August 23, 2016

Blog Entry: Small Business Administration Modifies Regulations Relating to Identity of Interest Affiliation

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Source: Construction Law Blog

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On May 31, 2016, the Small Business Administration ("SBA") issued its long awaited final rule regarding affiliation based on an identity of interest under 13 C.F.R. § 121.103(f). Specifically, the final rule amends the SBA's regulations concerning identity of interest arising out of family relationships and economic dependence. With respect to familial relationships, the final rule expressly limits the type of familial relationships potentially giving rise to affiliation, and additionally provides a rebuttable presumption for firms under consideration. With respect to economic dependence, the final rule presumes an identity of interest if the firm "derived 70% or more of its receipts from another concern over the previous three fiscal years," and again provides a rebuttable presumption for firms.

The SBA's final rule raises important considerations for disadvantaged business enterprises ("DBE"), particularly those firms seeking new certification as a DBE and DBEs seeking to maintain existing certification. Specifically, 49 C.F.R. § 26.65 provides that an eligible DBE "must be an existing small business, as defined by [SBA] standards," and a state regulating DBEs "must apply current SBA business size standard(s) found in 13 CFR part 121." Thus, the final rule amending 13 C.F.R. § 121.103(f) will directly affect those firms seeking new DBE certification or seeking to maintain DBE certification.

The first amendment to § 121.103(f) creates a presumption of affiliation for firms that conduct business with each other and are owned and controlled by persons who are married couples, parties to a civil union, parents and children, and siblings. However, the presumption is rebuttable. If a firm can establish that it does not engage in business transactions with another firm, this should prevent an affiliation based on an identity of interest. Moreover, and although some commenters to the proposed rule disagreed, the final rule expressly limits application of the presumption where married couples, parties to a civil union, parents and children, and siblings are involved.

The second amendment to § 121.103(f) creates a fixed percentage for affiliation based on economic dependence: an identity of interest will be presumed if the firm "derived 70% or more of its receipts from another concern over the previous three fiscal years." Previously, there was no fixed percentage that the SBA applied when evaluating economic dependence. The SBA stressed that the newly fixed percentage "is not a bright line rule, but a rebuttable presumption." Where a new or start up firm is involved, the firm can rebut the presumption with a showing that it has only been able to secure a limited number of contracts or subcontracts. Moreover, a firm can rebut the presumption by showing that the firm is not solely dependent on another firm.

The final rule is intended to reflect decisions of the SBA's Office of Hearings and Appeals interpreting § 121.103(f). Going forward, DBEs will have enhanced clarity regarding identity of interest affiliation.

New firms seeking DBE certification must ensure that they are compliant with the final rule, as states will now apply the amended § 121.103(f) during the certification process. Existing DBEs must also ensure that they are compliant with the final rule in preparation for a potential review of their certification status.

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