

## OSTENSIBLE SUBCONTRACTORS: HOW TO KNOW IF YOU ARE ONE

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One of the fundamental principles in the Small Business Administration (“SBA”) size regulations is that in determining a company’s size, “SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates....” 13 CFR §121.103 (a)(6). This issue is often important in the case of prime contractor/subcontractor relationships in a set-aside contract. A subcontractor who is “not small” may have too much importance in contract execution and may become an “ostensible subcontractor.” This will mean that it will be considered to be affiliated with, and cause the small business prime contractor to be “not small.” A recent SBA case extensively explained the ostensible subcontractor rule. *Size Appeal of Modus Operandi, Inc.*, SBA No. SIZ-5716 (Feb. 19, 2016).

In *Modus Operandi*, the Air Force issued a solicitation for geophysical management engineering and research studies, and set aside the procurement for small business. The solicitation was a successor to a prior procurement for similar services, which was performed by BAE (a large contractor), assisted in part by subcontractor Modus Operandi. Modus Operandi’s proposal on the new procurement:

- Included BAE as a subcontractor (BAE was “not small” and ineligible to bid on this procurement)
- Staffed Modus Operandi’s portion of the contract almost entirely from personnel it would hire from BAE
- Continued all non-managerial personnel at Modus Operandi in the “same role” that they had performed for BAE
- Retained BAE’s Deputy Project Manager to serve as Modus Operandi’s Program manager
- Stated that BAE was the only member of Modus Operandi’s team with experience in geophysical management and research studies
- Stated that Modus Operandi did not have geophysical management and research studies experience (the principal subject matter of the procurement)

Does something seem strange here? One of the other offerors thought so, and protested Modus Operandi’s size, alleging that BAE was an “ostensible subcontractor.” The SBA Office of Hearings and Appeals agreed, and analyzed the case as follows.

The ostensible subcontractor rule at 13 CFR §121.103(h)(4) says:

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

- [1] performs primary and vital requirements of a contract, or of an order under a multiple award schedule contract, or
- [2] a subcontractor upon which the prime contractor is unusually reliant.

All aspects of the relationship between the prime and subcontractor are considered, including, but not limited to, the

- [1] terms of the proposal (such as contract management, technical responsibilities, and the percentage of subcontracted work),
- [2] agreements between the prime and subcontractor (such as bonding assistance or the teaming agreement), and
- [3] whether the subcontractor is the incumbent contractor and
- [4] is ineligible to submit a proposal because it exceeds the applicable size standard for that solicitation.

The SBA analyzed *Modus Operandi* and BAE under the principles stated in the regulations above, the *Size Appeal of DoverStaffing, Inc.*, SBA no SIZ-5300 (2011), and a line of cases that followed it, showing “unusual reliance” on the subcontractor by the prime contractor. In *DoverStaffing*, the facts demonstrating unusual reliance were:

- (1) The proposed (large) subcontractor was the incumbent contractor
- (2) The proposed subcontractor was ineligible to submit a proposal in its own name
- (3) None of the prime contractor’s proposed personnel (both managerial and non-managerial) was employed by the prime contractor at the time of proposal submission
- (4) The prime proposed to staff the contract by hiring the subcontractor’s employees *en masse* to perform 51% of the work
- (5) The prime lacked an established performance record and relied upon the proposed subcontractor’s experience and past performance to win the contract.

On these facts, the SBA in *Dover* determined that the prime contractor was bringing “nothing to the contract but its small business status.” The SBA found that the facts in *Modus Operandi* (outlined above) fit squarely within the *DoverStaffing* pattern, and held that *Modus* was “unusually reliant” on BAE. Therefore BAE would be considered an ostensible subcontractor, and *Modus Operandi* no longer qualified for the set aside.

When a follow-on contract is solicited and set aside for small business, many subcontractors are likely to be interested in bidding as a prime contractor, if they qualify as “small.” The small business must ensure three things: (1) if they propose to use the previous prime incumbent contractor (a large business) as their subcontractor, they will not become unusually reliant by hiring large numbers of the previous prime’s personnel; (2) the small business must show its own satisfactory performance record and expertise *without reliance* on the former prime; and (3) the small business must also show that it will perform the “primary and vital requirements of a contract.” The vital parts of the contract are the technical requirements—not just maintaining payroll, human resources and miscellaneous contract administration matters, which can be done by any contractor. The small business must demonstrate its knowledge and performance of the work that is being performed in the contract.