



**Pearlman Association**

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# Small Business Set-Aside Contracts: *Implications of the Company You Keep*

September 6, 2012

Pearlman 2012

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**TLGGR**

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# Topics for Discussion

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- I. Why Understanding Bond Risks in the Federal Set-Aside Arena has Become Necessary
- II. Overview of SBA Programs and Their Administration
- III. Small Business Set Asides and the Basic Rules for Calculating Business Sizes
- IV. SBA Guidelines for Recognizing Improper Affiliations

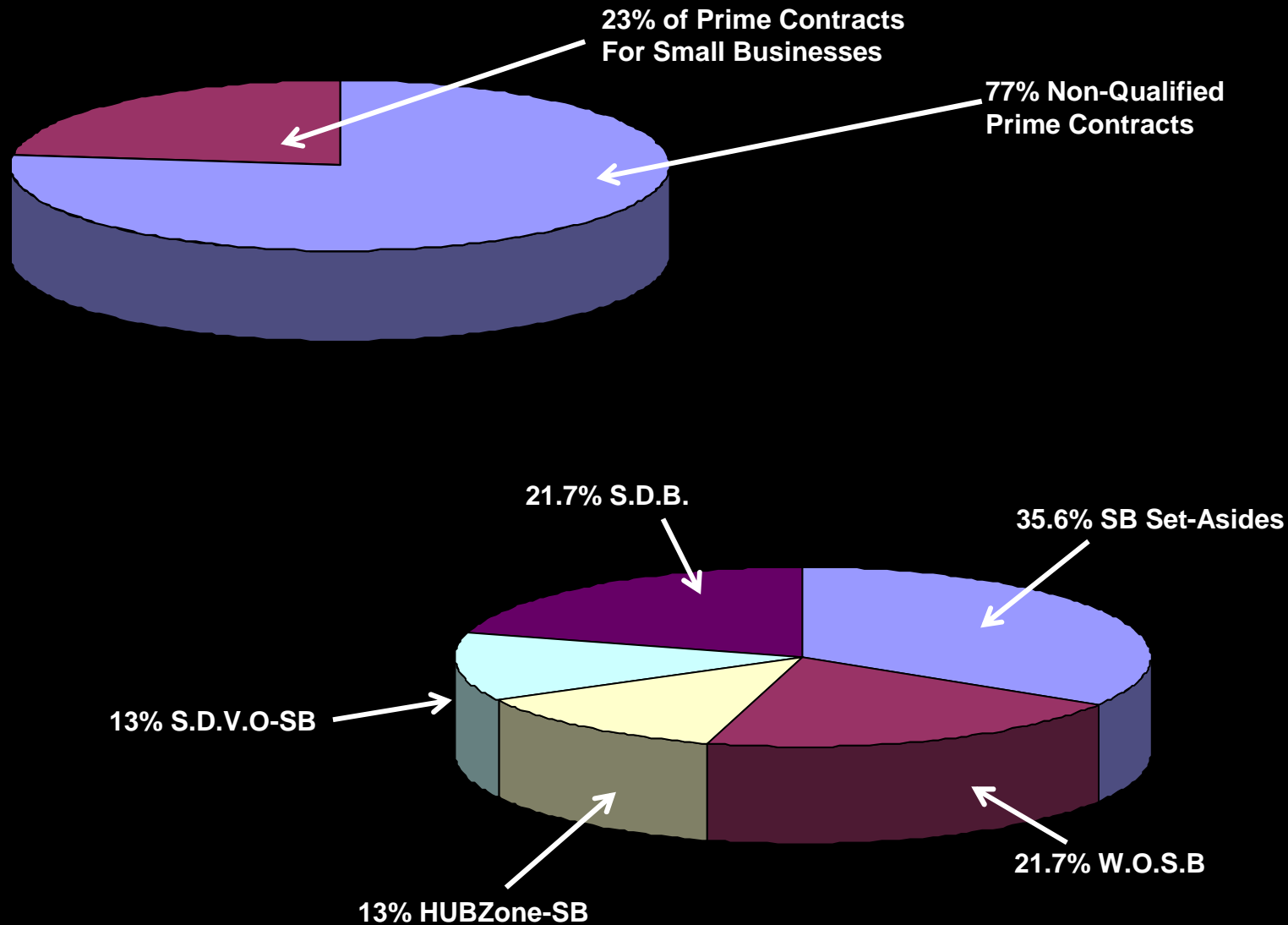
# I. Why Understanding Bond Risks in the Federal Set-Asides Arena Has Become Necessary

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**Current Market Trends + Federal Government Small Business Policy = New Players in Market**

**New Players in Market + Present Regulatory Framework/ Enforcement Policy = Increased Risk to Sureties**

# Goals for Allocating Federal Dollars



Source: SBA Website  
[www.sba.gov](http://www.sba.gov)

# Recovery Act Spending Resulted in Expanded Opportunities for Small Businesses

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- ◆ Ear-marked as \$13 billion of \$60 billion and growing



**U.S. Small Business Administration**

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**Recovery Act Report Card**

May 2010

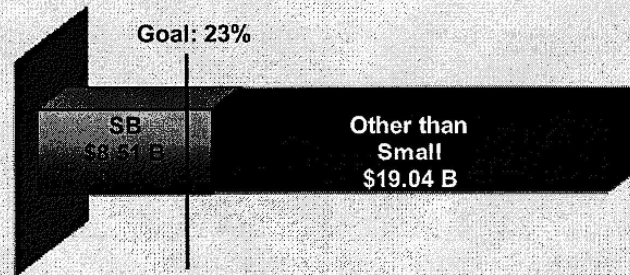


# Recovery Act contracts are getting into the hands of small and disadvantaged businesses

## ARRA contracts are getting into the hands of small businesses

- SBA is responsible for ensuring that 23% of all federal government contracts go to small businesses
- As of May, 2010, 30.89% of federal agency Recovery Act contracting dollars have gone into the hands of small businesses

### Prime Contracting to Small Businesses ARRA, May 31, 2010, % of Federal Contract Dollars

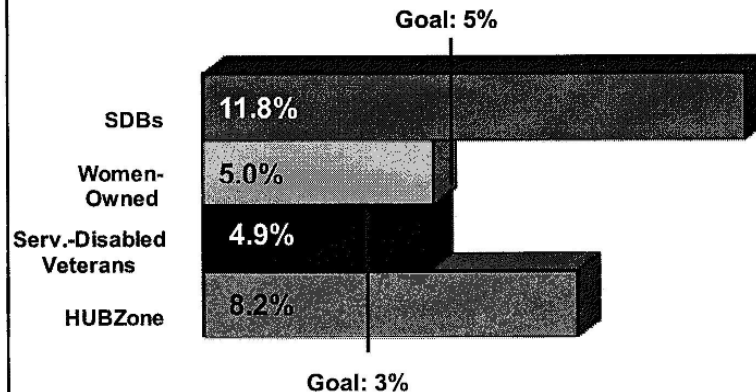


## The SBA is taking steps to support disadvantaged small businesses in government contracting

### Stakeholder Outreach Initiative

- Vice President Biden, SBA and the Department of Commerce are co-leading a Recovery Act contracting outreach initiative for small and disadvantaged businesses

### Prime Contracting to Disadvantaged Businesses ARRA, May, 2010, % of Federal Contract Dollars



NOTE: Preliminary figures. These numbers are only used by management to measure estimated progress towards government contracting goals. This data is reviewed annually at the end of the fiscal year and is corrected at that point for errors in data entry.

**GAO Investigation Finds Fraud  
and Abuse in Administering Small  
Business Set-Aside Projects**

**GAO**

United States Government Accountability Office

Testimony  
Before the Subcommittee on Contracting  
and Technology, Committee on Small  
Business, House of Representatives

For Release on Delivery  
Expected at 9:30 a.m. EDT  
Monday, May 24, 2010

**SERVICE-DISABLED  
VETERAN-OWNED SMALL  
BUSINESS PROGRAM**

**Fraud Prevention Controls  
Needed to Improve Program  
Integrity**

Statement of Gregory D. Kutz, Managing Director  
Forensic Audits and Special Investigations



GAO-10-740T

# GAO Investigation Finds Fraud and Abuse in Administering Small Business Set-Aside Projects



## Fraud Prevention Controls Needed to Improve Program Integrity

The Service-Disabled Veteran-Owned Small Business (SDVOSB) program is intended to provide federal contracting opportunities to...

GAO found a lack of government-wide prevention controls, a lack of validation of information provided by SDVOSB firms used to substantiate their eligibility for the program, non-existent monitoring of continued compliance with program requirements, and an ineffective process for investigating and

### What GAO Found

GAO found a lack of government-wide prevention controls, a lack of validation of information provided by SDVOSB firms used to substantiate their eligibility for the program, non-existent monitoring of continued compliance with program requirements, and an ineffective process for investigating and prosecuting firms found to be abusing the program.

investigation of selected SDVOSB firms.

To address these objectives, GAO reviewed prior findings from audits and investigations of the SDVOSB program and contacted investigative agency officials concerning the referrals GAO made on prior work. GAO also reviewed applicable guidance on internal control standards from the Comptroller General's *Standards for Internal Controls in the Federal Government*.

View GAO-10-7401 for key components. For more information, contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov.

Source: GAO.

GAO's prior investigation into allegations of fraud and abuse within SDVOSB contracts found 10 firms that were ineligible for the program but received approximately \$100 million in SDVOSB contracts. Upon completion of its investigation, GAO referred all 10 cases to various agency officials who had contracts with the firms, and each agency's Inspector General (IG). Based on the referrals, agencies have taken a variety of actions including the cancellation of existing contracts, termination of future contract options, and opening of civil and criminal investigations. IG officials have stated that many of their investigations are ongoing, and therefore details cannot be provided due to the risk of jeopardizing the investigation. These 10 companies have obtained over \$5 million in new SDVOSB sole-source and set-aside contact obligations since November 2009.

United States Government Accountability Office



## GAO Investigation Finds Fraud and Abuse in Administering Small Business Set-Aside Projects

### GAO Highlights

Highlights of GAO-10-740T, a testimony to the Subcommittee on Contracting and Technology, Small Business Committee, House of Representatives.

#### Why GAO Did This Study

The Service-Disabled Veteran-Owned Small Business (SDVOSB) program is intended to provide federal contracting opportunities to qualified firms. In fiscal year 2008, the Small Business Administration (SBA) reported \$6.5 billion in sole-source, set-aside, and other SDVOSB contract awards.

Testimonies GAO delivered on November 19 and December 16, 2009.

May 24, 2010

### SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM

#### Fraud Prevention Controls Needed to Improve Program Integrity

#### What GAO Found

GAO found a lack of government-wide prevention controls, a lack of validation of information provided by SDVOSB firms used to substantiate their eligibility for the program, non-existent monitoring of continued compliance with program requirements, and an ineffective process for investigating and prosecuting firms found to be abusing the program. The results of GAO's investigation serve to emphasize the overall lesson that a complete fraud prevention framework is necessary in order to minimize fraud, waste, and abuse within the SDVOSB program. The most effective and most efficient part of the framework involves the institution of rigorous controls at the beginning of the process for becoming eligible to bid on SDVOSB contracts. Next, active

GAO's prior investigation into allegations of fraud and abuse within SDVOSB contracts found 10 firms that were ineligible for the program but received approximately \$100 million in SDVOSB contracts. Upon completion of its investigation, GAO referred all 10 cases to various agency officials who had contracts with the firms, and each agency's Inspector General (IG). Based on the referrals, agencies have taken a variety of actions including the cancellation of existing contracts, termination of future contract options, and opening of civil and criminal investigations. IG officials have stated that many of their investigations are ongoing, and therefore details cannot be provided due to the risk of jeopardizing the investigation.

View GAO-10-740T or key components.  
For more information, contact Gregory D.  
Kutz at (202) 512-6722 or kutzg@gao.gov.

obligations since November 2009.

United States Government Accountability Office

**With Increased Spending  
Has Come Congressional  
Demand for Increased Oversight**



II

112TH CONGRESS  
1ST SESSION

## **S. 633**

To prevent fraud in small business contracting, and for other purposes.

IN THE SENATE OF THE UNITED STATES

MARCH 17, 2011

Ms. SNOWE (for herself, Ms. LANDRIEU, Mr. BROWN of Massachusetts, Mr. MERKLEY, and Mr. ENZI) introduced the following bill; which was read twice and referred to the Committee on Small Business and Entrepreneurship

### **A BILL**

To prevent fraud in small business contracting, and for other purposes.

**4 This Act may be cited as the “Small Business Con-**  
**5 tracting Fraud Prevention Act of 2011”.**

7 In this Act—  
8 (1) the term “8(a) program” means the pro-  
9 gram under section 8(a) of the Small Business Act  
10 (15 U.S.C. 637(a));

# The Congressional Response

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- ◆ In March 2011 the U.S. Senate Committee on Small Business and Entrepreneurship introduced the Small Contracting Fraud Prevention Act of 2011 seeking to further prevent fraud in small business contracting by:
  1. Stringent contractor certification requirements including on-line registration process (Prevention)
  2. Annual certification requirements (Detection)
  3. Increased oversight - additional certification review and annual SBA reporting requirements (Detection)
  4. Increasing damages available to government- Presumption of loss to United States based on total contract amount; potential “False Claims Act” damages (Enforcement)

## Presumed Loss

4

1

(i) by redesignating subparagraphs

the amount  
14 of the loss to the Federal Government or the damages sus-  
15 tained by the Federal Government, as applicable, shall be  
16 an amount equal to the amount that the Federal Govern-  
17 ment paid to the person that received a contract, grant,  
18 or cooperative agreement

no credit shall be applied against any loss or dam-  
16 ages to the Federal Government for the fair market value  
17 of the property or services provided to the Federal Govern8  
ment.”;

**Congress Continues to Investigate  
Fraud and Abuse in the Small  
Business Set-Aside Arena**

**EVALUATING THE U.S. DEPARTMENT OF VETERANS AFFAIRS SERVICE-DISABLED  
VETERAN-OWNED SMALL BUSINESS CERTIFICATION PROCESS**

**EVALUATING THE U.S. DEPARTMENT OF VETERANS AFFAIRS SERVICE-DISABLED  
VETERAN-OWNED SMALL BUSINESS CERTIFICATION PROCESS**

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS  
OF THE  
HEARING  
BEFORE THE  
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS  
OF THE  
COMMITTEE ON VETERANS' AFFAIRS  
U.S. HOUSE OF REPRESENTATIVES  
ONE HUNDRED TWELFTH CONGRESS  
FIRST SESSION

JULY 28, 2011

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON, DC: 2011

**In 2007, VA initiated the veterans first contracting program to increase contracting opportunities for veteran-owned small businesses. As a result, awards to veteran-owned businesses totaled about \$3.5 billion by the end of fiscal year 2010.**

The first panel is already seated. On this panel we will hear testimony from Belinda J. Finn, Assistant Inspector General for Audits and Evaluations at the VA Office of Inspector General. Ms. Finn is accompanied by James O'Neill, Assistant Inspector General for Investigations at the VA Office of Inspector General. We will also hear on this panel from Greg Kutz. Am I pronouncing that right, sir?

Mr. KUTZ. Kutz.

businesses reduce the accuracies of VA's reported socioeconomic goal accomplishments.

Thirty-eight percent of the reviewed businesses were not owned or controlled by a veteran, and over half did not meet Federal incurred cost and subcontracting thresholds. In many cases, ineligible businesses passed through the majority of the contract work requirements and funds to non-veteran-owned businesses.

**Our audit work disclosed that 76 percent of 42 randomly selected businesses were either not eligible for the program or not eligible to receive the specific contract award because they did not meet subcontracting requirements. Thirty-two businesses had received service-disabled vet-owned small business contracts.**

**We project that VA awards at least 1,400 of these contracts, valued at \$500 million annually, to ineligible businesses. This equates to a minimum of \$2.5 billion over the next 5 years.**

ACCOUNTABILITY OFFICE

STATEMENT OF BELINDA J. FINN

Ms. FINN. Thank you, sir. Chairman Johnson and Members of the Subcommittee, thank you for the opportunity to be here this morning.

Our investigative work recently resulted in the successful prosecution of the Chief Executive Officer (CEO) of a business that received set aside contracts from VA and the Department of Army. The CEO was convicted on charges of fraud against the United States, mail fraud, witness tampering, and making false statements.

To fix these problems, VA must ensure that legitimate veteran-owned businesses are receiving the contracts intended for them. VA is currently the only Federal agency that verifies the status of veteran-

**The OIG's Office of Investigations is aggressively pursuing allegations that ineligible businesses are misrepresenting themselves as veteran-owned to win contracts.**

**As of July 2011, we have opened 91 investigations, issued 268 subpoenas, and executed 19 search warrants.**

**Express Certification  
Supplemented by  
Deemed Certification**

1        tentional certifications of small business size and  
2        status:

3                “(A) Submission of a bid or proposal for a  
4                Federal grant, contract, subcontract, coopera-  
5                tive agreement, or cooperative research and de-  
6                velopment agreement reserved, set aside, or oth-  
7                erwise classified as intended for award to small  
8                business concerns.

9                “(B) Submission of a bid or proposal for  
10               a Federal grant, contract, subcontract, coopera-  
11               tive agreement, or cooperative research and de-  
12               velopment agreement which in any way encour-  
13               ages a Federal agency to classify the bid or pro-  
14               posal, if awarded, as an award to a small busi-  
15               ness concern.

16               “(C) Registration on any Federal elec-  
17               tronic database for the purpose of being consid-  
18               ered for award of a Federal grant, contract,  
19               subcontract, cooperative agreement, or coopera-

**“(3) CERTIFICATION BY SIGNATURE OF RE-  
SPONSIBLE OFFICIAL.—**

25               or application for a Federal contract, sub-

**Express Certification  
Supplemented by  
Deemed Certification**

21

1 contract, or grant shall contain a certification  
2 concerning the small business size and status of

**“(B) CONTENT OF CERTIFICATIONS.—A certification that a business concern qualifies as a small business concern of the exact size and status claimed by the business concern for purposes of bidding on a Federal contract or sub-contract, or applying for a Federal grant, shall contain the signature of a director, officer, or counsel on the same page on which the certification is contained.**



## Express Certification Supplemented by Deemed Certification

19

1 (1) shall take effect on the  
2 of this Act; and

3 (2) apply to the first full fis  
4 date of enactment of this Act.

### 5 **TITLE IV—SMALL BUSI** 6 **AND STATUS INTE**

#### 7 **SEC. 401. POLICY AND PRESUMPTIONS.**

8 Section 3 of the Small Business A  
9 is amended by adding at the end the foll

10 “(t) PRESUMPTION.—

11 “(1) IN GENERAL.—In eve  
12 contract, cooperative agreement  
13 search and development agreeme  
14 is set aside, reserved, or otherwis  
15 tended for award to small busine

16 shall be a presumption of loss to  
17 based on the total amount expend  
18 subcontract, cooperative agreeme  
19 search and development agreeme  
20 ever it is established that a busi  
21 than a small business concern w  
22 received the award by misrepresent

23 “(2) DEEMED CERTIFICATIO  
24 actions shall be deemed affirmati

•S 2989 IS

23 “(2) DEEMED CERTIFICATIONS.—The following  
24 actions shall be deemed affirmative, willful, and in-

3 “(A) Submission of a bid or proposal for a  
4 Federal grant, contract, subcontract, coopera-  
5 tive agreement, or cooperative research and de-  
6 velopment agreement reserved, set aside, or oth-  
7 erwise classified as intended for award to small  
8 business concerns.

9 “(B) Submission of a bid or proposal for  
10 a Federal grant, contract, subcontract, coopera-  
11 tive agreement, or cooperative research and de-  
12 velopment agreement which in any way encour-  
13 ages a Federal agency to classify the bid or pro-  
14 posal, if awarded, as an award to a small busi-  
15 ness concern.

16 “(C) Registration on any Federal elec-  
17 tronic database for the purpose of being consid-  
18 ered for award of a Federal grant, contract,  
19 subcontract, cooperative agreement, or coopera-  
20 tive research agreement, as a small business  
21 concern.

## Enforcement Training and Prosecution

23

1 shall be determined at the time of the award of a  
2 Federal—  
3 “(A) contract, except that, in the case of  
4 interagency multiple award contracts (as de-  
5 fined in section 44), small business size or sta-

(a) IN GENERAL.—Not later than 1 year after the date of enactment of this Act, the Federal Acquisition Institute, in consultation with the Administrator for Federal Procurement Policy, shall develop courses concerning proper classification of business concerns and small business size and status for purposes of Federal contracts, subcontracts, grants, cooperative agreements, and cooperative research and development agreements.

vs 2009 15

## Enforcement Training and Prosecution

24

1 (b) POLICY ON PROSECUTIONS OF SMALL BUSINESS  
2 SIZE AND STATUS FRAUD.—Section 3 of the Small Busi-  
3 ness Act (15 U.S.C. 632), as amended by this Act, is

“(v) POLICY ON PROSECUTIONS OF SMALL BUSINESS  
SIZE AND STATUS FRAUD.—Not later than 1 year after  
the date of enactment of this subsection, the head of each  
relevant Federal agency and the Inspector General of the  
Administration shall issue a Government-wide policy on  
prosecution of small business size and status fraud.”.

22 (v) make publicly available information re-  
23 garding—  
24 (A) the factors evaluated as part of the re-  
25 view conducted under paragraph (1); and

•S 2009 15

# What are the Surety Risks?

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- ◆ Direct (to Surety)
  - Default termination on bonded set aside project
- ◆ Indirect (to Account)
  - Debarment
  - Forfeiture of affirmative claims
  - Civil/criminal penalties

# Topics for Discussion

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- I. Why Understanding Bond Risks in the Federal Set-Aside Arena has Become Necessary
- II. Overview of SBA Programs and Their Administration
- III. Small Business Set Asides and the Basic Rules for Calculating Business Sizes
- IV. SBA Guidelines for Recognizing Improper Affiliations

## II. Overview of SBA Programs and Their Administration

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- ◆ 8(a) Business Development – Minority Small Business Development (8(a) BD)
- ◆ Historically Underutilized Business Zone Program (HUBZone)
- ◆ Small Disadvantage Business (SDB)
- ◆ Service-Disabled Veteran Owned Small Businesses (SDVOSB)
- ◆ Women-Owned Small Business (WOSB)

## 8(a) BD Program Basics

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- ◆ Small Business unconditionally owned (51%) and controlled by one or more socially and economically disadvantaged individuals
  - Subject to racial or ethnic prejudice due to circumstances beyond their control
  - Ability to compete has been impaired due to diminished capital and credit opportunities compared to others in same or similar line of business
- ◆ Good character
- ◆ Citizens of the United States
- ◆ Demonstrate potential for success

## 8(a) BD Program Basics

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- ◆ Interested business files application with the SBA certifying that it is a small business under the applicable size standard
- ◆ 8(a) Program personnel will verify qualifications prior to award of a contract
- ◆ SBA involvement in award of the contract
  - May sign primary contract with procuring agency and subcontract with program participant
  - Or may delegate authority to procuring agency to enter into contract directly with program participant



# HUBZone Program Basics

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- ◆ Principal office must be located within a designated historically underutilized business zone
- ◆ 35% of the business' employees must reside in the HUBZone
- ◆ Represent that the business will maintain 35% employee residence throughout the duration of the contract

# HUBZone Program Basics

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- ◆ Apply to the SBA for certification
- ◆ Must be small within the applicable size standard for the industry
- ◆ Important subcontracting guidelines for the HUBZone participant
  - Required to spend at least 50% of labor costs on its own employees
  - May subcontract 35% of the cost of the contract to other HUBZone participants
  - May not subcontract more than 50% to non-qualified HUBZone small businesses

13 CFR §§ 126.100-126.900

# Small Disadvantaged Business Basics

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- ◆ Participants in 8(a) BD Program automatically eligible
- ◆ 8(a) criteria apply to determine whether a firm qualifies as a SDB except demonstrating the potential for success is not required
- ◆ Receive certification from the procuring agency

# Service Disabled Veteran Owned Small Business (SD VOSB) Basics

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- ◆ At least 51% unconditionally and directly owned by one or more service-disabled veterans
- ◆ Management and daily operations must be controlled by one or more service-disabled veterans
- ◆ Contractor self-certification
  - It is a SDVOSB
  - It is small under the applicable size standard
  - Will meet the percentage of work requirements

# Women-Owned Small Businesses Economically Disadvantaged Women-Owned Businesses (EDWOSB)

- ◆ One or more women unconditionally and directly own at least 51% of the business
- ◆ Management and daily operations controlled by one or more women
- ◆ EDWOSB
  - Economically disadvantaged plus limitation on net worth – 750K in assets (excluding ownership of the business and primary residence)
- ◆ Contractor self-certification
  - Verified by third-party entity

13 CFR §§ 127.100-127.700

# Self-Performance Requirements for SBA-Managed Programs - *Construction*

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- ◆ 8(a) – perform 15% of the cost of the contract (excluding materials) with its own employees
- ◆ SDVOSBC – spend 15% of labor costs on own employees or another SDVOSBC
- ◆ HUBZone – spend 15% of labor costs with own employees
- ◆ WOSB/EDWOSB – spend 15% of the cost of the contract (excluding materials) with its own employees

# Topics for Discussion

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- I. Why Understanding Bond Risks in the Federal Set-Aside Arena has Become Necessary
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- IV. SBA Guidelines for Recognizing Improper Affiliations

**SOLICITATION, OFFER, AND AWARD**  
(Construction, Alteration, or Repair)

1. Solicitation No. SB1341-10-RP-0060	2. Type of Solicitation <input type="checkbox"/> Sealed Bid (IFB) <input checked="" type="checkbox"/> Negotiated (RFP)	3. Date Issued May 24, 2010	Page of Pages 1 of 52
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must be fully completed by offeror.

5. Requisition/Purchase Request No. NB190000-A-04802	6. Project No.
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7. Issued By NATIONAL INST OF STDS AND TECHNOLOGY 100 BUREAU DRIVE STOP 1640 BUILDING 301 ROOM B125 GAITHERSBURG, MD 20899-1640	Code 000SB	8. Address Offer to NATIONAL INST OF STDS AND TECHNOLOGY 100 BUREAU DRIVE STOP 1640 BUILDING 301 ROOM B125 GAITHERSBURG, MD 20899-1640	Code 000SB
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9. For Information Call: A. Name JOAN SMITH (ID 015)	B. Telephone No. (Include area code) (No Collect Calls) 301-975-6458 SMITHJO@MAIL.NIST.GOV
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**SOLICITATION**

NOTE: In sealed bid solicitation "offer" and "offeror" mean "bid" and "bidder"

10. THE GOVERNMENT REQUIRES PERFORMANCE OF THE WORK DESCRIBED IN THESE DOCUMENTS: (Title, Identifying No., Date)

THE CONTRACTOR SHALL PROVIDE ALL SUPERVISION, LABOR, EQUIPMENT, AND MATERIAL TO PERFORM INFRASTRUCTURE UPGRADES TO SUPPORT THE NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY (NIST) CENTER FOR NEUTRON RESEARCH (NCNR), LOCATED AT THE NIST, GAITHERSBURG, MARYLAND CAMPUS.

THE MAGNITUDE OF CONSTRUCTION IS MORE THAN \$10,000,000.

THE REQUIREMENT IS 100% FUNDED BY THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009.

**THIS REQUIREMENT IS A 100% COMPETITIVE 8(A) SET-ASIDE WITH A NAICS CODE OF 236220 AND INCLUDES A SMALL BUSINESS STANDARD OF \$33.5M.**

11. The Contractor shall begin performance within 10 calendar days and complete it within 455 calendar days after receiving the  award,  notice to proceed. This performance period is  mandatory  negotiable. (See Section F, Clause F.3.)

12A. The Contractor must furnish any required performance and payment bonds? (If "YES", indicate within how many calendar days after award in item 12B.) <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	12B. Calendar Days 10
--	--------------------------

13. Additional Solicitation Requirements:
- A. Sealed offers in original and 3 copies to perform the work required are due at the place specified in Item 8 by 03:00 PM (hour) local time Jun 25, 2010 (date). If this is a sealed bid solicitation, offers must be publicly opened at that time. Sealed envelopes containing offers shall be marked to show the offeror's name and address, the solicitation number, and the date and time offers are due.
  - B. An offer guarantee  is  is not required.
  - C. All offers are subject to the (1) work requirements, and (2) other provisions and clauses incorporated in the solicitation in full text or by reference.
  - D. Offers providing less than 90 calendar days for Government acceptance after the date offers are due will not be considered and will be rejected.





**U. S. Small Business Administration**  
**Table of Small Business Size Standards**  
**Matched to**  
**North American Industry Classification System Codes**

**North American Industry Classification System Codes**

This table lists small business size standards matched to industries described in the North American Industry Classification System (NAICS), as modified by the Office of Management and Budget in 2007. The latest NAICS codes are referred to as NAICS 2007.

The size standards are for the most part expressed in either millions of dollars (those

**For the most part, size standards are the average annual receipts or the average employment of a firm. How to calculate average annual receipts and average employment of a firm can be found in 13 CFR § 121.104 and 13 CFR § 121.106, respectively.**

publication of 13 CFR 121.

For more information on these size standards, please visit <http://www.sba.gov/size>.

If you have any other questions concerning size standards, contact a Size Specialist at your nearest SBA Government Contracting Area Office (list at the end of the table), or contact the Office of Size Standards by email at [sizestandards@sba.gov](mailto:sizestandards@sba.gov) or by phone at (202) 205-6618.

*Effective August 22, 2008*

NAICS Codes	NAICS U.S. industry title	Size standards in millions of dollars	Size standards in number of employees
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111110	Soybean Farming	\$0.75	
111120	Oilseed (except Soybean) Farming	\$0.75	
111130	Dry Pea and Bean Farming	\$0.75	
111140	Wheat Farming	\$0.75	
111150	Corn Farming	\$0.75	
111160	Rice Farming	\$0.75	
111191	Oilseed and Grain Combination Farming	\$0.75	
111199	All Other Grain Farming	\$0.75	
111211	Potato Farming	\$0.75	
111219	Other Vegetable (except Potato) and Melon Farming	\$0.75	
111310	Orange Groves	\$0.75	
111320	Citrus (except Orange) Groves	\$0.75	
111331	Apple Orchards	\$0.75	
111332	Grape Vineyards	\$0.75	
111333	Strawberry Farming	\$0.75	
111334	Berry (except Strawberry) Farming	\$0.75	
111335	Tree Nut Farming	\$0.75	
111336	Fruit and Tree Nut Combination Farming	\$0.75	
111339	Other Noncitrus Fruit Farming	\$0.75	
111411	Mushroom Production	\$0.75	
111419	Other Food Crops Grown Under Cover	\$0.75	
111421	Nursery and Tree Production	\$0.75	
111422	Floriculture Production	\$0.75	
111910	Tobacco Farming	\$0.75	
111920	Cotton Farming	\$0.75	
111930	Sugarcane Farming	\$0.75	
111940	Hay Farming	\$0.75	
111991	Sugar Beet Farming	\$0.75	
111992	Peanut Farming	\$0.75	
111998	All Other Miscellaneous Crop Farming	\$0.75	
<b>Subsector 112 – Animal Production</b>			
112111	Beef Cattle Ranching and Farming	\$0.75	

221112	Fossil Fuel Electric Power Generation	See Footnote 1	
221113	Nuclear Electric Power Generation	See Footnote 1	
221119	Other Electric Power Generation	See Footnote 1	
221121	Electric Bulk Power Transmission and Control	See Footnote 1	
221122	Electric Power Distribution	See Footnote 1	
221210	Natural Gas Distribution		500
221310	Water Supply and Irrigation Systems	\$7.0	
221320	Sewage Treatment Facilities	\$7.0	
221330	Steam and Air-Conditioning Supply	\$12.5	

**Sector 23 – Construction**

**Subsector 236 – Construction of Buildings**

236115	New Single-Family Housing Construction (except Operative Builders)	\$33.5	
236116	New Multifamily Housing Construction (except Operative Builders)	\$33.5	
236117	New Housing Operative Builders	\$33.5	

<b>238120</b>	<b>Structural Steel and Precast Concrete Contractors</b>	<b>\$14.0</b>
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237220	Commercial and Institutional Building Construction	\$33.5	
<b>Subsector 237 – Heavy and Civil Engineering Construction</b>			
237110	Water and Sewer Line and Related Structures Construction	\$33.5	
237120	Oil and Gas Pipeline and Related Structures Construction	\$33.5	

<b>237310</b>	<b>Highway, Street, and Bridge Construction</b>	<b>\$33.5</b>
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<b>237990</b>	<b>Other Heavy and Civil Engineering Construction</b>	<b>\$33.5</b>
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**Subsector 238 – Specialty Trade Contractors**

<b>236210</b>	<b>Industrial Building Construction</b>	<b>\$33.5</b>
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238140	Masonry Contractors	\$14.0	
238150	Glass and Glazing Contractors	\$14.0	
238160	Roofing Contractors	\$14.0	

# Calculating Average Annual Receipts for SBA Size Determination

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- ◆ Receipts = total income + cost of goods sold
- ◆ Receipts do not include:
  - Capital gains or losses
  - Taxes collected or remitted
  - Proceeds from transactions with affiliated entities
- ◆ Period of measurement
  - In business for more than 3 years – 3 most recent years divided by 3
  - In business for less than 3 years – total receipts during period of business divided by number of weeks in business, multiplied by 52

# Calculating Average Number of Employees for SBA Size Determination

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- ◆ All employees = full time + part-time + any other basis
- ◆ Consider totality of the circumstances to determine whether individuals are employees
- ◆ Period of measurement
  - Number of employees for each of the pay periods for the preceding completed 12 calendar months

# Topics for Discussion

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- I. Why Understanding Bond Risks in the Federal Set-Aside Arena has Become Necessary
- II. Overview of SBA Programs and Their Administration
- III. Small Business Set Asides and the Basic Rules for Calculating Business Sizes
- IV. **SBA Guidelines for Recognizing Improper Affiliations**

# The Process for Resolving Challenges to Size Qualifications for Eligibility

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- ◆ Challenge can be initiated by the SBA or by referral to the SBA by government procurement officer or aggrieved bidder/prospective bidder
- ◆ After challenge is initiated, investigation is performed by SBA area office
- ◆ Party aggrieved by SBA size determination can appeal to United States Small Business Administration Office of Hearings and Appeals (“OHA”)
- ◆ A party may then seek judicial review of the OHA decision in the Federal Courts under the Administrative Procedure Act
  - Reviewed under the deferential arbitrary and capricious standard

# Affiliation

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- ◆ Central question in SBA size determination is often whether an entity being measured is properly considered *individually* or *in combination with other entities*



# Affiliation

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## ◆ Affiliation Defined

- An affiliation exists when an entity controls or has the power to control the other, or a third party or parties controls or has the power to control both

# Consequences of an Affiliation Finding

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- ◆ The combined size of the SBC and its affiliates determine whether the SBC falls within the size classification for a project
  - Example: Project set-aside for businesses with \$10 million or less in annual revenue
    - SBC with \$8 million in revenue for FY2009 = Eligible
    - SBC with \$8 million in revenue but affiliated with entity with \$5 million in revenue for FY2009 = Ineligible

# Consequences of an Affiliation Finding

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- ◆ At the time of bidding, contractors must represent their status as an eligible small business or a participant in an SBA program
- ◆ Obtaining a small business set-aside by fraud or misrepresentation may result in Inspector General investigations, termination, debarment, suspension, criminal or civil penalties [See, e.g., 15 U.S.C § 645]

→ 19.301-1 Representation by the offeror.

Code of Federal Regulations Currentness  
Title 48, Federal Acquisition Regulations System  
Chapter 1, Federal Acquisition Regulation  
Subchapter D, Socioeconomic Programs  
Part 19, Small Business Programs (Refs & Annos)  
§ 19.301-1 Subpart 19.3, Determination of Small Business Status for Small Business Programs (Refs & Annos)

(d) If the SBA determines that the status of a concern as a small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, or women-owned small business has been misrepresented in order to obtain a set-aside contract, an 8(a) subcontract, a subcontract that is to be included as part or all of a goal contained in a subcontracting plan, or a prime or subcontract to be awarded as a

(a) To be eligible for award as a small business, an offeror must represent in good faith that it is a small business at the time of its written representation.

~~concern in connection with a specific solicitation if it~~  
meets the definition of a small business concern applicable to the solicitation and has not been determined to be a Small Business Administration (SBA)

[55 FR 3882, Feb. 5, 1990; 60 FR 48261, Sept. 18, 1995; 62 FR 236, Jan. 2, 1997; 63 FR 70268, Dec. 18, 1998; 64 FR 61831, Nov. 24, 1999; 65 FR 46645

(b) The contracting officer shall accept an offeror's representation in a specific bid or proposal that it is a small business unless (1) another offeror or interested party challenges the concern's small business representation or (2) the contracting officer has a reason to question the representation.

→ **52.219-1 Small Business Program Representations.**

Subpart 52.2. Texts of Provisions and Clauses

→ **52.219-1 Small Business Program Representations.**

As prescribed in 19.308(a)(1), insert the following provision:

(3) (Complete only if the offeror represented itself as a small business concern in paragraph (b)(1) of this provision.) The offeror represents as part of its offer that it [ ] is, [ ] is not a veteran-owned small business concern.

(4) (Complete only if the offeror represented itself as a veteran-owned small business concern in paragraph (b)(1) of this provision.) The offeror represents as part of its offer that it [ ] is, [ ] is not a service-disabled veteran-owned small business concern.

(5) [Complete only if the offeror represented itself as a veteran-owned small business concern in paragraph (b)(4) of this provision.] The offeror represents as part of its offer that it [ ] is, [ ] is not a service-disabled veteran-owned small business concern.

(6) [Complete only if the offeror represented itself as

**(b) Representations. (1) The offeror represents as part of its offer that it [ ] is, [ ] is not a small business concern.**

**(2) (Complete only if the offeror represented itself as a small business concern in paragraph (b)(1) of this provision.) The offeror represents, for general statistical purposes, that it [ ] is, [ ] is not, a small disadvantaged business concern as defined in 13 CFR 124.1002.**

(3) (Complete only if the offeror represented itself as a small business concern in paragraph (b)(1) of this provision.) The offeror represents as part of its offer that it  is,  is not a women-owned small business concern.

(4) [Complete only if the offeror represented itself as a small business concern in paragraph (b)(1) of this provision.] The offeror represents as part of its offer that it  is,  is not a veteran-owned small business concern.

(5) [Complete only if the offeror represented itself as a veteran-owned small business concern in paragraph (b)(4) of this provision.] The offeror represents as part of its offer that it  is,  is not a service-disabled veteran-owned small business concern.

c

Effective: March 23, 2005

(3) (Complete only if the offeror represented itself as a small business concern in paragraph (b)(1) of this provision.) The offeror represents as part of its offer that it [ ] is, [ ] is not a women-owned small business concern

(i) It [ ] is, [ ] is not a HUBZone small business concern listed, on the date of this representation, on the List of Qualified HUBZone Small Business Concerns maintained by the Small Business Administration, and no material change in ownership and control, principal office, or HUBZone employee percentage has occurred since it was certified by the Small Business Administration in accordance with 13 CFR part 126; and

near purposes, that it [ ] is, [ ] is not, a small business concern as defined in 13 CFR 124.1002.

(c) Definitions. As used in this provision--

# Factors to Weigh When Making an Affiliation Finding

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- ◆ The SBA considers
  - Ownership Interest
  
  - Management Control
    - Newly Organized Concern Rule
  
  - Employee and Family Ties
  
  - Contractual Agreements (i.e. Teaming Agreements, Joint Venture Agreements)
    - Ostensible Subcontractor Rule



## Affiliation Determination – *Not Necessarily a Bright Line Determination*

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- ◆ Totality of the circumstances analysis  
(weighted averaging of several factors)
- ◆ The SBA may find an affiliation even though no single factor, by itself, would constitute an affiliation
- ◆ Particularly fact-intensive and may produce different results on a case-by-case basis

13 CFR § 121.103(a)(5)

# Threshold Inquiries – *Exceptions from an Affiliation Finding*

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- ◆ Businesses will not be considered affiliated *solely on the basis* of the following characteristics:
  - Businesses owned by investment / development companies qualified under the Small Business Investment Act
  - Businesses owned and controlled by Indian tribes, Alaskan Native Corporations, Native Hawaiian Organizations
  - Businesses part of an SBA-approved pool for a joint program of research and development
  - Businesses which lease employees from a common organization

## Threshold Inquiries – *Exceptions from an Affiliation Finding (cont'd)*

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- ◆ Businesses will not be considered affiliated *solely on the basis* of the following characteristics
  - Participation in ERISA plans, charitable trusts and foundations
  - Firms participating in the Federal Mentor / Protégé Program
  - Member shareholders of a small agricultural cooperative

## Indicia of Affiliation – *Ownership Interest / Management Control*

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- ◆ Owning a majority of stock
- ◆ Power to control a majority of voting stock
- ◆ Own or control a combination of minority voting blocks
- ◆ Owning future stock interests
- ◆ Sharing officers, directors, managing members or partners
- ◆ Profit-Sharing Agreements

# Indicia of Affiliation – *Family Ties*

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## ◆ Undue Family Influence

### ■ Identity of Interest Rule

- Rebuttable presumption that family members have identical interests and will be treated as affiliates
  - May be rebutted by evidence showing that the family members are estranged or that they have independent economic interests

### ➔ Key Point:

The rebuttable presumption that family members have identical interests arises from the family relationship itself, not from the members involvement with each other's business transactions.  
Gallagher Transfer & Storage Co., SBA No. SIZ-4295 (1998)

# Indicia of Affiliation – *Employee Ties*

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## ◆ Former Key Employee Influence

- Newly Organized Concern Rule – when former officers, directors, principal stockholders, managing members or other “key employees” form new business and receive assistance from former employer there is a rebuttable presumption that entities are affiliates
  - May be rebutted by demonstrating “a clear line of fracture” between the two entities

### → Key Point:

Prevents large businesses from creating “spin off” firms which appear to be small and independent, but are, in fact, an extension of the large business [Field Support Services Inc., SBA No. 4176 (1996)]

13 CFR § 121.103(g)

## Indicia of Affiliation – *Contractual Agreements*

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- ◆ Joint Venture Agreements necessitate combining the size of each entity comprising the joint venture for a size determination unless special exceptions are met:
  - Mentor / Protégé relationship
  - Two small businesses bidding upon:
    - “Bundled” small procurements made into a single, larger contract
    - A contract with an employee-based sized standard and the dollar value is greater than \$10 million
    - A contract with a receipts-based size standard in which the dollar value of the contract exceeds one-half of the assigned NAICS size standard

## Indicia of Affiliation – *Contractual Agreements*

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- ◆ Special exceptions to combining size of joint ventures (cont'd)
  - A joint venture of an 8(a) participant and another small business bidding upon an 8(a) contract when:
    - At least one 8(a) participant is less than one-half of the SIC code assigned to the contract; and
    - For contract with revenue-based size standard, the contract exceeds the size standard; or
    - For a contract with an employee-based size standard, the contract is greater than \$10 million



# JV Affiliation Exceptions (8(a) Joint Ventures)

- ◆ New Performance of the Work Requirements as of February 2011
  - The prior regulation required an 8(a) to perform “a significant portion of the contract”
  - Current regulations require the 8(a) to perform 40% of the work performed by the JV:
    - The 8(a) must do more than administrative functions
    - Unpopulated Joint Venturers - when both the 8(a) and non-8(a) partners are technically subcontractors, the amount of work performed by the partners will be aggregated and the work by the 8(a) must be at least 40% of the work done by all partners
    - Populated Joint Venturers - the non-8(a) JV partner, or any affiliates, may not be a subcontractor to the JV, unless approved by the SBA
- ◆ New Annual Reporting Requirement
  - The 8(a) partner must report annually to the SBA how the performance of the work threshold is being met for each contract

## Indicia of Affiliation – *The Ostensible Subcontractor*

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- ◆ An affiliation is found under the ostensible subcontractor doctrine when a small business is in essence, performing as a subcontractor to a large business that is nominally a subcontractor on the project
- ◆ The small business general contractor is therefore “unusually reliant” on the large subcontractor

## Indicia of Affiliation – *The Ostensible Subcontractor*

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- ◆ The large subcontractor performs “primary and vital” requirements of the contract
  - Contract management
  - Technical responsibilities
  - Large percentage of actual labor
  - Teaming Agreements
  - Financial and bonding assistance
  - Large subcontractor is the incumbent contractor

## Indicia of Affiliation – *The Ostensible Subcontractor*

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- ◆ An Ostensible Subcontractor affiliation may be found during contract performance
- ◆ A new regulation closed a “loophole” in which a small business contractor could submit an offer proposing that it will perform primary and vital portions of the contract and then subcontract the entire contract after award
- ◆ Now, a contractor no longer may annually certify it is a small business when a subcontractor assumes primary and vital tasks during contract performance

# Indicia of Affiliation – *The Ostensible Subcontractor – A Focus on Teaming Agreements*

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- ◆ Defined in the Federal Acquisition Regulations (FAR) as a potential prime contractor agreeing with one or more other companies for them to act as a subcontractor under a Government contract
- ◆ The FAR recognizes teaming arrangements may offer the best combination of performance, cost and delivery
- ◆ The Government will accept the validity of teaming arrangements provided they are fully and timely disclosed

# Mentor / Protégé – *The Basics*

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- ◆ A feature of the 8(a) Program
- ◆ Purpose
  - Enhance the capabilities of the protégé and improve its ability to compete
- ◆ Mentor may provide many forms of assistance:
  - Technical
  - Management
  - Financial – equity or loans
  - Subcontracts
  - Performing prime contract work in the joint venture

# Mentor / Protégé – *The Basics*

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## ◆ To be a Mentor

- Financially stable
- Good character
- Not on debarred or suspended list
- Able to impart knowledge and experience to the protégé

# Mentor / Protégé – *The Basics*

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- ◆ To be a Protégé
  - In the developmental stage of the 8(a) Program
  - Have never been awarded a contract set aside for an 8(a) Program participant
  - Less than one-half of the size standard corresponding to its SIC code
  - In good standing within the program
- ◆ Generally, can only be involved in one mentor / protégé relationship at a time



# Mentor / Protégé – *The Basics*

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- ◆ No affiliation due to the mentor / protégé agreement or assistance provided
  - Must enter into written agreement subject to SBA review
  - Relationship will be annually reviewed by the SBA

# JV Affiliation Exceptions

## *(Mentor / Protégé Joint Ventures)*

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- ◆ New annual reporting requirements
  - Protégé must report to the SBA on the mentor's assistance each program year
  - Annual certification whether any changes to the agreement
  
- ◆ New consequences of the mentor not providing the stated plan of assistance
  - Termination of the mentor / protégé relationship
  - Firm will be ineligible to mentor for two years
  - SBA may recommend the procuring agency issue stop work order for each mentor / protégé JV contract
  - SBA may consider failure to be a basis for debarment

13 CFR § 124.520(H)

## Weighing the Surety's Risks – Other Consequences

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- ◆ Has there been a SBA certification approval?
- ◆ Has the small business entity provided the Government with documentation defining its relationship with the large entity?
- ◆ Is the relationship between the small business entity and the large entity an approved relationship, i.e. Mentor/Protégé?

## Weighing the Risks – *Other Consequences*

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- ◆ Will the rights and obligations of the “small business” entity be enforceable if the entity was actually ineligible for the set-aside contract?
  - Recent decision held that an affiliated large subcontractor could not enforce provisions of its agreement with a small business who obtained a set-aside contract in violation of the SBA Regulations Morris-Griffin Corp. v. C&L Serv. Corp., 731 F.Supp. 2d 488 (E.D. Va. 2010) order vacated (Dec. 7, 2011).
  
- ◆ Potential implications for sureties

# Question / Comments

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