

SBA PROPOSES EXCEPTION TO “OSTENSIBLE SUBCONTRACTOR” RULE

INTRODUCTION

The Small Business Administration (SBA) has proposed a small but significant change to the "Ostensible Subcontractor" Rule in [13 CFR § 121.103\(h\)\(4\)](#). Under the proposed change, small businesses would be allowed to subcontract with similarly situated businesses without fear of running afoul of the Ostensible Subcontractor Rule. An explanation of the Rule reveals the significance of the proposed exception.

OSTENSIBLE SUBCONTRACTOR RULE

The Ostensible Subcontractor Rule holds that a small business (or 8(a), or other disadvantaged business) which “is unusually reliant” on a subcontractor may be deemed affiliated for purposes of size determination. Small government contractors or 8(a) concerns that rely too heavily on another business for subcontracting may elicit a finding of affiliation under the Ostensible Subcontractor Rule. If a contractor is found to be affiliated with its subcontractor under this Rule, the aggregate size of both contractors is used to determine the contractor’s set-aside status, which in turn could result in the contractor being disqualified as a small business (or 8(a), and so on).

The rule, which applies equally to all set-aside contracts — including small business, 8(a), and HUBZone contracts — aims to “prevent other than small firms from forming relationships with small firms to evade SBA’s size requirements.” (*Size Appeal of Iron Sword Enters., LLC*, SBA No. SIZ-5503, 2013 SBA LEXIS 113, *13 (2013)) Factors that the SBA considers when making a size determination include:

1. **Division of Work:** The larger the subcontractor’s share of the work, the greater the risk of affiliation
2. **Management:** if the prime contractor relies on the subcontractor to provide key personnel, the SBA is more likely to find a prime contractor affiliated with a subcontractor
3. **Relative Experience:** The relative inexperience of the prime contractor in relation to a highly experienced subcontractor also increases the likelihood of a finding of ostensible subcontractor affiliation
4. **Bonding, Financing, and Equipment:** if the subcontractor supplies critical bonding, financing, or equipment, the SBA is likely to find affiliation, particularly if the prime could not obtain these things on its own from other sources

If the SBA finds that affiliation exists, the SBA will consider the revenue of both firms in determining whether they meet the size standard for the specific NAICS code assigned to the project. If the combined revenue of the two companies exceed the size standard, then the company (prime) would be considered a large business for the purpose of the current procurement. The resulting consequence would be forfeiture of the contract.

PROPOSED EXCEPTION TO THE RULE

If approved, the [proposed change](#) to the rule would read: "[a]n ostensible subcontractor is a subcontractor *that is not a similarly situated entity*" that performs primary and vital contract requirements or upon which the contractor is unusually reliant." Thus, similarly situated entities would be excluded from the definition of an "ostensible" contractor, permitting a small business to affiliate with other small businesses on a set-aside contract, without violating the Ostensible Subcontractor Rule.

For example, suppose an 8(a) prime contractor teamed with one or more 8(a) subcontractors on an 8(a) set-aside contract, and affiliation was found between them under the current rule. Under the proposed rule, if the aggregate revenue exceeded the SBA's size standards for 8(a) contractors, there would be no finding of affiliation because the prime contractor and subcontractor(s) are similarly situated entities. Consequently, the proposed rule would open up more opportunities for small businesses, 8(a) contractors, and other contractors within other set-aside categories.

CONCLUSION

Knowledge is power, especially for small businesses. Knowing the rules going into a bid – and thereafter – allows a contractor to maneuver within the boundaries of those rules to maximize the contractor's advantage on the project. Taking advantage of the SBA's proposed exception to the Ostensible Subcontractor Rule would allow qualifying contractors more power and more opportunities to team with like-entities on set-aside contracts.

In the end, you will be glad you made the call; by the way, it's a FREE CALL.

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