is found and subsequently determined to be other-than-small (hereinafter referred to as a "Large Business") as the result of a successful size protest.

Just about every Set-Aside Procurement nowadays involves at least one, and sometimes several, size protests. Unsuccessful offerors have very little to lose by filing a size protest, but a lot to gain if they can convince the SBA that the awardee is not an SBC. Hence, the number of size protests increases just about every year. Literally, billions of dollars of Set-Aside Contract

value are put at risk each year by size protests. Put another way, the stakes in the small business and size protest game are high and today's Set-Aside Contract awardee can turn into tomorrow's disqualified awardee overnight due to a successful size protest. Accordingly, it is imperative for SBCs to understand and be able to navigate the complex size-protest process.

Most size protests allege that an SBC is unusually connected to, or "affiliated," with other business entities. Affiliation is a uniquely federal concept used most prevalently in the SBA size protest arena. Under the SBA regulations, affiliated entities must aggregate their gross annual revenue or their number of employees with those of their affiliates to determine if an SBC is considered small for a particular Set-Aside Procurement's Size Standard. Even though an SBC may be small in its own right based on its own revenue or own employees, the aggregation of its revenue or number of employees with the revenue or employees of its affiliated entities may cause it to exceed the applicable Size Standard. An SBC that exceeds the Size Standard applicable to a Set-Aside Procurement (whether due to affiliation or due to the SBC's own revenue or employees) is by definition a Large Business. A Large Business is ineligible to receive a Set-Aside Contract award, and if it is the awardee, it must be stripped of the award.

In general, affiliation exists between entities where one entity has the power to control another entity, or where one or more third parties has the power to control both entities. Control of one entity over another may be based on a host of related factors identified in the SBA regulations, such as: common ownership, common management, identity of interest, joint venture agreements, financial connections, family connections, business connections, the "Ostensible Subcontractor Rule," the "Newly Organized Concern Rule," the "Totality of the Circumstances Rule," and many other affiliation relationships.

SBCs must constantly take proactive steps to minimize affiliation with other entities wherever and whenever possible. Business relationships between entities that are considered typical, acceptable and advantageous in the commercial world are oftentimes considered indicators of affiliation in the federal contracting world. Therefore, SBCs should constantly review all of their business relationships to eliminate, reconfigure, or at the very least minimize any relationship that may be viewed as an affiliation relationship by the SBA. Otherwise, an SBC runs the risk of being found to be a Large Business because of affiliation alleged in a successful size protest.

In sum, the SBA regulations on small business set-asides, Size Standards, size protests, and affiliation govern and control the award of all small business Set-Aside Contracts. Accordingly, SBCs must fully understand and be able to comply with the SBA regulations under all circumstances. Further, an SBC must understand the SBA size protest process in order to: (1) defend itself and its Set-Aside Contract award from a size protest filed by a disgruntled competitor; or (2) challenge a competitor's Set-Aside Contract award when evidence exists that the awardee is, or may be, a Large Business. The SBA size protest process and the concept of affiliation can be both a sword and shield for an SBC when properly applied.

II. Small Business Set-Aside Procurements

Procuring agencies establish goals for the number of Set-Aside Procurements they seek to award each year. These Set-Aside Procurement goals generally average around 30 percent of procuring agencies' overall federal procurement dollars.

For example, the Department of Defense's ("DOD") Fiscal Year 2018 Set-Aside Procurement goal is 22 percent (according to the SBA website). The DOD breaks that goal down further into specific goals for the different SBC business categories: 5 percent for Small Disadvantaged Businesses; 5 percent for Women Owned Small Businesses; 3 percent for Service Disabled Veteran Owned Small Businesses; 3 percent for Historically Underutilized Business Zone small businesses; with the remaining balance of the 22 percent goal capable of being set aside for any SBC category. These goals vary from agency to agency, with some agencies seeking to set-aside significantly more procurements for SBCs than DOD. For example, the Department of the Interior and the Department of Agriculture have Set-Aside Procurement goals of 51 percent and 53 percent for Fiscal Year 2018, respectively.

Additionally, federal agencies set small business subcontracting goals for prime contractors to achieve when awarding subcontracts to SBCs. DOD's subcontracting goal is to award 33 percent of all DOD subcontracts to SBCs, whereas the Department of the Interior's and the Department of Agriculture's goals, for example, are 42.5 percent and 22 percent, respectively. Accordingly, it is prudent for SBCs to investigate which procuring agencies provide the most opportunities for Set-Aside Procurements (and subcontracts) in order to maximize their ability to compete for and win Set-Aside Contracts (and subcontracts).

Procuring agencies assign each Set-Aside Procurement a Size Standard, which is established by a North American Industry Classification System ("NAICS") Code. A Set-Aside Procurement's assigned NAICS Code is based on the type of goods or services being procured. Each procurement has only one NAICS Code. The Size Standard designated by each NAICS Code is based either on an entity's: (1) gross annual revenue; or (2) total number of employees. A list of the applicable NAICS Codes and their corresponding Size Standards can be found at 13 C.F.R. § 121.201.

Size Standards based on gross annual revenue range from $750,000 to $38.5 million. Size Standards based on number of employees range from 100 to 1,500 employees. Entities that exceed a Set-Aside Procurement's applicable Size Standard are ineligible to submit a proposal for or receive the contract award under that Set-Aside Procurement. 13 C.F.R. § 121.402(a) ("A concern must not exceed the Size Standard for the NAICS code specified in the solicitation"). For example, Set-Aside Procurements assigned NAICS Code 236220 (for "Commercial and Institutional Building Construction" contractors) have a $36.5 million Size Standard. Therefore, entities with gross annual revenue below $36.5 million are considered small for the procurement and are eligible to compete for, and receive, the Set-Aside Contract award. Entities with gross annual revenue in excess of the $36.5 million Size Standard are considered Large Businesses for the purposes of the procurement and are ineligible to compete for or receive the Set-Aside Contract award.

Size Standards based on gross annual revenue are calculated based on an entity's average annual revenue for the past three tax years (added with any of its affiliates' gross annual revenue over the same period). 13 C.F.R. § 121.104 ("The average annual receipts size of a business concern with affiliates is calculated by adding the average annual receipts of the business concern with the average annual receipts of each affiliate"). This calculation of annual revenue provides some flexibility for entities to maintain their SBC status for a procurement even though their revenue for one or more of the past three years may have actually exceeded the Size Standard. As long as an entity's three-year average revenue falls below the applicable Size Standard, the entity is considered small.

The same analysis applies to Size Standards based on an entity's number of employees. For example, Set-Aside Procurements assigned NAICS Code 517911 (for "Telecommunications Resellers") have a 1,500 employee Size Standard. Therefore, entities that have fewer than 1,500 employees are considered small for the procurement and are eligible to compete for and receive the Set-Aside Contract award. Entities with more than 1,500 employees are considered Large Businesses for the procurement and are ineligible to compete for or receive the Set-Aside Contract award.

Number of employees is calculated based on the average number of an entity's employees (plus the employees of its affiliates) per pay period for the past 12 months. 13 C.F.R. § 121.106 ("The average number of employees of the concern is used (including the employees of its domestic and foreign affiliates) based upon numbers of employees for each of the pay periods for the preceding completed 12 calendar months").

In general, an SBC's Size Standard for a Set-Aside Procurement is determined as of the date the SBC submits its proposal to the procuring agency in response to a solicitation. If a SBC's size is ever challenged through a size protest, the SBA will take a snapshot of that entity's size on the date its proposal was submitted to determine its size for the procurement. Further, an SBC's size for a Set-Aside Procurement is set, or locked in for the duration of a procurement as of the date of proposal submission. In other words, if an entity is small as of the date of proposal submission, it is considered small

for the duration of the contract. Therefore, an SBC can grow from a Small to a Large Business after receiving a Set-Aside Contract award with no adverse consequences (in most cases) as long as it was an SBC when its proposal was submitted. 13 C.F.R. § 121.404(a) ("SBA determines the size status of a concern, including its affiliates, as of the date the concern submits a written self-certification that it is small to the procuring activity as part of its initial offer (or other formal response to a solicitation), which includes price").

III. Consequences of Misrepresenting an Entity's Size Status

All SBCs must certify their SBC status when submitting a proposal for a Set-Aside Procurement and when accepting a Set-Aside Contract award. An entity that knowingly misrepresents itself as an SBC for a Set-Aside Procurement or Set-Aside Contract when it is really a Large Business is subject to significant penalties and sanctions at the hands of the federal government.

For starters, any entity that knowingly submits a proposal for a Set-Aside Procurement for which the entity knows (or should know) that it does not qualify for as a Large Business may be liable for a False Claims Act ("FCA") violation. The FCA penalizes contractors that make "false" statements or claims to the government, which includes the submission of a proposal misrepresenting an entity's size. The FCA defines "knowingly" as when a contractor has "actual knowledge" that its statement is false, "acts in deliberate ignorance of the truth or falsity" regarding its size status, or "acts in reckless disregard of the truth or falsity" regarding its size status. 31 U.S.C. § 3729(b)(1). An FCA violation carries with it significant penalties, such as financial sanctions, treble damages, suspension and debarment of the entity from performing federal contracts, and other adverse consequences. 31 U.S.C. §§ 3729 *et seq*.

Additionally, entities that misrepresent their size status for a Set-Aside Procurement may be liable for damages in an amount equal to the entire value of any Set-Aside Contract improperly awarded and performed. Under the "Presumed Loss Rule," a procuring agency has the ability to claim that the "presumed loss" to the government as the result of an entity's misrepresentation of its SBC status is the overall value of the Set-Aside Contract inappropriately obtained, even when the contract was properly and completely performed. For example, if a procuring agency determines that an entity misrepresented its status as an SBC to obtain and perform a $20 million Set-Aside Contract, the agency can seek to collect $20 million in damages from the offending contractor under the "Presumed Loss Rule," even when the agency received a $20 million completed contract from the contractor. 13 C.F.R. § 121.108 ("In every contract, subcontract . . . which is set aside . . . for award to small business concerns, there shall be a presumption of loss to the United States based on the total amount expended on the contract . . . whenever it is established that a business concern other than a small business concern willfully sought and received the award by misrepresentation").

Accordingly, it is imperative that SBCs take all necessary precautions to avoid intentionally or unintentionally misrepresenting their SBC status in relation to a Set-Aside Procurement. Even innocent or unintentional misrepresentations of an SBC's size may be looked upon by procuring agencies (and the Department of Justice) as serious violations of applicable law, and may lead to significant financial and other penalties. In other words, before a contractor certifies itself to be an SBC for a Set-Aside Procurement, it must exercise due diligence to ensure that it truly is small. The consequences of not conducting such due diligence can be severe.

IV. The SBA Size Protest Process

SBA size protests may be filed by an interested offeror (or bidder) to challenge the size of a competitor on a Set-Aside Procurement based on that procurement's applicable Size Standard. Size protests must be filed in relation to a specific procurement in which the protestor has a significant interest (as an offeror or bidder). The procedures for filing a size protest are found primarily at 13 C.F.R. §§ 121.1001 *et seq*.

In general, the SBA regulations allow a wide range of "interested parties" to file a size protest, including the contracting officer, any offeror not eliminated from an award competition for reasons unrelated to size, and, in limited circumstances, a Large Business entity. The fact that almost any offeror for a Set-Aside Procurement may file a size protest, regardless of whether the offeror is next in line for the contract award or not, significantly increases the pool of potential protestors. An offeror simply needs to submit a proposal for a Set-Aside Procurement in order to file a size protest.

The primary benefit of a successful size protest is that it provides an SBC the ability to disqualify Large Businesses masquerading as SBCs from Set-Aside Procurements. The threshold for filing a size protest is ridiculously low – a protestor must only have a reasonable and good faith basis for filing a size protest, i.e., a reasonable or good faith belief that the presumed Set-Aside Contract awardee is not small. Therefore, even where there is only a small chance that a Set-Aside Contract awardee may be found to be a Large Business, which alone may justify filing a size protest in the hopes of disqualifying the awardee from the procurement. In other words, a size protest – much like a post-award bid protest filed with the Government Accountability Office or the U.S. Court of Federal Claims – potentially provides an unsuccessful offeror another bite at the apple to reset the procurement and potentially wrestle the contract award away from the presumed awardee.

A. Size Protest Timing

Size protests must be filed quickly – within five business days of bid opening (for non-negotiated procurements) or five business days from the date the protestor receives notice of the identified contract awardee (for negotiated procurements). 13 C.F.R. § 121.1004(a). Failure to file a size protest within the five-day timeframe will result in the automatic dismissal of the protest by the SBA. 13 C.F.R. § 121.1004(d). Accordingly, SBCs should analyze the likely chance of success of a size protest as soon as bids are opened or the Set-Aside Contract awardee is identified, depending upon whether the procurement is negotiated or non-negotiated.

B. Size Protest Contents

The level of specificity required in a size protest is minimal. A protest need only be "sufficiently specific to provide reasonable notice as to the grounds upon which the protested entity's size is questioned." 13 C.F.R. § 121.1007(b). As long as the protest provides "some basis for the belief or allegation stated in the protest" that a Set-Aside Contract awardee is not small, the protest will be sufficient to trigger an SBA investigation into the protested entity's size. 13 C.F.R. § 121.1007(b). In other words, the evidentiary bar required to file a size protest and trigger an SBA investigation of a protested entity is incredibly low.

Rarely, if ever, does the SBA find that a size protest fails to meet the low evidentiary threshold required to initiate a size investigation of the protested entity. One-page size protests that do nothing more than allege that an entity is a Large Business without any factual support have been accepted by the SBA as legitimate size protests, so it truly does not take much effort to meet the low evidentiary bar.

Any SBC with access to the internet is generally capable of finding and providing the SBA with the evidence capable of showing "some basis for the belief" that a protested entity is not an SBC. The SBA readily accepts all manner of documentary evidence when determining whether a size protest meets the "some basis for belief or allegation" threshold, such as SAM.gov entity profiles, commercial business profiles (such as Dun & Bradstreet reports), newspaper articles, contract and subcontract histories, publicly available corporate filings, affidavits, and a host of other information that may demonstrate that the protested entity is a Large Business or affiliated with other business. 13 C.F.R. § 121.1008(c).

Online content is often the most fertile source of information regarding a protested entity's size. Oftentimes, a protested entity's own website will contain information regarding affiliation relationships between the entity and other businesses that may be interpreted to show that the entity is a Large Business. For example, many federal contractors list their

strategic and teaming partners on their websites for marketing purposes. This information may potentially be used against an SBC for size protest purposes. Accordingly, SBCs should closely scrutinize the information displayed on their websites, filed with state entities or otherwise made publicly available to avoid having their own information used against them as evidence during a size protest. SBCs should, where possible, avoid references to their teaming partners, strategic partners, joint venture partners, sister companies and parents or subsidiaries, and any other information that could reasonably lead someone to believe that affiliation exists between the SBC and other entities. Where SBCs do make a business decision to share that information publicly, they should do so with an eye toward preempting allegations that those relationships create affiliations, and they should be ready to rebut those allegations as they arise.

C. SBA Size Investigations

If the SBA decides that sufficient grounds exist on the face of a protest to investigate the size of the protested entity (which is nearly 100% of the time), it conducts an investigation of the protested entity's ownership, business structure, relationships and financial standing. The SBA requires that the protested entity turn over – generally within three business days – its most intimate business information, including but not limited to: corporate formation documents and annual reporting documents; ownership information and the names of all directors and officers; all business, financial or familial relationships between the entity, its owners, directors and officers and any other business entity; income statements for the past three years; tax returns and audited financial statements for the past three years; number of employees for the past year (if the procurement is based on a number of employees Size Standard); and a host of other information. In short, the SBA will request all information about the protested entity that is required to address the specific allegations raised in a size protest, and then some.

This information must be provided by the protested entity in the form of a completed SBA Form 355 (Application for Small Business Size Determination), which can be found here. SBA Form 355 contains approximately 30 questions regarding the protested entity's ownership, business structure, relationships, and financial standing. The form is similar to many Internal Revenue Service forms in complexity. Similarly, SBA Form 355 provides little guidance for the layperson on how to properly prepare the form or how to sufficiently respond to its questions. The form facilitates the SBA's comprehensive auditing of a protested entity during a size investigation, which digs into confidential and proprietary data that business entities generally do not want to reveal.

Size investigations can be incredibly taxing on SBCs due to the sheer volume of information and documentation requested by the SBA within a three-day timeframe. Refusing to respond to the SBA's demands for information is not an option. Any information a protested entity fails to provide can create a presumption that the entity is a Large Business. 13 C.F.R. § 121.1008(d) ("If a concern whose size status is at issue fails to submit a completed SBA Form 355, responses to the allegations of the protest, or other requested information within the time allowed by SBA, or if it submits incomplete information, SBA may presume that disclosure of the information required by the form or other missing information would demonstrate that the concern is other than a small business").

It is imperative that protested entities put their full attention into comprehensively responding to the questions raised in SBA Form 355 and to the specific allegations raised in the protest. It is unwise to let specific size protest allegations go unrebutted, regardless of how outlandish or speculative they may be. Each and every size protest allegation should be addressed and refuted in the size protest response. The response should be a narrative supported by documentary evidence and affidavits from key entity personnel to refute the allegations.

Protested entities should put together their best and most comprehensive response to a size protest to avoid a presumption by the SBA that some of the size protest allegations may be true. The burden is on the protested entity to rebut the size protest allegations, not on the SBA to assist the protested entity in putting together a winning response. While hard to believe, a protested entity is basically deemed guilty of being a Large Business unless it otherwise proves it is a SBC. While the SBA may come back to a protested entity seeking additional information regarding a specific allegation, the SBA is not required to do so. Therefore, the goal in all size protest responses should be to do it once and do it right the first time.

There is no guarantee that a protested entity will get a second chance to provide information. A substandard response may lead to a substandard result—i.e., a determination that the protested entity is a Large Business.

Another consideration is that once a size protest opens the door to a size investigation, nobody knows what additional facts may be uncovered by the SBA or revealed by the protested entity regarding its size. For example, a size protest may allege that the protested entity is a Large Business due to its affiliation with Company A. However, the SBA may discover during the size investigation from the responses to SBA Form 355 that the protested entity is not affiliated with Company A, but is affiliated with Company B, which causes it to be a Large Business. In sum, the size investigation may dig up crucial evidence on the protested entity's size that the protestor would never be able to discover on its own. Accordingly, a protestor should consider not only the strength of its own evidence, but also the evidence that the SBA may uncover during its size investigation when weighing whether to file a size protest.

The SBA considers the totality of the evidence presented with a size protest, and no one piece of evidence is required to show that the protested entity is a Large Business. All of the evidence presented in the size protest and in the protest response is to be considered by the SBA. That said, the burden of persuasion in a size protest is surprisingly placed on the protested entity, not the protestor. Specifically, the protested entity must prove to the SBA that it really is an SBC. It must do this based on hard facts and evidence, not just mere unsupported assertions that it is a SBC. 13 C.F.R. § 121.1009(c) ("The concern whose size is under consideration has the burden of establishing its small business size").

D. SBA Size Determinations

The end result of the SBA's size investigation is a "Size Determination," in which the SBA issues its ruling on whether the protested entity is an SBC or a Large Business based on the facts presented to the SBA. As described above, the SBA's Size Determination is based primarily on the information contained within the size protest and the size protest response, but can also rely upon other information requested by or obtained by the SBA during the size investigation. 13 C.F.R. § 121.1009(b) (a Size Determination is to be primarily based on "the information supplied by the protestor or the entity requesting the size determination and that provided by the concern whose size status is at issue. The determination, however, may also be based on grounds not raised in the protest or request for size determination"). In other words, the SBA's Size Determination may rely on information not addressed or alleged in the size protest to find that the protested entity is a Large Business.

The SBA regulations indicate that Size Determinations should be issued within 15 business days after the SBA's receipt of a protest. 13 C.F.R. § 121.1009(a)(1). During this 15-day timeframe, the procuring agency may not issue a Set-Aside Contract award to the protested entity unless the contracting officer "determines in writing that an award must be made to protect the public interest." 13 C.F.R. § 121.1009(a)(1). Therefore, a size protest buys the protestor some additional time that may be used to its advantage in various ways, such as allowing it to gather additional evidence necessary to support a corresponding bid protest.

If no Size Determination is issued after the 15-day timeframe, the contracting officer may "award the contract if he or she determines in writing that there is an immediate need to award the contract and that waiting until SBA makes its determination will be disadvantageous to the Government." 13 C.F.R. § 121.1009(a)(2). A significant percentage of Size Determinations are not decided by the SBA within this 15-day timeframe. In reality, the SBA may take several weeks or sometimes several months or longer to issue a Size Determination. Therefore, the filing of a size protest may stretch the procurement process out significantly, which may be to the benefit or the detriment of the protestor, depending on the circumstances. For example, a protestor that is an incumbent contractor on the procurement generally benefits significantly from size protest delays. However, most procuring agencies generally wait for the SBA to issue its Size Determination even if it takes much longer than 15 days, which is the prudent path for the agency to take to ensure that it is only awarding Set-Aside Contracts to true SBCs.

Size Determinations are made by regional SBA Area Offices throughout the country. While Area Offices are to follow the same SBA regulations and policies when making Size Determinations, the application of these principles is oftentimes inconsistent between the different Area Offices, which can result in confusing and inconsistent Size Determinations. Further, there is no precedential value between Size Determinations, which means the SBA is not required to follow or apply its past Size Determinations when issuing new decisions, even though the facts of two cases may be substantially similar. This lack of consistency ultimately creates uncertainty amongst protestors and protested concerns alike.

E. What Happens to Entities Found To Be Large Businesses

A protested entity that is found to be a Large Business by an SBA Size Determination on a Set-Aside Procurement is ineligible to compete for the Set-Aside Procurement and must disgorge its Set-Aside Contract award (unless the procuring agency has justified allowing the protested entity to proceed with the contract award based on the needs of the agency). Further, the protested entity is ineligible to compete for, or receive a Set-Aside Contract on any future procurement that requires the same Size Standard (or a lower Size Standard). For example, a protested entity found to be a Large Business for NAICS Code 236220 (Commercial and Institutional Building Construction), which has a $36.5 million Size Standard, is ineligible to compete for any procurement with a Size Standard of $36.5 million or under. 13 C.F.R. § 121.1009(g)(5) ("A concern determined to be other than small under a particular Size Standard is ineligible for any procurement or any assistance authorized by the Small Business Act or the Small Business Investment Act of 1958 which requires the same or a lower Size Standard . . .").

A protested entity deemed to be a Large Business must also self-report an adverse Size Determination to contracting officers on any of its other pending Set-Aside Procurements. Specifically, the protested entity "must immediately inform the officials responsible for [any] pending procurement" that it has been found to be a Large Business. 13 C.F.R. § 121.1009(g)(5). This self-reporting will likely result in the entity being deemed ineligible to compete for those Set-Aside Procurements as well (depending on the Size Standards of those procurements).

Entities that are found to be Large Businesses by a Size Determination have limited options for relief. First, an entity may appeal an adverse Size Determination to the SBA Office of Hearings and Appeals ("OHA"). The procedures for filing such an appeal are found at 13 C.F.R. §§ 134.101 *et seq*. In order to overturn a Size Determination on appeal, the appellant must show that the SBA committed a "clear error of fact or law" in rendering its Size Determination. 13 C.F.R. §§ 134.314. This is an incredibly high burden to achieve. Hence, the success rate on OHA appeals is relatively low.

Second, the entity may seek to "recertify" itself as an SBC by submitting a request for recertification to the SBA. 13 C.F.R. § 121.1010. The recertification process generally takes a number of months to complete and is rarely successful right after an adverse Size Determination. Otherwise, the entity would not have been found to be a Large Business in the first place. The petitioning entity has to demonstrate that it has transformed itself from a Large Business to an SBC, or at the very least, significantly mitigated the issues that led to it being found to be a Large Business by the SBA. At a minimum, this lengthy process prevents an entity from being able to compete for Set-Aside Contracts for a significant period. In reality, a protested entity found to be a Large Business by the SBA may never be able to recertify as a SBC if its gross annual revenue or number of employees significantly exceed its applicable Size Standards.

V. SBA Affiliation

Affiliation is a uniquely federal concept with amorphous and subjective rules that are contrary to commercial business principles and common sense. The SBA uses the affiliation concept to determine if individuals or business entities are inextricably linked in such a manner that the individuals/entities should be treated as one and the same for determining whether a purported SBC is considered small for a particular Set-Aside Procurement. Affiliation is a concept that allows the SBA to tie individuals and entities together based on various connections. Business relationships that are considered

routine and typical in the commercial world are oftentimes deemed impermissible by the SBA as *de facto* indicators of affiliation. Whether affiliation exists between two or more business entities (or between an entity and one or more individuals) is determined by the SBA primarily in the context of an SBA size protest.

While the SBA regulations set forth the general rules of affiliation, the regulations also recognize numerous exceptions to those rules, in that the exceptions oftentimes swallow the general rules. Further, the application of the affiliation principles is oftentimes inconsistent between the different regional SBA Area Offices charged with rendering Size Determinations, which can result in confusing and inconsistent Size Determinations. In sum, the nebulous concept of affiliation has been an enigma for both small and large businesses over the years, despite the fact that the SBA's application of the affiliation rules has ultimately resulted in the loss of hundreds of millions of dollars of Set-Aside Contract value due to sustained size protests. Therefore, it is imperative for contractors to understand both the base rules of affiliation and the numerous exceptions that provide potential avenues to avoid affiliation problems.

In general, the rule of thumb for SBCs is to only enter arms-length relationships with other entities based on commercially reasonable and acceptable terms, and to never enter any agreement that provides an entity a level of control over another. A finding of affiliation between an SBC and a Large Business causes the SBC to lose its small business status, even though the SBC is small based upon its own annual revenue or number of employees, due to the mandatory aggregation of both entities' revenue or number of employees.

The SBA affiliation rules are primarily addressed in 13 C.F.R. §121.103. This regulation establishes both general and specific grounds upon which affiliation can be found between two or more entities. The most common grounds of affiliation routinely alleged in size protests are addressed in more detail below.

In general, the SBA rules hold that control over an entity indicates that affiliation exists between those entities – "Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists." 13 C.F.R. §121.103(a)(1). This control over an entity can be affirmative or negative, direct or indirect and need not actually be exercised to find that affiliation exists. 13 C.F.R. §121.103(a)(3) ("Negative control includes, but is not limited to, instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders").

The SBA considers many factors to determine if control and/or affiliation exists, including, but not limited to, "ownership, management, previous relationships with or ties to another concern, and contractual relationships . . . ." 13 C.F.R. §121.103(a)(2). Accordingly, it is imperative for SBCs to avoid both actual control between entities where possible, and as importantly, the perception of control between entities, even where it may not exist. Any and all connections between entities can be interpreted or misinterpreted by competing contractors or the SBA to be indicators of control between entities, and hence, affiliation.

A. Affiliation Based on Ownership

The SBA finds affiliation between a SBC and another entity where common ownership exists. The SBA size regulations hold that common ownership exists where:

(1) An individual, entity or other entity owns "or has the power to control, 50 percent or more of a concern's voting stock, or a block of voting stock which is large compared to other outstanding blocks of voting stock." 13 C.F.R. §121.103(c)(1). Put another way, any person or business that owns 50 percent or more of an entity *per se* controls that entity;

(2) "[T]wo or more persons (including any individual, concern or other entity) each owns, controls, or has the power to control less than 50 percent of a concern's voting stock, and such minority holdings are equal or approximately equal in size, and the aggregate of these minority holdings is large as compared with any other stock holding . . ." 13 C.F.R. §121.103(c)(2). Put another way, where two or more persons or businesses own the largest blocks of ownership of an entity, which are large compared to the other blocks of ownership, the "SBA presumes that each such person controls or has the power to control the concern whose size is at issue. This presumption may be rebutted by a showing that such control or power to control does not in fact exist." 13 C.F.R. §121.103(c)(2). In other words, the owners alleged to be in control of an entity may provide evidence demonstrating that they truly do not have the power to control the entity based on their minority ownership shares; and

(3) "[A] concern's voting stock is widely held and no single block of stock is large as compared with all other stock holdings, the concern's Board of Directors, CEO, and/or President will be deemed to have the power to control the concern in the absence of evidence to the contrary." 13 C.F.R. §121.103(c)(3). Put another way, where an entity's ownership is widely held, such as in large corporations with thousands of shareholders, and no single ownership block is large compared to the other owners, control is deemed to be held by the entity's CEO, President, board or other management entities. However, in situations where multiple owners own the same or similar shares of an entity, even very small ownership shares, the SBA has found that each owner of those smaller shares has the ability to control the entity. *See Size Appeal of Government Contracting Resources, Inc.*, SBA No. SIZ-5706 (2016) (OHA found that 26 equal owners of a captive insurance provider each individually had the power to control the entity and that each owner was thereby affiliated with the entity).

Accordingly, SBCs should scrutinize their ownership status prior to competing for any Set-Aside Procurements to ensure that their respective owners are not affiliated with any other entities, as that "other ownership" can lead to affiliation between the SBC and those other entities. For example, the owner of an SBC should, where possible, divest itself of all ownership interests in another entity that exceeds 49 percent of the overall ownership interests of the other entity if the SBC wants to be eligible for Set-Aside Contracts. The owner of an SBC that owns 50 percent or more of another entity will cause the SBC to be affiliated with the other entity based on common ownership. The smaller the percentage of common ownership that exists between an SBC and other entities, the less likely the SBC will be found affiliated with those other entities. However, ownership of less than 50 percent of another entity can still be an indicator of affiliation regardless of the size of the ownership stake held when other affiliation factors exist. (*See* the discussion of the "Totality of the Circumstances" in Section V.6 below). Therefore, all ownership percentages in other entities, regardless of how large or small, should be scrutinized, and where possible, mitigated.

B. Affiliation Based on Common Management

The SBA finds affiliation between an SBC and another entity where common management exists, which occurs "where 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." 13 C.F.R. §121.103(e).

Management ties between an SBC and other entities must be carefully regulated by the SBC to ensure that the relationships do not adversely affect the SBC's size. SBCs should scrutinize their management situation prior to competing for any Set-Aside Procurements to avoid any overlap in management with other entities. Specifically, an SBC should analyze the ownership and management interests that it, its owners, directors or officers, and other key personnel hold in other entities.

SBCs should minimize or dissolve any management ties with other entities that may be viewed as affiliation with that other entity. Further, directors, officers, and key personnel of SBCs should, where possible, divest themselves of management positions in other entities to minimize the risk of affiliation. Additionally, an SBC's corporate and other business documents

and filings should be regularly reviewed and updated to ensure that the documents do not list personnel affiliated with other entities due to common management where possible. Failure to cut management ties with other entities, even based on passive management relationships, can lead to affiliation between unrelated entities.

C. Affiliation Based on Identity of Interest

The SBA finds affiliation between an SBC and another entity where there exists "identical or substantially identical business or economic interests" between the two entities. 13 C.F.R. §121.103(f). Identity of interest generally occurs between entities when an SBC: (1) fails to maintain arms-length relationships with its subcontractors, suppliers, and other business partners; (2) is economically dependent on another entity (such as where an entity "derived 70% or more of its receipts from another concern over the previous three fiscal years" 13 C.F.R. §121.103(f)(2); or (3) has relationships with other entities that suggest a lack of independence. The SBA routinely finds that businesses that share resources, such as employees, equipment, office space, administrative staff, bonding capacity, lines of credit, phone numbers, and other ties are affiliated due to an identity of interest. For example, OHA has held that the leasing of office space in the same building, sharing a common reception area, telephone system, and a receptionist are clear indicators of affiliation between two entities based on an identity of interest.

Familial relationships also can lead to an identity of interest between an SBC and other entities. The SBA regulations indicate that entities owned or controlled by family members "may be treated as one party with such interests aggregated" as a result of identity of interest, even where the entities are completely unrelated. Specifically, the SBA regulations state that "[f]irms owned or controlled by married couples, parties to a civil union, parents, children and siblings are presumed to be affiliated with each other if they conduct business with each other, such as subcontracts or joint ventures or share or provide loans, resources, equipment, locations, or employees with one another." 13 C.F.R. §121.103(f)(1). This "presumption arises not from active involvement in each other's business affairs, but from the family relationship itself." *Size Appeal of Speegle Constr., Inc.*, SBA No. SIZ-5147 (2010).

Identity of interest allegations or findings may be rebutted by an SBC by providing evidence that "interests deemed to be one are in fact separate" or that a "clear line of fracture" exists between two entities. 13 C.F.R. §121.103(f) and (f)(1). A protested entity may show a clear line of fracture "by proving there is no business relationship or involvement with each other's business entities" or that the family members are "estranged." *Size Appeal of Speegle Constr., Inc.*, SBA No. SIZ-5147 (2010) (OHA found familial identity of interest existed between father and son-owned businesses where father was listed as a vice president of son's business, even though the father had no active role in managing the affairs of his son's company and the father's vice president title was an "honorary position" based on his previous history with the company).

Affiliation based upon an identity of interest can be avoided by ensuring that an SBC enters only arms-length relationships with other entities and is capable of functioning in all respects as an independent business. SBCs that are dependent upon other entities for employees, equipment, lines of credit, office space, contracts, or other resources will likely be found affiliated with those other entities. SBCs should not share resources of any kind with another entity unless that relationship is based upon an arms-length contractual relationship and SBCs pay fair market value for the resources obtained. Even where an SBC's relationships with other entities are arms-length, those relationships should be minimized to the extent possible because resource sharing creates the appearance of affiliation between two entities. Examples of acceptable arms-length relationships (in most cases) are subcontracts, supply contracts, insurance policies, financing agreements, and other standard business arrangements with unrelated entities.

An SBC should also ensure that a "clear line of fracture" exists between it and familial interests to avoid affiliation based on familial identity of interest. The easiest way to establish a familial line of fracture is for an SBC to avoid business relationships with family member-owned entities altogether. If avoidance is not possible or practicable, a SBC should

only engage in arms-length transactions with family member-owned entities. Familial involvement in an SBC's ownership and management should be avoided altogether, or significantly controlled if that involvement may lead to affiliation with another entity.

The presumption of identity of interest between related businesses and/or family members owning or controlling different businesses is difficult to rebut once it is alleged. Accordingly, an SBC should monitor and limit the involvement of other businesses, family members, and family-owned entities in the SBC's business affairs to avoid the appearance of affiliation.

D. Affiliation Based on the "Newly Organized Concern Rule"

The SBA finds affiliation between an entity and its newly organized concern when: (1) "former officers, directors, principal stockholders, managing members, or key employees of one concern organize a new concern." A "key employee is defined as one who has "a critical influence in or substantive control over the operations or management of the concern"; (2) the newly organized entity is "in the same or related industry or field of operation" as the forming entity; (3) the founders of the newly organized entity "serve as the new concern's officers, directors, principal stockholders, managing members, or key employees"; and (4) the forming entity "is furnishing or will furnish the new concern with contracts, financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities, whether for a fee or otherwise." 13 C.F.R. §121.103(g). All four of these factors must be met to find affiliation based on the Newly Organized Concern Rule. *Size Appeal of J.W. Mills Mgmt.*, SBA No. SIZ-4909, at 5 (2008) ("If the challenged firm was not formed by shareholders, officers, or key employees of the large firm, it is unnecessary to examine the other requirements of 13 C.F.R. § 121.103(g)").

The primary purpose of the Newly Organized Concern Rule is to prevent clearly large businesses from spinning off or forming new SBCs for the purposes of competing for Set-Aside Contracts. *Size Appeal of Coastal Management Solutions, Inc.*, SBA No. SIZ-5281, at 4 (2011) ("The purpose of the newly organized concern rule is to prevent circumvention of the Size standards by the creation of "spin-off" firms that appear to be small, independent businesses but are, in actuality, affiliates or extensions of large firms").

In general, newly organized entities are presumed to be affiliated with their forming entities. However, as with identity of interest, this presumption can be rebutted by a newly formed entity "by demonstrating a clear line of fracture between the two concerns," i.e., the forming entity and the newly formed entity. 13 C.F.R. §121.103(g).

An entity seeking to represent itself as an SBC should fully analyze the pros and cons of being formed as a spin-off or newly formed entity of another business. Newly formed entities claiming SBC status are always looked at with a high level of scrutiny by the SBA, and an SBC must ensure that a clear line of fracture exists between it and its forming entity. However, in many cases, it is simply impossible to demonstrate that such separation exists between the two entities.

E. Affiliation Based on Joint Ventures

The SBA finds affiliation between entities that are parties to a joint venture agreement where: (1) a joint venture submits a proposal for a particular procurement, so the entities of that joint venture "are affiliated with each other with regard to the performance of that contract"; or (2) a joint venture party "seeks SBA financial assistance for use in connection with the joint venture." 13 C.F.R. §121.103(h)(1). In other words, entities that compete as a joint venture will always be affiliated for purposes of the procurement for which they are competing. Therefore, joint venture parties will have to aggregate their gross annual income or their number of employees to determine whether they qualify as a SBC for a particular procurement.

However, the SBA affiliation regulations recognize several exceptions to the general joint venture affiliation rule. Specifically, joint venture partners will not be deemed affiliated when: (1) the joint venture was formed pursuant to an approved SBA mentor-protégé arrangement (pursuant to 13 C.F.R. §124.520 or 13 C.F.R. §125.9); or (2) the joint venture

is comprised of partners who are both "small under the size standard corresponding to the NAICS code assigned to the contract." 13 C.F.R. §121.103(h)(3)(i), (ii). For size status purposes, each joint venture partner must include in its total receipts its "proportionate share of joint venture receipts, and in its total number of employees its proportionate share of joint venture employees." In other words, where two joint venture partners each own 50 of the joint venture, each partner must aggregate 50 percent of the joint venture revenue or number of employees to their own entity for size purposes. 13 C.F.R. §121.103(h)(5).

While joint ventures are a prudent and common way for contractors to pool resources and compete for federal contracts, SBCs must be keenly aware that partnering in a joint venture will result in affiliation with their joint venture partners unless an exception to the joint venture affiliation rules exists.

F. Affiliation Based on the "Ostensible Subcontractor Rule"

The SBA finds affiliation between a contractor and its ostensible subcontractor based on the premise that a contractor and its ostensible subcontractor are deemed to be joint venture partners. 13 C.F.R. §121.103(h)(4).

An "ostensible subcontractor" is defined as a subcontractor that is "not a similarly situated entity" that "performs primary and vital requirements of a contract" or a subcontractor that a contractor is "unusually reliant" upon to perform a contract. 13 C.F.R. §121.103(h)(4). In order to determine if an ostensible subcontractor relationship exists, the SBA will analyze "[a]ll aspects of the relationship between the prime and subcontractor" including the following: (1) "the terms of the proposal" issued by the parties for a Set-Aside Procurement, such as "contract management, technical responsibilities, and the percentage of subcontracted work"; (2) "agreements between the prime and subcontractor," which include "bonding assistance or the teaming agreement"; and (3) "whether the subcontractor is the incumbent contractor and is ineligible to submit a proposal because it exceeds the applicable size standard for that solicitation." 13 C.F.R. §121.103(h)(4). In other words, the SBA will analyze any and all factors that indicate undue reliance between the parties, whether based on written documents, shared resources, the planned apportionment of work on a contract, and many other factors.

SBCs routinely enter into teaming agreements and/or subcontracts with key subcontractors to perform Set-Aside Contracts. These agreements allow an SBC and its subcontractors to take advantage of each other's capabilities and to pursue federal work they would otherwise not be able to compete for or perform individually. However, SBCs that enter such arrangements must take care to avoid affiliation under the ostensible subcontractor rule by becoming overly reliant on any one subcontractor. This occurs when a subcontractor is tasked with performing the "primary and vital requirements of a contract," which may include providing the major share of project management, essential equipment, or key employees. There is no bright-line test to determine when a subcontractor becomes an ostensible subcontractor based on the work or services provided. To the contrary, the SBA analyzes all aspects of the relationship between a SBC and its subcontractors to determine if an ostensible subcontractor relationship exists.

Specifically, the SBA looks at factors such as the SBC's contract proposal, the terms of any teaming agreement with the subcontractor, the apportionment of work between the parties, the skill level and capabilities of each party, the key employees and resources provided by each party, whether the SBC is the incumbent contractor on a Set-Aside Procurement, whether the subcontractor is a SBC, and other relevant factors. *Size Appeal of DoverStaffing, Inc.*, SBA No. SIZ-5300 (2011) (OHA found a SBC unduly reliant on its subcontractor (deemed ostensible subcontractor) because the SBC planned to subcontract 40 percent of its work to, and hire en masse its subcontractor's employees). In addition, the SBA may also look at any other factors it deems relevant. Whether an ostensible subcontractor relationship exists depends on the facts and circumstances of each situation. What may constitute an ostensible subcontract relationship in one set of circumstances may not constitute undue reliance based on another set of circumstances. *Size Appeal of TKTM Corp.*, SBA No. SIZ-4885 (2008) (Ostensible subcontractor relationship existed where subcontractor would perform approximately 25 percent of the Set-Aside Contract work and the SBC prime contractor would perform primarily administrative functions);

Size Appeal of Alutiiq Int'l Solutions LLC, SBA No. SIZ-5098 (2009) (Subcontractor who would perform approximately 49 percent of the contract work was not an ostensible subcontractor).

To avoid affiliation under the ostensible subcontractor rule, an SBC should ensure that: (1) its proposal-related documents, teaming agreements, and subcontracts do not, on their face, portray the existence of an ostensible subcontractor relationship; and (2) the SBC will perform the primary and vital requirements of a contract, to include providing the primary project management resources. In sum, arms-length subcontracts and teaming agreements, by themselves, are not enough to avoid ostensible subcontractor affiliation. An SBC must ensure that it and it alone provides and performs the key Set-Aside Contract requirements (the "primary and vital requirements."). 13 C.F.R. §121.103(h)(4).

G. Affiliation Based on the "Totality of the Circumstances"

The SBA may also find affiliation between an SBC and another entity based upon the "Totality of the Circumstances." 13 C.F.R. §121.103(a)(5). Affiliation may exist based on the Totality of the Circumstances even though affiliation may not exist under an independent basis of affiliation, such as common ownership, common management, identity of interest, the Newly Organized Concern Rule, the Ostensible Subcontractor Rule or another independent ground for finding affiliation. 13 C.F.R. §121.103(a)(5) (the SBA "may find affiliation even though no single factor is sufficient to constitute affiliation").

In other words, Totality of the Circumstances is a "catch-all" analysis that allows the SBA to find affiliation when no one factor by itself is conclusive, but several less relevant indicators of affiliation exist. The Totality of the Circumstances test allows the SBA to consider the entirety of the evidence introduced against an SBC during a size protest to determine if affiliation exists based on multiple factors. *Med. Comfort*, SBA No. SIZ-5640 (2015) ("Stated differently, in order to find affiliation through the totality of the circumstances, 'an area office must find facts and explain why those facts caused it to determine one concern had the power to control the other'") quoting *Size Appeal of Faison Office Prods., LLC*, SBA No. SIZ-4834 (2007)).

SBCs should seek to avoid affiliation with another entity under the Totality of the Circumstances by mitigating relationships with other entities based on common ownership, common management, identity of interest, undue reliance, co-dependence, and multiple other indicators or affiliation. Further, ties between a SBC and dormant or defunct affiliates should be severed by dissolving the affiliates before the SBC submits a bid or proposal for a Set-Aside Procurement.

VI. Conclusion

SBCs have tremendous opportunities to compete for roughly 25 percent of all federal contract work via Set-Aside Procurements. However, with the benefits of being able to compete for this set aside work also comes significant regulatory requirements that SBCs must follow. Failure to comply with these regulatory requirements can lead to the loss of SBC status, or worse, violations of the False Claims Act and other punitive statutes. Accordingly, SBCs must carefully plan and manage their businesses and business relationships.

As part of that management, SBCs must understand, be able to file, and be able to defend against SBA size protests. The two primary arguments generally raised in a size protest against a purported SBC is that the protested SBC is a Large Business based on: (1) the protested SBC's own revenue and/or own number of employees, which cause it to exceed the applicable Size Standard; and/or (2) the protested SBC's affiliation with one or more entities cause its revenue and/or number of employees to exceed the applicable Size Standard. SBCs must anticipate size protests on almost every Set-Aside Procurement, and as such, should take proactive steps to mitigate factors and affiliation relationships that may lead to it being suspected of being a Large Business.

SBA size protests can be a powerful tool for SBCs seeking to disqualify competitors from a Set-Aside Procurement, because they are relatively easy to file and will more than likely result in the SBA initiating a comprehensive size investigation of the protested SBC. Once a size investigation is initiated, you never know what the SBA may reveal about the protested SBC. Accordingly, size protests may provide SBCs with another chance at obtaining a Set-Aside Contract award if the protested entity is disqualified from the procurement as other-than-small.

On the flip side, if an SBC is the target of a size protest, the SBC must take the protest seriously and provide the SBA will all of the information requested in an effort to get the SBA to dismiss the protest. However, before any size protest is filed, SBCs should take proactive steps (as addressed in this Guide) to protect itself as much as possible from such protests. Common sense and a solid understanding of the SBA size regulations and affiliation rules will enable most SBCs to maintain their small business status for years to come.

Doug Hibshman and the attorneys at Fox Rothschild LLP routinely assist clients with understanding and applying the SBA regulations, filing and defending against SBA size protests, mitigating possible affiliation issues, and ensuring compliance with the SBA regulations. Doug can be contacted at (202) 461-3113 or DHibshman@foxrothschild.com to answer any small business questions that may arise.

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