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Ostensible Subcontracting and the SBA Affiliation Rule

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Ostensible subcontractor affiliation can arise for many reasons—but a Small Business Prime may be in grave danger of affiliation with its subcontractor when specific factors are present.

- **What is an ostensible subcontractor?**
 - A sub that performs primary and vital requirements of the contract or
 - A sub that the SB Prime is unusually reliant upon
- **How it is determined that such an arrangement exists?**
 - The SBA uses among other data within the proposal, a “Seven Factor” test to determine the size status of the prime/sub relationship
- **If it is determined such an arrangement exists, then what?**
 - If an ostensible sub arrangement does exist, the CO must consider the revenue of both firms in determining if they meet the size standard for the procurement.
 - If the combined revenue exceeds the standard, then the company would be considered large business for the purpose of the current procurement.

- For Decades the SBA has been using the 7-Factor Test:
 - Which party will be managing the contract?
 - Which party possesses the requisite background and expertise to carry out the contract?
 - What party pursued the contract award?
 - What degree of collaboration was there on the proposal effort?
 - Were the tasks allocated to be performed by each party or is there commingling of personnel and material?
 - What is the amount of work to be performed by each party?
 - Which party will perform the more complex and costly contract functions?

- Is SB Prime hiring incumbent's project management team and subcontracting significant portions of the contract to the incumbent
- Did SB Prime fail to identify discrete tasks each concern would perform
- Does the SB firm lack, and subcontractor possesses, the qualifications relevant to the contract requirements
- Is the greater share of labor costs borne by the ostensible subcontractor
- Does the SB Prime have inexperience in the primary and vital requirements of the solicitation
- Does the SB Prime plan to hire a substantial number of the incumbent's (and ostensible subcontractor's) employees.

These items can be “red flags” that an ostensible subcontractor arrangement exists

The Governments looks for these things

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- Review a breakdown of management and technical tasks with regard to which firm is performing the “primary and vital” portions of the work. The prime contractor must be doing the majority of the managerial and technical work.
 - The work force ratio should reflect both the number of employees as well as the wages of those employees, which is in contrast to previous practice of just doing a 49%/51% of the employee head count analysis.
 - The overall percentage of work subcontracted out
 - Status of the subcontractor
 - Are they the incumbent?
 - Have they grown in size such that they are now ineligible for award of this contract?)
- The past performance of each vendor. The prime must have relevant experience in the area under consideration.
- The allocation of key persons between the prime and subcontractor. Be alert to instances where key persons remain on staff with the subcontractor, especially if that company is the incumbent.
- Which party pursued the award and degree of collaboration on the proposal

After considering the ‘totality of circumstances between the SB Prime and Subcontractor’, if it can be determined that the subcontractor is performing a significant portion of the work or if it can be determined that the prime contractor is not capable of doing the work independently, then an ostensible subcontractor arrangement exists.

Case Study – SBA Office of Hearings and Appeals

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- **Ostensible Subcontractor Affiliation: Beware These “Four Key Factors,” Says SBA OHA**
- Posted on [March 14, 2016](#) by [Steven Koprince](#)
- Ostensible subcontractor affiliation can arise for many reasons—but a small business may be in grave danger of affiliation with its subcontractor when four specific factors are present.
- In a recent size appeal decision, the [SBA Office of Hearings and Appeals](#) held that a small prime contractor was unusually reliant on its large subcontractor where “four key factors” indicated that the small prime contractor was bringing little to the table but its small business status.
- OHA’s decision in [Size Appeal of Modus Operandi, Inc., SBA No. SIZ-5716 \(2016\)](#) involved an Air Force solicitation for research, studies, engineering, and related services. The solicitation was issued as a small business set-aside under NAICS code 541690 (Other Scientific and Technical Consulting Services), with a corresponding \$15 million size standard.
- The solicitation was a follow-on to a procurement for similar services, known as the Sustainment Systems Engineering & Acquisition Management Services contract. BAE Systems Technology Solutions & Services, Inc., a large business, was the incumbent under the SSEAMS contract.
- After reviewing competitive proposals, the Air Force awarded the contract to Modus Operandi, Inc. An unsuccessful competitor subsequently filed an SBA size protest. The competitor alleged that Modus Operandi had proposed to use BAE as its subcontractor, and that Modus Operandi was affiliated with BAE under the ostensible subcontractor rule.
- The SBA Area Office reviewed Modus Operandi’s proposal. The proposal indicated that Modus Operandi would perform 51.1% of the contract services and BAE the remaining 48.9%. Of a total workforce of 20 personnel, 10 would be Modus Operandi employees and 10 would be BAE employees. All 20 employees were incumbent SSEAMS employees, and the 18 non-managerial personnel would perform the same role on the new contract as on SSEAMS.
- As its Program Manager, Modus Operandi offered the incumbent SSEAMS Deputy Project Manager, a BAE employee who would move to Modus Operandi’s payroll. In the past performance portion of the proposal, Modus Operandi identified two prior contracts for itself and two for BAE—one of which was the incumbent SSEAMS contract. The proposal identified the SSEAMS contract as the only one involving geophysical research support, an important component of the Air Force solicitation.
- The SBA Area Office issued a size determination finding Modus Operandi to be affiliated with BAE under the ostensible subcontractor affiliation rule. The SBA Area Office found that Modus Operandi was hiring BAE’s incumbent personnel “en masse,” and concluded that Modus Operandi would contribute nothing more than its small business status to the procurement.

Case Study (continued)

- Modus Operandi filed a size appeal with OHA. Modus Operandi argued that the SBA Area Office had erred by finding ostensible subcontractor affiliation.
- OHA wrote that a recent line of size appeal decisions have “identified ‘four key factors’ that have contributed to the findings of unusual reliance.” OHA explained:
- *First, the proposed subcontractor was the incumbent contractor, and was not itself eligible to compete for the procurement. Second, the prime contractor planned to hire the large majority of its workforce from the subcontractor. Third, the prime contractor’s proposed management previously served with the subcontractor on the incumbent contract. And fourth, the prime contractor lacked relevant experience, and was obliged to rely on its more experienced subcontractor to manage the contract.*
- Modus Operandi’s case, OHA wrote “fits squarely within [this] fact pattern.” Here, BAE was the ineligible incumbent contractor. Modus Operandi “proposed to staff [its] portion of the project almost entirely with personnel hired from BAE, and all non-managerial personnel would continue in the ‘same role’ that they performed on SSEAMS.” To manage the contract, Modus Operandi “proposed to retain BAE’s incumbent Deputy Project Manager . . . to serve as” the new Program Manager. And finally, “according to [Modus Operandi’s] own proposal, BAE is the only member of [Modus Operandi’s] team with experience in the ‘Geophysics and Research’ technical discipline, and the Contracting Officer likewise acknowledged that Modus Operandi ‘does not have Geophysical Research Support experience.’”
- OHA affirmed the SBA Area Office’s decision, and denied Modus Operandi’s size appeal.
- Because ostensible subcontractor affiliation cases are very fact-specific, it can be frustrating for potential prime contractors and subcontractors to determine when their relationship might cross the line. The *Modus Operandi* size appeal decision offers some helpful guidance. Although the “four key factors” identified in *Modus Operandi* are neither conclusive nor exhaustive, they are a good starting point—and if all four factors are met, there may be grave danger of ostensible subcontractor affiliation.

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Case Study #2

- **Ostensible Subcontractor Rule: Hiring Subcontractor's Project Manager Didn't Create Affiliation**
- Posted on [November 25, 2015](#) by [Steven Koprince](#)
- Ostensible subcontractor affiliation was not created when the small prime contractor proposed to hire its subcontractor's current employee to serve as the prime contractor's project manager.
- In a recent size appeal decision, the SBA Office of Hearings and Appeals held that, where the prime contractor would retain supervision and control of contract performance, the prime contractor was not dependent on its subcontractor for contract management.
- OHA's decision in [Size Appeal of Glacare and Medtrust JV, LLC, SBA No. 5690 \(2015\)](#) involved an Army solicitation for registered nursing services in the San Antonio Military Health System. The solicitation was issued as a small business set-aside under NAICS code 621399 (Offices of All Other Miscellaneous Health Care Practitioners).
- Global Dynamics, LLC submitted a proposal. GDL proposed a prime/subcontractor teaming relationship with OMV Medical, Inc. Under the teaming arrangement, GDL would perform 51% of the work and OMV would perform 49%. GDL would hire a current OMV employee (whose name is redacted from OHA's public decision) to serve as the Senior Project Manager. The Senior Project Manager would be responsible for day-to-day contract management and communication with the Government. The Senior Project Manager would report to GDL's Chief Executive Officer, Ledell Weaver.
- After evaluating competitive proposals, the Army announced that GDL was the apparent successful offeror. Giacare and Medtrust JV, LLC, an unsuccessful competitor, filed a timely SBA size protest. The protester alleged that GDL was affiliated with OMV under the ostensible subcontractor rule.
- The SBA's ostensible subcontractor rule provides that when a subcontractor is actually performing the primary and vital requirements of the contract, or when the prime contractor is unusually reliant upon the subcontractor, the two firms are affiliated for purposes of the contract at issue. To evaluate whether an ostensible subcontractor relationship exists, the SBA Area Office is to examine "all aspects" of the relationship between the firms. In its evaluation, the SBA Area Office is to consider the terms of the proposal, as well as the terms of any teaming agreement between the parties.
- In this case, after evaluating the protester's initial allegations, the SBA Area Office issued a size determination in GDL's favor, holding that no ostensible subcontractor rule violation had occurred. The protester then filed a size appeal with OHA. In the course of the size appeal, the protester learned for the first time that the proposed Senior Project Manager was a current high-ranking employee of OMV. The protester then supplemented its appeal, asking OHA to consider this relationship as new evidence of ostensible subcontractor affiliation.

Case Study #2 - Continued

- OHA agreed to consider the new evidence, but held that the protester's "contention that OMV will control management of the contract through [Senior Project Manager] amounts to no more than unsupported speculation." OHA explained that "when key personnel, even if hired from the subcontractor, remain under the supervision and control of the prime contractor, there is no violation of the ostensible subcontractor rule."
- Here, "although [Senior Project Manager] was employed by OMV at the time GDL submitted its proposal, she will be a GDL employee during contract performance, and will operate under GDL's supervision and control." In that regard, "[a]ccording to the proposal, GDL's CEO, Ms. Weaver, will oversee the program management office and supervise [Senior Project Manager] and other managers." The Senior Project Manager "thus will be subordinate to and report to Ms. Weaver, and ultimate control and decision-making rests with GDL." OHA concluded: "[b]ecause all contract performance will occur under Ms. Weaver's supervision and direction, GDL is not dependent on OMV for contract management." OHA denied the protester's size appeal.
- Ostensible subcontractor rule analyses are intensely fact-specific, and the outcomes of these cases often turn on multiple factors. For that reason, it may be a bridge too far to suggest that the ostensible subcontractor rule will never be violated by hiring a subcontractor's current employee in the Project Manager role. However, *Glacare and Medtrust* does indicate that such a hire is unlikely to lead to ostensible subcontractor affiliation so long as the proposal demonstrates that ultimate supervision and control rests with the small prime contractor, and so long as the other aspects of the parties' relationship do not demonstrate the existence of affiliation.
- - See more at: <http://smallgovcon.com/sbaohadecisions/ostensible-subcontractor-rule-hiring-subcontractors-project-manager-didnt-create-affiliation/#more-4532>

The background features a dark blue field with a complex network of glowing blue nodes and lines, resembling a data or social network. On the left side, there are several overlapping geometric shapes: a white triangle, a light blue triangle, a yellow-green triangle, and a dark blue triangle, all pointing towards the right.

Business' must be knowledgeable and guard against the specific factors that could create an 'Affiliation' with their subcontractor.

The background features a dark blue field filled with a complex network of glowing blue nodes connected by thin lines, resembling a molecular or data network. On the left side, there are several overlapping geometric shapes: a white triangle, a light blue trapezoid, a yellow-green triangle, and a dark blue triangle, all pointing towards the right. The word "Questions?" is centered in the upper right area in a white, bold, sans-serif font.

Questions?