CROSSFIRE ON BONDING FEDERAL PROJECTS

NASBP 2013 Annual Meeting & Expo
San Francisco, California
Does the Miller Act apply to subcontractor bonds?
What type of contractor’s license is needed to build barracks on a Marine Corps base?
When does the assignment clause in the surety’s indemnity agreement effectively assign the principal’s rights to the surety?
Uncle Sam has billions of your tax dollars, so why is identifying the source of funds relevant?
Do state prevailing wage laws apply to federal projects?
What is the most famous surety case in U.S. jurisprudence?
What is the new Lumberman’s case all about?
True or False: What happens abroad stays abroad.
What is the most famous classic English play where the surety wins?

Darn you high school English classes!!! No one taught the Surety Classics. I’m doomed.
What happens when we have a tribal contractor doing work for the Federal Government on Federal property who sues his sub in Tribal Court over some imagined dispute and the sub brings a Miller Act lawsuit against the tribal contractor and the surety?
Test your acronyms:

ROICC
HUBZone
FARS
DFARS
CDA
CO
Test your acronyms:

MOD
IDIQ
DFARS
MACC
DCAA
FOIA
Test your acronyms:

- SBA
- VA
- DOD
- SIN

OMG!!

90 seconds are up
What is a false claim?
How are green building initiatives affecting federal construction?
Are conditional payment provisions enforceable on federal Miller Act projects?
When is termination convenient?
Are the surety’s options different when the principal defaults on a federal project?
Can I use funds control on a federal project?
Can the IRS offset contract money ahead of the surety?
Practice Pointer: Don’t aggravate your Contracting Officer. It could mean...
Why is the Contracts Disputes Act relevant to surety bonding?
What Does a Broker and Surety Need to Know About the Rules, Risks and Rewards of SBA 8(a) Work?
Small Business Set-Aside Contracts: 
Implications of the Company You Keep
Topics for Discussion

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
V. Weighing the Surety’s Risks
I. Why Understanding Bond Risks in the Federal Set-Asides Arena Has Become Necessary


New Players in Market + Present Regulatory Framework/Enforcement Policy = Increased Risk to Sureties
Goals for Allocating Federal Dollars

77% Non-Qualified Prime Contracts
23% of Prime Contracts For Small Businesses
77% Non-Qualified Prime Contracts

35.6% SB Set-Asides
21.7% W.O.S.B
13% HUBZone-SB
13% S.D.V.O-SB
21.7% S.D.B.

Source: SBA Website
www.sba.gov
With Increased Spending Has Come Congressional Demand for Increased Oversight

This Act may be cited as the “Small Business Contracting Fraud Prevention Act of 2011”.

In this Act—

(1) the term “8(a) program” means the program under section 8(a) of the Small Business Act (15 U.S.C. 637(a));
The Congressional Response

◆ 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)
(i) by redesignating subparagraphs (C) and (D) as subparagraphs (D) and (E).
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

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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.

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.

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.
What are the Surety Risks?

◆ Direct (to Surety)
  ■ Default termination on all Government Contracts
  ■ Severe impact on Contractor balance sheet / backlog / operations
  ■ Severe impact on Indemnitor financials

◆ Indirect (to Account)
  ■ Debarment
  ■ Forfeiture of affirmative claims
  ■ Disgorgement or repayment of any amounts paid by the Government
  ■ Civil/criminal penalties
  ■ False Claims Act damages / liability
Topics for Discussion

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

V. Weighing the Surety’s Risks
II. Overview of SBA Programs and Their Administration

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

- 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

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
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III. Small Business Set Asides and the Basic Rules for Calculating Business Sizes

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

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.
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.
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<th>NAICS Codes</th>
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<td>238160</td>
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238120 | Structural Steel and Precast Concrete Contractors | $14.0 |

237310 | Highway, Street, and Bridge Construction | $33.5 |

237990 | Other Heavy and Civil Engineering Construction | $33.5 |

236210 | Industrial Building Construction | $33.5 |
Calculating Average Annual Receipts for SBA Size Determination

◆ 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

13 CFR § 121.104
Calculating Average Number of Employees for SBA Size Determination

❖ 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

13 CFR § 121.106
Topics for Discussion

I. Why Understanding Bond Risks in the Federal Set-Aside Arena has Become Necessary
II. Overview of SBA Programs and Their Administration
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IV. SBA Guidelines for Recognizing Improper Affiliations
V. Weighing the Surety’s Risks
IV. SBA Guidelines for Recognizing Improper Affiliations

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

◆ 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

- 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

- 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.

(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.

(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.

(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.
(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
Factors to Weigh When Making an Affiliation Finding

- 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

- 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
Threshold Inquiries

Exceptions from an Affiliation Finding

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

13 CFR § 121.103(b)
Threshold Inquiries
Exceptions from an Affiliation Finding

◆ 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

13 CFR § 121.103(b)
Indicia of Affiliation

Ownership Interest / Management Control

◆ 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

13 CFR §§ 121.103(c)–(e)
The Process for Resolving Challenges to Size Qualifications for Eligibility

- 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
Indicia of Affiliation

Family Ties

◆ 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)

13 CFR § 121.103(f)
Indicia of Affiliation

Employee Ties

◆ 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

- 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

13 CFR § 121.103(h)
Indicia of Affiliation

Contractual Agreements

◆ Special exceptions to combining size of joint ventures

■ 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

13 CFR § 121.103(h)
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 Ventures - 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 Ventures - 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

13 C.F.R 124.513(d)
124.513(i)
Indicia of Affiliation – *The Ostensible Subcontractor*

- 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.

13 CFR § 121.103(h)(4)
Indicia of Affiliation –
*The Ostensible Subcontractor*

◆ 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

13 CFR § 121.103(h)(4)
Indicia of Affiliation –
*The Ostensible Subcontractor*

- 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

13 CFR § 121.404(g)(4)
Indicia of Affiliation –
The Ostensible Subcontractor – A Focus on Teaming Agreements

- 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

FAR 9.601 – 9.603
Mentor / Protégé
The Basics

◆ 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

13 CFR § 124.520
Mentor / Protégé
The Basics

◆ 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

◆ 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

13 CFR § 124.520
Mentor / Protégé
*The Basics*

- 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

13 CFR § 124.520
JV Affiliation Exceptions (Mentor / Protégé Joint Ventures)

◆ 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)
Topics for Discussion

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
V. Weighing the Surety’s Risks
V. Weighing the Surety’s Risks

- 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 Surety’s Risks – Other Consequences

◆ 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. 

◆ Potential implications for sureties