

LEGAL ADVISOR



A PilieroMazza Update for Federal Contractors and Commercial Businesses

Size Matters: Corporate Strategies for Maintaining Small Business Status

By John Shoraka



Through my experiences working with small businesses as the Associate Administrator of Government Contracting and Business Development at SBA, I have seen first-hand how a company's small business status can be a critical tool to develop as a contractor working with the federal government. And I

have also seen how when companies grow beyond their size standard, many will fail because they are not ready to compete with the "big boys." So I really appreciate the importance of protecting your small business status. With PilieroMazza Advisory Services, one of the areas I am focusing on is working with the firm's corporate group to share strategies with our clients to help them plan ahead and maintain their small business status.

One of the strategies that small businesses can employ when approaching their size standard is divesting a part of their business. If structured correctly according to SBA's rules, when a small business sells part of the business it will trigger SBA's "former affiliate" rule. The former affiliate rule says that "annual receipts of a former affiliate are not included if affiliation ceased before the date used for determining size. This exclusion of annual receipts of a former affiliate applies during the entire period of measurement, rather than only for the period after which affiliation ceased." 13 C.F.R. § 121.104(d)(4). This means that, by selling a "former affiliate," a small business concern can retroactively remove the former affiliate's last three years of revenue from the small business's revenue when calculating size. This can be a real win-win for the buyer and the seller. The buyer obtains valuable assets and the seller (which may have been approaching or even

exceeding its size standard) can stay small or immediately become a small business again.

Of course, the success of this strategy depends on how the transaction is structured. The devil is in the details and it is important to be mindful of SBA's rules (and their thinking) when putting the deal together. That is how we work with the firm's corporate group to marry the SBA experience with our corporate expertise. Most importantly, we have to ensure there is a clear fracture between the seller and whatever was sold. To demonstrate clear fracture, all prior links between the small business and the former affiliate should be eliminated. That means you have to be mindful about ongoing connections between the seller and what was sold, including continuing guarantees on the line of credit, ongoing financial or administrative assistance, continued intermingling of management, ongoing contractual performance together, or continued sharing of facilities or other resources. We also have to be mindful of how the deal structure is impacted by the status of the former affiliate prior to the sale (i.e., was the former affiliate a distinct division or subsidiary of the seller, or was it indiscreetly intermingled within the seller?).

A separate strategy I have seen effectively used to manage and control small business revenue growth is to take advantage of joint ventures. In a traditional prime/sub relationship, the small business prime has to count 100% of the contract revenue toward its annual revenue, even if the small business ends up subcontracting a significant portion of the work. But, for joint ventures, revenues generated by a joint venture only count toward the size of a small business in proportion to the work performed by the small business in the joint venture.

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And, with SBA's new All Small Mentor-Protégé Program in place, all small businesses are able to enter into mentoring relationships and then joint venture with large businesses. Therefore, unlike a prime/sub relationship, entering into joint ventures will allow small businesses to avoid artificially inflating their revenue and stay small longer while still gaining experience at the prime contract level.

SBA's Mentor-Protégé Program is also useful for small businesses that cannot avoid growing above their size standard. Even if a company grows above the size standard for its primary industry, the program will permit a small business to be a protégé in a secondary industry, as long as it is small in that industry and shows a business progression in that type of work. Additionally, the program permits a company to be both a protégé and a mentor at the same time. You may be able to soften the blow when transitioning to large business status through a mutually-beneficial relationship with a small business protégé.

In conclusion, sale by clear fracture of a former affiliate, joint ventures, and mentor protégé arrangements can all be used as weapons in a company's arsenal for protecting its valuable small business size status and continuing to play in the small business set-aside market place. Know that PilieroMazza Advisory Services is available to discuss any of these strategies.

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