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How Affiliate Employees Impact HUBZone Eligibility

Law360, New York (August 21, 2012, 1:12 PM ET) -- If you are a HUBZone contractor familiar with the U.S. [Small Business Administration](#)'s HUBZone regulations, you know that, under 13 C.F.R. § 126.204, a HUBZone concern is expressly allowed to have affiliates. The rule states that “[a] concern may have affiliates provided that the aggregate size of the concern and all of its affiliates is small as defined in part 121 of this title, except as otherwise provided for small agricultural cooperatives in §126.103.”

Unfortunately, the regulations do not provide further guidance on how the SBA treats the affiliate employees when determining whether the HUBZone firm is in compliance with the 35-percent residency and principal office requirements of the HUBZone program.

Our recent experiences with the SBA have shed some light on how the SBA approaches the counting of employees from the affiliates of HUBZone concerns. In short, the SBA will add together the employees of a HUBZone concern and its affiliates for both the 35-percent HUBZone residency requirement and the principal office determination if the SBA finds that there is no “clear line of fracture” between the two entities based on a “totality of the circumstances” test.

The “totality of the circumstances” is based on a number of factors that go to whether the operations of the HUBZone concern are sufficiently separate from the operations of its affiliate. The SBA will look at evidence of day-to-day operational contacts between the HUBZone concern and its affiliate, such as whether the HUBZone firm and its affiliate:

- engage in similar types of work;
- subcontract with each other; or
- share employees, equipment, facilities or other resources.

When the totality of the circumstances shows a lack of clear fracture between the HUBZone firm and its affiliate, the SBA will aggregate the employees of the HUBZone firm and its affiliate to determine HUBZone compliance. If the HUBZone firm’s affiliate does not have sufficient employees who reside in a HUBZone, adding these employees to the employees of the HUBZone firm could cause the HUBZone firm to fall out of compliance with the HUBZone program.

So how can you ensure that your HUBZone concern maintains a clear line of fracture with its affiliates? A threshold step is to avoid having affiliates in the same or similar line of business as your HUBZone firm. The other indicia of a failure to maintain a clear line of fracture — such as sharing employees or subcontracting between the companies — are more likely to indicate a lack

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of clear fracture when the HUBZone firm and its affiliate are in similar fields. Limiting or eliminating subcontracting and sharing of employees, equipment, and facilities are also advisable. Your goal should be to ensure that the operations of the HUBZone firm and its affiliate are as independent of each other as possible.

You should also be mindful that a HUBZone contractor must be prepared to prove its compliance with all of the program's requirements on two specific dates:

- the date of proposal submission; and
- the date of contract award.

If you know that a HUBZone set-aside proposal or award is due soon, you should take stock of your potential affiliates and whether your company is properly maintaining a clear line of fracture between them, based on the factors listed above. Such an internal review can help fend off potential protests of your HUBZone status if your company receives a contract award.

Despite these precautions, remember that the SBA does allow HUBZone concerns to have affiliates. Indeed, companies that have legitimately hired 35-percent of their workforce from a HUBZone and maintain a HUBZone-located principal office should not be disqualified from HUBZone eligibility simply because of affiliation with another firm. However, you need to be mindful of how to operate the affiliated entities to ensure that the HUBZone firm's employees alone are counted in determining its HUBZone eligibility.

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