GC-217
SBA’s Rules of Affiliation and How They Impact Small Businesses
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Background

Why Affiliation is Important to Small Businesses

Government Programs Affected by the Affiliation Rules

The Rules

How Affiliation Can Affect You

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Background
The Term “Affiliates” is first defined for GovCon purposes in FAR 2.101(b)(2) as follows:

- “Affiliates” means associated business concerns or individuals if, directly or indirectly—
  - (1) Either one controls or can control the other; or
  - (2) A third party controls or can control both.
Why Affiliation Is Important to Small Businesses
The SBA determines whether an entity *qualifies as a small business concern* by counting its receipts, employees, or other measures, *including those of all its domestic and foreign affiliates* (13 C.F.R. § 121.103(a)(6))

Any affiliation with another business (even another small business) can cause BOTH to lose their qualifications as “small” *(which can also affect other qualifications)*
Other qualifications can also be at risk by affiliation

- Title 8(a) certification
- Veteran-Owned Small Business
- Service-Disabled Veteran-Owned Small Business
- Woman-Owned Small Business

Some qualifications are not jeopardized by affiliation

- Tribal corporations
- Alaska Native Corporations
Programs Affected by the Rules of Affiliation
Programs Subject to Affiliation Rules

Small business set asides

Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs

Certificate of Competency (COC) program

Historically Underutilized Business Zone (HUBZone) program

Women-Owned Small Business (WOSB) and Economically Disadvantaged Women-Owned Small Business (EDWOSB) programs

Service-Disabled Veteran-Owned Small Business program

8(a) Business Development program
The Rules
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

Ownership, management, relationships (current and previous), *both contractual and personal* are considered

Control may be affirmative or negative

Control by a third party may constitute affiliation

In determining size, SBA counts receipts, employees, or other measure of size of the concern and all of its affiliates, regardless of whether the affiliates are organized for profit
Concerns owned by investment companies are not considered affiliates of the investment company (private equity, etc.)

Entities owned by Indian Tribes, Alaska Native Corporations (ANCs), Native Hawaiian Organizations (NHOs), Community Development Corporations (CDCs) and their subsidiaries are not considered affiliates of such entities.

Entities which lease employees from or which enter into a co-employer arrangement with a Professional Employer Organization (PEO) are not considered to be affiliated with the leasing company or PEO solely on the basis of the leasing agreement.
A protégé firm is not an affiliate of a mentor firm solely because the protégé firm receives assistance from the mentor.

The member shareholders of a small agricultural cooperative are not considered affiliated with the cooperative.
For financial, management or technical assistance under the Small Business Investment Act of 1958, entities under the common control of the following types of investors are not considered to be affiliated:

- Venture capital operating companies
- Benefit or pension plans maintained by the Federal government or any state, or their political subdivisions for the benefit of employees
- Employee benefit or pension plans within the meaning of ERISA
- Charitable trusts, foundations, endowments, or similar organizations that are tax-exempt under section 501(c) of the tax code
- Investment companies if the company's principal purpose is investment in securities rather than the operation of commercial enterprises
Coverage Based on Stock Ownership

- A person who owns or controls 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, controls or can control the concern.

- If two or more persons each owns or controls a block of stock less than 50 percent and approximately equal in size, and the aggregate of these holdings is large as compared with any other stock holding, SBA presumes that each such person controls or has the power to control the concern.

- If 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 and CEO or President will be deemed to have the power to control the concern.
Coverage based on Options, Securities, or Agreements to Merge

- SBA will consider stock options, convertible securities, and agreements to merge to have a present effect as if they had been exercised.
- Agreements to open or continue negotiations toward the possibility of a merger or a sale of stock at some later date are not given present effect.
- Options, convertible securities, and agreements subject to conditions incapable of fulfillment, speculative, conjectural, or unenforceable, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.
- An individual, concern, or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so.
Coverage based on common management or identity of interest

- Affiliation is considered to exist when one or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns.

- Affiliation may arise among two or more persons with an identity of interest and they may be treated as one party with interests aggregated. These may include…
  - Family members, individuals, or firms with common investments
  - Firms that are economically dependent through contractual or other relationships
Coverage Based on the Newly Organized Concern Rule

- Officers, directors, principal stockholders, managing members, or key employees of one concern sometimes organize a new concern in the same or related industry or field of operation.

- Affiliation may occur if the first concern is furnishing or will furnish the new concern with contracts, financial or technical assistance, and/or other facilities, whether for a fee or not.
Coverage Based on Joint Ventures

- Parties to a joint venture are affiliates if any one of them seeks SBA financial assistance for use in connection with the joint venture
  
  **RED FLAG!** One venturer may request SBA financial assistance in connection with a joint venture, thereby compromising the status of the other venturer(s) without their knowledge!

- Concerns submitting offers on a particular procurement as joint venturers are affiliated with each other with regard to the performance of that contract
  
  **RED FLAG!** The status of the joint venture is dependent on the aggregate status of the venturers!
A JV of two or more business concerns may submit an offer as a small business without regard to affiliation so long as each concern is small under NAICS code for the contract, provided:

- The procurement qualifies as a “bundled” requirement
- The procurement is other than a “bundled” requirement and:
  - For a procurement having a receipts-based size standard, the dollar value of the procurement, including options, exceeds half the size standard, or
  - For a procurement having an employee-based size standard, the dollar value of the procurement, including options, exceeds $10 million.
A joint venture of at least one 8(a) Participant and one or more other business concerns may submit an offer for a competitive 8(a) procurement *without regard to affiliation*.

Two firms approved by SBA to be a mentor and protégé may joint venture as a small business provided the protégé qualifies as small for the NAICS code of the procurement.
A contractor and its ostensible subcontractor are treated as joint venturers, *and therefore affiliates*, for size determination purposes.

- An ostensible subcontractor is a subcontractor that performs ...
  - A contract, or
  - An order under a multiple award schedule contract, or
  - Acts as a subcontractor upon which the prime contractor is unusually reliant (Pass-through arrangements)

A concern must include in its receipts its proportionate share of JV receipts, and in its total number of employees its proportionate share of JV employees.
How Affiliation Can Affect You
If the owner or CEO of your firm owns or controls another firm, your size determination may be affected by the size of the other firm (stock or ownership rules).

If the spouse, children, or parents of the owner, CEO, or even a Board Member of your firm owns or controls another firm, your size determination may be affected by the size of the other firm (identity of interest rules).

If you enter into JVs, your size determination may be affected by the size of the JV (JV rules).
Questions?
Call to Action/Contact Us