



## When Is a Small Business Contractor Really “Small?” An Overview of Improper Affiliations Under SBA Regulations

By Adam M. Tuckman, Esq. Watt, Tieder, Hoffar & Fitzgerald, LLP

Recently, the Federal Government has placed a spotlight on federal projects set aside for small businesses. The rationale for these set asides is to foster access to federal procurement among businesses of all sizes. The Small Business Administration (“SBA”) has reported that federal spending on small business contracts increased by \$4 billion from FY 2008 to FY 2009. Further, according to SBA preliminary figures, approximately 30 percent of economic stimulus funding was directed to small business contracts from 2009 through 2010.

The expansion of opportunities for small business set-aside contracts has attracted many players. As might be expected, contractors are entering into business relationships to secure small business contracts. These relationships, however, must comply with stringent SBA regulations. The SBA requires contractors to comply with qualification requirements (when applicable) and certain size standards so that small business set-aside projects are only awarded to their intended beneficiaries. In addition to satisfying the particular socio-economic criteria, the SBA regulations also call for reviewing the size of the contractor as well as its affiliates.

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Central to any size determination, SBA regulations define an “affiliation” to exist when one entity has the power to control the other, or a third party has the power to control both. The consequences of a “affiliation” finding may be severe. When a contractor is affiliated with another entity, the SBA will impute the size of the affiliate to the contractor seeking the award of the prime contract. Thus, when the combined size of the bidding contractor and its affiliated entity exceeds the applicable size standard for a project, the contractor is considered to be other than “small,” and therefore, ineligible for the small business set-aside contract. The SBA examines numerous

factors to determine whether small business contractors have affiliates. SBA regulations instruct that the SBA will consider each potential nexus point under a “totality of the circumstances” analysis.

Informing prospective business decisions, the SBA regulations provide numerous indicia of affiliation to serve as guideposts for industry participants to consult in advance of entering into relationships that may later lead to disqualification from a small business set-aside award. For instance, with a few exceptions, contractors comprising a joint venture are deemed affiliated with each other, as well as the joint venture itself, by virtue of their relationship. Contractors also will often be considered affiliated when the same individual(s) share ownership or management interests in both firms. In addition, an affiliation may likely be found if a familial relationship exists between the owners or managers of the contractors being considered. Moreover, contractors are presumed to be affiliated when a former key employee establishes a new business and receives assistance from the former employer. SBA regulations forbid affiliations of this kind under the “Newly Organized Concern Rule.” Evidence demonstrating a “clear line of fracture” between the newly organized concern and the former employer is necessary under the SBA regulations to rebut the presumption of an affiliation.

Lastly, an affiliation may exist when a small business acts as the prime contractor in name only and essentially delegates essential project responsibilities to a large subcontractor. An affiliation of this type is prohibited under the SBA regulations by the “Ostensible Subcontractor Rule.” Under this rule, a small business will be found affiliated with a large subcontractor on the project that is performing “primary and vital” requirements of the contract. Primary and vital requirements can include performing contract management, technical responsibilities, a large percentage of actual labor, and providing financial and bonding assistance.

It is essential for a Construction Manager, or any company considering entering into a relationship to pursue small business set-aside work, to consult the SBA regulations and obtain legal advice concerning its application when necessary. It is also important for Construction Managers advising federal agencies in their procurement of small business set-aside projects to fully understand SBA regulation of improper affiliations. A Construction Manager should carefully review the entirety of the SBA regulations bearing on these issues and confer with an attorney if questions remain. **CM**

Adam Tuckman is an attorney at the law offices of Watt, Tieder, Hoffar & Fitzgerald, LLP in McLean, Virginia. Mr. Tuckman’s practice covers all facets of construction law, including complex dispute and claims resolution, contract administration, construction risk management, and government contracts. He can be reached at [atuckman@wthf.com](mailto:atuckman@wthf.com)

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