



# Most Common Pitfalls for SDVOSB and HUBZone Firms

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Cy Alba is a Partner at PilieroMazza. He counsels clients in a broad range of government contracting matters before government agencies and federal courts that includes overall regulatory compliance with all of SBA’s small business programs. Cy represents small and mid-sized companies looking to structure compliant teaming, joint venture, and mentor-protégé agreements. He handles the prosecution and defense of small business size and status protests and appeals before SBA and OHA, as well as bid protests before GAO, COFC, and the U.S. Court of Appeals for the Federal Circuit.

# About PilieroMazza

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PilieroMazza—a business law firm—serves as a strategic partner to government contractors and commercial businesses from across the United States in numerous industries.

We deliver results for our clients by implementing legal and business solutions that take the client’s best interests into consideration. Moreover, PilieroMazza’s efficient operational structure and lean approach to staffing matters translate into competitive pricing for our clients, while providing the highest standard of client service and legal acumen.

PilieroMazza is privileged to represent clients in the following areas:

- Audits & Investigations
- Business & Corporate
- Business Succession Planning
- Corporate and Organizational Governance
- Cybersecurity & Data Privacy
- Debt Financing
- Employee Incentive and Bonus Plans
- False Claims Act
- Government Contracts
- Government Contract Claims & Appeals
- Intellectual Property & Technology Rights
- Labor & Employment
- Labor & Employment for Government Contractors
- Litigation & Dispute Resolution
- Mergers & Acquisitions
- Native American Law & Tribal Advocacy
- Private Equity & Venture Capital

# Topics to Be Covered

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- Benefits and drawbacks of:
  - HUBZone
  - Service-Disabled Veteran-Owned Small Business (SDVOSB)
    - Veteran-Owned (VOSB)

# Small Business Contracting Goals

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- Total USG Contracting: 23%
  - 8(a): 5%
  - WOSB: 5%
  - SDVOSB: 3%
  - HUBZone: 3%
- There is no VOSB goal
  - The VA does have a 17% VOSB goal and 15% SDVOSB goal
- Every agency sets their own goals, so make sure the agencies for which you are looking to do business have solid goals for your set-aside type.

# HUBZone Benefits

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# The HUBZone Program Benefits

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- Ability to go after both HUBZone and small business work
- Minimal limitations on owners
  - 51% of owners need to be US Citizens (or Tribes/ANCs/NHOs/CDCs)
  - Still have to have control by eligible owners
  - There is no economic or social limitations that apply to the individuals who own the company
- The program is not for a limited period of time and companies may be certified for so long as they remain eligible.

# The HUBZone Program Benefits

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- Sole source allowed without a formal justification and authorization if:
  - The Agency decides to use a HUBZone set-aside procurement strategy
  - The Rule of Two has been met because market research shows that two or more HUBZone small businesses are available to perform the work at a reasonable price
  - BUT the Agency concludes that one of the HUBZone firms is eligible for award
  - AND the value of the procurement is \$4M for services, \$6.5M manufacturing or less

# The HUBZone Program Benefits

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- HUBZone firms get 10% evaluation preference
  - This only applies to unrestricted competitions, HUBZone firms do not get this in any other context
    - This does not apply to part of solicitations where price is not a factor (down selects)
    - It does not apply to reserved portions of a full and open IDIQ
    - It does not apply where all reasonable offers are accepted
  - When you bid work the government must increase all non-HUBZone awardees by 10%
    - You must first include all costs which are evaluated prior to applying the 10% (transportation costs, rent-free use of Government property)
  - If the HUBZone business is technically equal to the large business after the 10% is applied the contracting officer must award the contract to the HUBZone firm

# The HUBZone Program Benefits

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- Fewer restrictions on business structure
  - indirect ownership allowed – so a HUBZone firm need not be owned or controlled by an individual human being, it may be under a holding company
  - This allows for easy divestiture of business units to reduce revenues and extend small business life cycle
    - SBA recently changed the rules (Jan 2020) to prohibit the reduction in revenues based upon the sale of a division or other “cognizable business unit” that is part of a single legal entity
  - It also allows for liability benefits
    - Placing high-risk work into a subsidiary (unionized labor contracts, manufacturing, physically dangerous work, etc.)
  - Possible lowering of G&A and overhead by leveraging a holding company to before administration

# The HUBZone Program Benefits

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- Affiliates may be able to be excluded for purposes of determining HUBZone status
  - HUBZone firms may have affiliates for size purposes that are not affiliates for HUBZone compliance (i.e., the 35% or principal office requirements)
  - Allows you to perform work requirements not easily met in the HUBZone program within the same corporate family as the HUBZone entity without jeopardizing the HUBZone status
  - Not a clear or easy test to make the determination
    - SBA will look at whether the employees appear to be shared or if the businesses are sufficiently intertwined that there should be no separation allowed
    - More of a “Totality of the Circumstances” test

# HUBZone Risks

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# The HUBZone Program Risks

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- Must be certified by SBA
  - You cannot start bidding HUBZone work until after you receive the certification
  - Same applies for subcontracting or JVs where the HUBZone firm is the managing member or sharing the HUBZone performance of work requirements

# The HUBZone Program Risks

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- Complicated compliance requirements:
  - PRINCIPAL OFFICE:
    - Is the location where the greatest number of the company's employees work
    - If an employee works in multiple offices, SBA looks at where more than 50% of the time spent – if equal and one of the offices is not in a HUBZone the employee is deemed to work in the Non-HUBZone office
    - If you have employees working from home regularly (not during COVID) each house is its own office
    - If all “offices” have the same number of employees, you have no principal office

# The HUBZone Program Risks

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- Complicated compliance requirements
  - EMPLOYEES:
    - For initial certification, 35% of the Company's employees must reside in a HUBZone
      - Must also comply for the 3-year recertification
      - You round to the nearest whole number
    - For ongoing compliance (attempt to maintain – must have an active HUBZone contract), 20% must reside in a HUBZone
    - Employees:
      - Need only 40 hours in the completed pay periods in the 4 weeks prior to the certification/eligibility date
      - 1099s do not count
      - Can use HUBZone employee aggregators
      - Need proof of permanent residency
      - If employee lives in a HUBZone for at least 180 days before and after certification (or recert), and has never left the employ of the HUBZone firm, that employee shall still be considered to live in a HUBZone even if the person later moves out of a HUBZone

# The HUBZone Program Risks

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- JVs Work Share is More Complex (than SB)
  - You must follow the “Internal” and “External” performance of work requirements
    - 40% of the work done by the JV must be performed by HUBZone firms that are members of the JV...cannot be shared with non-member HUBZone companies
    - 60% of the work performed by the JV can be done by non-HUBZone members
  - Can be very difficult to determine work share for IDIQ Contracts
    - The “Internal” and “External” performance of work is determined across all task orders per period of performance
    - UNLESS the KO states that it will be measured order-by-order

# The HUBZone Program Risks

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- Restrictions on employees – leads to restrictions on type of work and work location
  - NOTE: If you have secondary businesses you can work around this restriction
- Company could not maintain HUBZone after moving to a PHD focused workforce
  - They advertised using paper “pull tab” type advertisements placed in grocery stores
  - SBA proposed for termination from the program for failing to attempt to maintain

# SDVOSB Benefits

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# Service-Disabled Veteran-Owned Benefits

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- Able to go after SDVOSB and Small Business work
- Self certification (For most agencies)
  - There is no approval process or automatic audits or reviews
  - You must still be 51% owned and controlled by Service Disabled Veterans
    - However, you can have a 0% disability and still qualify
- For Department of Veterans Affairs (VA) procurements it allows you to go after SDVOSB and VOSB work BUT...
  - The entity must be CVE Certified
  - VOSB work only exists at the VA, no other agency has that program

# Service-Disabled Veteran-Owned Benefits

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- Ownership and Control may be split amongst SDVs
  - One SDV can own 51% of the company and have an entirely different SDV control the company
    - I have seen this be beneficial where a Mother or Father wishes to maintain voting control but a Son, Daughter, Friend, etc. is the heir apparent and will control the day-to-day operations
    - It can also be helpful where the controlling owner wishes to invest the time and energy in other endeavors (perhaps a new SDVOSB) in a different field or specialty but wants to maintain ownership
- It is not absolutely prohibited to have more than one SDVOSB
  - If they are in different lines of business though it can be tricky due to the full time effort requirement
    - Claiming you work 80 hours a week does not work (even if true!)

# Service-Disabled Veteran-Owned Benefits

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# SDVOSB Risks

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# Service-Disabled Veteran-Owned Risks

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- Ownership restriction
  - Direct ownership required
    - You cannot set up a holding company or own the business indirectly
  - Prevents more complex corporate structures that allow divestiture of subsidiary entities to stay small
    - Can be done if the subsidiary entities are just vanilla small businesses, but you cannot claim SDVOSB status for such subsidiaries
  - Unable to segregate high risk business lines to limit liability
  - If you are an S-Corp it stops you from being able to perform a reorganization to allow another entity to acquire you without causing possible serious tax consequences

# Service-Disabled Veteran-Owned Risks

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- Control restrictions
  - Strictest “Control” rules – Negative Control only allowed for:
    - Adding a new equity stakeholder;
    - Dissolution of the company;
    - Sale of the company;
    - The merger of the company; and
    - Company declaring bankruptcy
  - This essentially eliminates any ability to get outside investment from any institutional or high net worth investors who are not willing to take on that risk
  - Even limits options like convertible debt because the SDV must be in total control of the conversion (present effect rule issues)

# Service-Disabled Veteran-Owned Risks

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## – Control Restriction

- SDV must be highest officer & have suitable experience
  - This is looked at very carefully and is a key area of concern and fraud. Thus, if you are on the line it can be very problematic
- General management experience is usually not sufficient if given heavy scrutiny
  - Had someone who managed an entire repair department of a large car dealership and did some handyman work on the side
  - Individual was friends with person who had a construction firm
  - SDV took over ownership and control but the lack of experience in construction kept them out of CVE and ran into trouble after an investigation
- General leadership experience in the military can be insufficient
  - I've dealt with clients who have managed all kinds of things in the military (common to be moved from post to post at higher ranks) but with little experience (a couple years at best) in each area of expertise, it can be questioned whether the SDV has the knowledge to truly manage

# Service-Disabled Veteran-Owned Risks

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- Ownership restriction
  - If the SDV dies the spouse can only continue to qualify the company for 3 years after the death of the veteran...BUT...can be for 10 years IF:
    - The SDV has a 100% disability rating or dies due to the service connected disability
    - The Company is in CVE just prior to the death of the SDV
    - The 10 year period does not expire early due to the Spouse remarrying or relinquishing ownership in the SDVOSB
  - ☐ NOTE: 3-year rule from the 2020 NDAA, not yet in SBA regulations
  - A permanent caregiver cannot be in control after the death of the SDV, only prior to the death.
    - The caregiver cannot just be someone placed in after the fact or a non-spousal relative
  - SDV must be highest officer & have suitable experience
    - This is looked at very carefully and is a key area of concern and fraud. Thus, if you are on the line it can be very problematic

# Service-Disabled Veteran-Owned Risks

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# Service-Disabled Veteran-Owned Risks

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- Highest fraud visibility and fall-out of all programs
- VOSB is not a highly valued designation
  - It is only available for VA work
  - It is rarely used as the SDVOSB community is so large and you only go to VOSB if no SDVOSB is capable of performing the work
- Even at the VA, they have fought tooth and nail to avoid using the SDVOSB and VOSB programs to their fullest
  - Certain industries of SDVOSBs are being decimated – like resellers of medical equipment as the VA takes all of that in house (essentially)

# Questions?

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