SMALL BUSINESS AFFILIATION RULES

Teaming Agreements and Size Protests
McMahon, Welch and Learned, PLLC represents many small and mid-sized federal services contractors in Northern Virginia, DC and Maryland, including small-disadvantaged firms, veteran-owned firms, women-owned firms and Hub Zone qualified firms. We also have a strong corporate and acquisitions-support practice which focuses on general business legal matters of significant interest to the broader business community.
J. Patrick McMahon, Partner

Mr. McMahon has nearly thirty years of experience with a primary focus on representation of companies that offer information technology products and services to the federal government. Mr. McMahon advises corporations and other business entities in connection with all aspects of their federal procurement business including contract award and terminations, claims, contract disputes, bid protests, and prime contractor/subcontractor relationships.
William T. Welch, Partner

Mr. Welch has twenty years of experience providing legal counsel for the entire lifecycle of a government contractor from contract negotiation, award, and protests to contract administration and contract claims. Mr. Welch also has experience in teaming agreements, subcontractor agreements, and related issues. In addition, Mr. Welch advises contractors who qualify for small business set-aside awards, 8(a) competitive and non-competitive contracts, and HUBZone and Service-Disabled, Veteran Owned contracts.
Kevin R. Learned, Partner

Mr. Learned’s practice focuses on advising clients on general corporate and securities matters, including company formation and governance, buy-sell agreements, operating and stockholder agreements, mergers and acquisitions, private offerings of debt and equity securities (including friends and family, angel, venture capital and private equity investments), corporate divorces and other reorganizations, joint ventures, small business certifications (including 8(a), SDVO, WOSB, HUB Zone and MBE/DBE certifications), executive employment and equity matters, deferred compensation plans, franchise agreements, trademarks, and other commercial contracts and agreements.
Small Business Affiliation Rules
Why Size is Important

Small Business Set-Asides

- Procurements can be set-aside for small business competition.

- Company size must not exceed the size standard set for the procurement.
Why Size is Important

**NAICS Codes** *(North American Industry Classification System)*

- A code is assigned by industry and/or products/services to be provided to almost all federal solicitations, procurements or RFPs.
- Each NAICS code is associated with a size standard that has been set by the SBA.
How Does SBA Determine Size?

Size Standards

- Personnel/Staff –
  - NAICS Code 517110, Wired Telecommunications Carriers, has a size standard of 1500 employees.

- Receipts/Total Receipts – Includes “total income” from whatever sources, including pass-through income.
  - NAICS Code 541930, Translation and Interpretation Services, has a size standard expressed in terms of dollars – $7 million.
  - NAICS Code 541511, Custom Computer Programming Services, has a size standard of $25.5 million.
How Does SBA Determine Size?

Period of Measurement

- If you have been in business for at least three years, SBA will look at your total receipts for the most recently completed three fiscal years, divided by three.

- Modified rules if you have been in business for less than three years or if one of your years is a short year.
How Does SBA Determine Size?

Self-Certification

- Companies bidding on set-asides must certify that they are small.
  - Each time you sign the representations and certifications that accompany your offer, you are making a formal certification that your size representations are accurate.
  - Penalties for false certification of size – 15 USC §645(d) – $500,000 + 10 years.
- When do you need to be small – 13 CFR 121.404.
Definition

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 CFR 21.103(a).
Affiliation

Relevant Factors

- SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists.

- In determining whether affiliation exists, SBA will consider the “totality of the circumstances,” and may find affiliation even though no single factor is sufficient to constitute affiliation.
Affiliation

Examples of Affiliations Recognized By SBA

- Stock Ownership
- Stock Options/Agreements to Merge
- Common Management
- Identify of Interest
- Newly Organized Concern
- Franchises and License Agreements
- Joint Ventures
A person that owns, or has the power to control, 50 percent or more of a concern's voting stock, or a block of voting stock that is large compared to other outstanding blocks of voting stock, controls or has the power to control the concern.

Control can be negative. Negative control includes 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.
OpCo and InvestCo are affiliated in the following two examples, where OpCo is owned 51% by John Smith and 49% by InvestCo:

- OpCo’s bylaws say that at least two shareholders must be present to make a quorum to vote on shareholder resolutions.
- OpCo’s bylaws say that all expenditures in excess of $100,000 must be approved by at least 75% of the shareholders.
Affiliation – Stock Options/Agreements to Merge

- SBA treats stock options, convertible securities, and merger agreements as though the rights granted have been exercised.
- Agreements to enter into merger talks are not sufficient to create affiliation.
Affiliation – Common Management

Affiliation arises where one or more officers, directors, managing members, or partners control the board of directors and/or management of one company and also control the board of directors or management of one or more other companies.
Affiliation – Identity of Interests

- Affiliation may arise among two or more companies with an “identity of interest”.
- Classic example of identity of interest is family relations. Two companies owned by immediate family members are presumed to be affiliated. Assumption is rebuttable.
- Other examples of identity of interest: individuals or firms with common investments, or firms that are economically dependent through contractual or other relationships.
Affiliation – Newly Organized Concern

Affiliation may arise where former officers, directors, principal stockholders, managing members, or key employees of one concern organize a new concern in the same or related industry or field of operation, and serve as the new concern's officers, directors, principal stockholders, managing members, or key employees, and the one concern 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.
Affiliation – Franchise/License Agreements

Typical franchisor/franchisee relations do not by themselves create affiliation. Tests include whether the franchisee has the right to profit from its efforts and bears the risk of loss commensurate with ownership. Affiliation may arise, however, through other means, such as common ownership, common management, or excessive restrictions upon the sale of the franchise interest.
A Joint Venture is another type of affiliation. Under new rules published in February 2011, SBA has announced that joint ventures will not necessarily be considered affiliates unless they are enduring (3 or more contracts in a two year period).
Why Can Teaming Be Dangerous?

- Affiliation
  - Easy to accidentally drift into affiliation situation
- Joint Venture
  - Presume affiliation unless excepted
- The Subcontractor Relationship
  - Small Prime Contractor v. Large Subcontractor
- Case Study – CardioMetrix, Inc.
- Ostensible Subcontractor
Why Can Teaming Be Dangerous?

Case Study – CardioMetrix, Inc.

- No Teaming Agreement
- No Subcontract Agreement
- Deemed unduly dependent on, and thus an affiliate of, its large subcontractor
Why Can Teaming Be Dangerous?

Ostensible Subcontractor

- “Ostensible” means appearing to be true, but not necessarily so.
- SBA defines an ostensible subcontractor as one that performs primary and vital requirements of a contract or a subcontractor upon which the prime contractor is unusually reliant – 13 CFR 121.103(h)(4).
How to Avoid Affiliation

Seven Factors

☐ Who will manage the contract?
☐ Who has the requisite background and expertise to perform?
☐ Who chased the contract?
☐ Who wrote the proposal?
☐ Does the teaming agreement assign discrete tasks for performance?
☐ What is the distribution of the amount of work to be performed by each?
☐ Who has the higher skilled staff, more costly staff?
How to Avoid Affiliation

Content of the Teaming Agreement

- Limitation in Subcontracting Requirement—13 CFR 125.6(a)(1).
- Teaming Agreement Should Not:
  - unduly restrict the prime contactor’s right to select other subcontractor;
  - insist on escrow or lock box provisions;
  - include over-reaching subcontract provisions that are favorable to the Sub;
  - assign primary and vital contract performance requirements to the Sub;
  - assign the higher skilled and higher salaried staff to the Sub;
  - assign project or program management to the Sub;
  - suggest a sharing of program management with the Sub; or
  - suggest any arrangement between the Prime and the Sub that would allow the Sub to control either directly or indirectly the Prime contractor’s relationship with the customer.
How to Avoid Affiliation

Content of the Teaming Agreement

- Tailored Agreements.
- Do not rely on the large business to understand these rules – they often do not.
What is a Size Protest?

- A legal challenge of a prospective awardee’s size.
- Usually occurs in the context of a procurement and only after a company has been selected for award.
Size Protests

Who can file a Size Protest?

☐ In the context of a procurement:
  ☐ A small business competitor in the procurement who has not been eliminated during the procurement.
  ☐ A large business who could perform the work and where only one small business submitted a proposal.
  ☐ The contracting officer.
  ☐ The SBA Government Contracting Area Director.
Size Protests

When and Where to file?

☐ For a contractor protest, within five (5) business days of when the contractor receives notice of the proposed awardee.

☐ Protests must be submitted directly to the Contracting Officer within the time required.
Size Protests

Who Decides the Protest?

- The Contracting Officer receives the protest, but does not make the decision on size.
- The SBA Government Contracting Area Director makes the initial decision.
- SBA size determinations are subject to appeal to the SBA Office of Hearings and Appeals.
Why Can Teaming Be Dangerous?

Case Study – DoverStaffing

- Undue reliance on incumbent management
- Over-reliance on incumbent staff
Questions?

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