

business card; HUBZone residency documentation from [REDACTED] employees; [REDACTED] State unemployment tax filings; [REDACTED] Federal income tax returns; a copy of the offer submitted in response to the above-reference solicitation.

According to [REDACTED]'s written response, the search results from LinkedIn did not produce all employees of [REDACTED], therefore seeming to alter the percentage of HUBZone qualified employees.

I. 35% HUBZone Residency Requirement

The HUBZone Act and the implementing regulations require that at least 35% of the HUBZone small business concern's (SBC's) employees reside in a HUBZone. 15 U.S.C. § 632(p)(5)(A)(i)(I)(aa); 13 C.F.R. § 126.200(b). SBA's HUBZone regulations define the term employee as follows:

Employee means all individuals employed on a full-time, part-time, or other basis, so long as that individual works a minimum of 40 hours per month. This includes employees obtained from a temporary employee agency, leasing concern, or through a union agreement or co-employed pursuant to a professional employer organization agreement. SBA will consider the totality of the circumstances, including criteria used by the IRS for Federal income tax purposes and those set forth in SBA's Size Policy Statement No. 1, in determining whether individuals are employees of a concern. Volunteers (i.e., individuals who receive deferred compensation or no compensation, including no in-kind compensation, for work performed) are not considered employees. However, if an individual has an ownership interest in and works for the HUBZone SBC a minimum of 40 hours per month, that owner is considered an employee regardless of whether or not the individual receives compensation.

13 C.F.R. § 126.103.

II. Totality of the Circumstances

As noted above, [REDACTED] has stated that it utilizes four independent contractors. However, regardless of whether a firm labels an individual an independent contractor, SBA must still determine if that individual should be treated as an employee for the purposes of determining a firm's HUBZone eligibility. As explained below, in order to determine whether an individual is an employee, SBA applies the 'totality of the circumstances' test.

For purposes of the HUBZone program SBA defines the term "employee" as follows:

Employee means all individuals employed on a full-time, part-time, or other basis, so long as that individual works a minimum of 40 hours per month. This includes employees obtained from a temporary employee agency, leasing concern, or through a union agreement or co-employed pursuant to a professional employer organization agreement. SBA will consider the totality of the circumstances, including criteria used by the IRS for Federal income tax purposes and those set forth in SBA's Size Policy Statement No. 1, in determining whether individuals are employees of a concern. Volunteers (*i.e.*, individuals who receive deferred compensation or no compensation, including no in-kind compensation, for work performed) are not considered employees. However, if an individual has an ownership interest in and works for the HUBZone SBC a minimum of 40 hours per month, that owner is considered an employee regardless of whether or not the individual receives compensation.

SBA's definition of the term "employee," which explains that "[t]he totality of the circumstances, including factors relevant for tax purposes, will determine whether persons are employees of a concern." 13 C.F.R. § 126.103. That means that SBA will review the totality of circumstances to determine whether three individuals working for SCI are employees for HUBZone program purposes.

The "totality of the circumstances" language first appeared in SBA Size Policy Statement No. 1, published in the Federal Register on February 20, 1986, 51 Fed. Reg. 6099. Size Policy Statement No. 1 gave notice of SBA's "intended application and interpretation of the definition of 'number of employees.'" 51 Fed. Reg. 6099. According to Size Policy Statement No. 1, the intended application of the regulation was to broaden the SBA's authority to find that certain individuals be considered employees of the concern on an "other basis." *Id.* Specifically, the SBA stated its concern that administrative precedent had interpreted the size regulation "in a way which is overly mechanical and has the potential for subjecting the SBA size determinations to abuse. In these cases, the Agency has merely applied the common law indicia of an employee/employer relationship, *i.e.*, who hires, fires, pays and withholds taxes and provides benefits, to determine whether such individuals would be treated as employees of the business or not." *Id.* The SBA further explained that:

The mechanical exclusion of employees retained through an employment contractor from the number of employees counted in determining a business' size status would encourage circumvention of the size standards by means of creative employment practices. Therefore, in order to preserve the integrity of its size regulations, the SBA has determined that in appropriate cases individuals whose services have been procured through an employment contractor should be considered 'individuals employed on . . . [an] other basis,' under [SBA's size regulations] and be counted as part of that business' 'number of employees' even if technically the employees of the contractor under common law principles. To do

otherwise would be to permit form to prevail over substance. The Agency will not condone the use of employment practices that allow a business to create the facial appearance of being small under the size standards while at the same time deriving the usual benefits from the services of individuals in excess of those standards.

Id. at 6100 (emphasis added).

In determining whether a particular concern should be viewed as employing certain individuals on an “other basis,” Size Policy Statement No. 1 directs that the SBA “should consider any information or data relevant to the question of whether an employer is deriving the usual benefits incident to employment of such individuals, and the circumstances under which the situation came to exist.” Id. The Size Policy Statement again directs the SBA to consider the “totality of the circumstance,” including the following eleven factors:

1. Did the company engage and select the employees?
2. Does the company pay the employee’s wages and/or withhold employment taxes and/or provide employment benefits?
3. Does the company have the power to dismiss the employees?
4. Does the company have the power to control and supervise the employees' performance of their duties?
5. Did the company procure the services of the employees from any employment contractor involved in close proximity to the date of self-certification as a small business?
6. Did the company dismiss employees from its own payroll and replace them with the employees from any employment contractor involved? Were they replaced soon after their dismissal?
7. Are the individual employees supplied by any employment contractor involved the same individuals that were dismissed by the company?
8. Do the employees possess a type of expertise or skill that other companies in the same or similar lines of business normally employ in-house (as opposed to procuring by sub-contract or through an employment contractor)?
9. Do the employees perform tasks normally performed by the regular employees of the business or which were previously performed by the company's own employees?
10. Were the employees procured through an employment contractor to do other than fill in for regular employees of the company who are temporarily absent?
11. Does the contract with the independent contractor have a term based on the term of an existing Government contract?

Id. at 6100-6101. The presence of one or more of the factors in a particular case “may but will not necessarily support a finding that the employees should be attributed to the business whose

size is an issue.” Id. at 6101. The SBA explained that there may be legitimate business reasons in some cases for a company’s employment practices and the SBA’s policy is not meant to penalize a business from engaging in legitimate business arrangements. Id. The SBA explained that its regulations were meant to “reach situations where the number of employees is artificially reduced to meet particular size standards for the purpose of becoming eligible for a particular procurement or for receipt of some other SBA program benefit while the firm continues to operate or be capable of operating for all intents and purposes as though it employed a larger number of individuals.” Id.

It would make sense that the SBA interprets the “totality of circumstances” language set forth in the size and HUBZone regulations similarly. See Ben Venue Lab., Inc. v. Novartis Pharmaceutical Corp., 10 F. Supp. 2d 446, 457 (D.N.J. 1998) (it would be “illogical, indeed, even potentially dangerous, for the FDA to have contradictory understandings of critical terms . . . within its own regulations”); see also Gustafson v. Alloyd Co., 513 U.S. 561, 570 (1995) (the normal rule of statutory construction is that identical words used in different parts of the same act are intended to have the same meaning). Thus, I will look at the SBA’s interpretation of the “totality of circumstances” for size purposes to guide me with the interpretation for HUBZone program purposes.

The SBA utilizes the principles enunciated above concerning the totality of circumstances and the need to review all factors, when determining whether a person should be counted as an employee of a HUBZone SBC. The crux of this totality of circumstances test is to preserve the integrity of the HUBZone program and prevent certain employment practices that circumvent the HUBZone Act and implementing regulations.

In Size Appeal of Maryland Assemblies, Inc., SBA No. 3134 (July 12, 1989), OHA found leased employees to be employees of the challenged concern despite the fact the two companies – the leasing company and the challenged firm – were separate and independent companies. OHA found both companies were involved in a permanent business relationship where Maryland Assemblies essentially had control over the employees, although the leasing company paid their wages. After applying the totality of circumstances, “including how the employee-leasing situation came to exist,” the OHA attributed the employees leased from the leasing company to the challenged concern.

In Metro Machine, the court addressed the totality of circumstances test specifically with respect to the HUBZone program. In that case, the SBA had decertified Metro Machine from the HUBZone program after learning that the company transferred 182 non-management employees to a dormant, wholly-owned subsidiary of Metro Machine called Metro On-Call. Metro Machine Corp. v. SBA, 305 F.Supp.2d 614, 617 (E.D. Va.), aff’d, 102 Fed. Appx. 352 (4th Cir. 2004). In addition to transferring the employees, Metro Machine entered into an agreement with Metro On-Call “guaranteeing that the transferred employees would be available at all times to work on

Metro Machines projects. Further, Metro Machine revised a collective bargaining agreement with its union to ensure that employees transferred to [the subsidiary] would not lose any of the rights that they would have had under that agreement.” Id. Specifically, Metro Machine ensured that the transferred employees had the same terms relative to seniority, layoff and recall, discipline, shop assignments and pension payments. Id. at 618. The transferred employees performed the same work, in the same location, and under the same supervisors as they did before the transfer. Id. at 617. Metro Machine advised the SBA that its subsidiary was being capitalized and organized as a subsidiary to Metro Machine.

Using the totality of circumstances as a guide, the SBA had determined that the employees of Metro On-Call were really employees of Metro Machine. Specifically, the SBA determined:

- (1) Metro Machine dismissed employees from its own payroll and replaced them with employees of Metro On-Call immediately after their dismissal;
- (2) the individual employees supplied by Metro On-Call were the same individuals who were dismissed from Metro Machine;
- (3) Metro Machine has the power to control and supervise Metro On-Call employees in the performance of their duties;
- (4) Metro Machine engaged and selected Metro On-Call employees;
- (5) Metro Machine has the power to dismiss Metro On-Call employees;
- (6) Metro On-Call employees possess skill and expertise that other companies in the same line of business normally employ in-house; and
- (7) Metro On-Call employees perform tasks that were formerly performed by Metro Machine employees.

Id. at 619. The court held that the SBA’s interpretation of 13 C.F.R. § 126.103, and the use of the totality of circumstances test as a guide, was not erroneous, inconsistent with the HUBZone regulations, nor contrary to clearly established rules. Further, the court ruled that the SBA’s decision that Metro On-Call employees should be deemed employees of Metro Machine was not arbitrary or capricious.

In this case, [REDACTED] stated that it ‘generally employs independent contractors rather than employees in situations where the expertise required to execute what is requested of [REDACTED] is so highly specialized that it is either impractical or impossible for [REDACTED] to retain the expertise in-house.’ [REDACTED] also provided detailed information about its four independent contractors including the signed contracts and invoices between the individuals and [REDACTED]. Additionally, [REDACTED] stated that according to the Totality of the Circumstances test, they believed that one independent contractor, [REDACTED], should be included as an employee. The other three independent contractors – [REDACTED], [REDACTED], and [REDACTED] – should not be counted as employees. In reviewing the materials, SBA applied the totality of circumstances test to these individuals to determine if they should be considered ‘employees’ for the purposes of HUBZone eligibility.

A. [REDACTED]

In response to SBA's request for information, [REDACTED] provided the following statement; [REDACTED] performs various tasks as directed by [REDACTED]'s officers, and performs those tasks in various locations, including both client site and [REDACTED] site locations.' A review of Mr. [REDACTED]'s employment contract indicates that he has ultimate responsibility for portions of standup and performance of a contract. [REDACTED] has a business card from [REDACTED], labeling him as the Chief Strategy Officer; he is the point of contact for [REDACTED] on the contract with another of the independent contractors. There is an email address assigned to [REDACTED] which he uses to conduct his daily business. Invoices show that he does not bill his time in hourly increments, but rather is paid by monthly retainer and by project. Therefore, after reviewing all of the information provided and applying the totality of the circumstances test, I have concluded that for the purpose of determining HUBZone eligibility [REDACTED] is considered an employee of [REDACTED].

B. [REDACTED]

[REDACTED] is a firewall engineer who works on site at the Defense Logistics Agency for [REDACTED]. According to a statement from [REDACTED], 'it is very difficult to find Firewall Engineers with current Secret Clearance with required Security Certifications that DLA requires.' The contract between [REDACTED] and [REDACTED] is specific to the DLA contract in terms of scope of work and period of performance. Invoices show that [REDACTED] works approximately 40 hours per week; billed at an hourly rate. He has not been issued an [REDACTED] business card. He does have an email address from [REDACTED], but uses a government-issued email address to conduct his daily client business and uses his personal email address to communicate with [REDACTED] – the [REDACTED]-issued email address is exclusively used for timekeeping, invoicing and subcontractor management systems. Therefore, after reviewing all of the information provided and applying the totality of the circumstances test, I have concluded that for the purpose of determining HUBZone eligibility [REDACTED] is not considered an employee of [REDACTED].

C. [REDACTED]

[REDACTED] is a Jive Community Architect who works on site at the Veterans Administration (VA). [REDACTED] owns his own business, and has clients other than [REDACTED]. The contract between [REDACTED] and [REDACTED] is specific to work on [REDACTED]'s VA subcontract; with a period of performance less than one year. Invoices show that [REDACTED] works approximately 40 hours per week; billed at an hourly rate. He has not been issued an [REDACTED] business card. He does have an email address from [REDACTED], but uses a government-issued email address to conduct his daily client business and uses his personal email address to communicate with [REDACTED] – the [REDACTED]-issued email address is exclusively used for timekeeping, invoicing and subcontractor management systems. Therefore, after reviewing all of the information provided and applying the totality of the circumstances

test, I have concluded that for the purpose of determining HUBZone eligibility [REDACTED] is not considered an employee of [REDACTED].

D. [REDACTED]

[REDACTED] is VLER (a system specific to the VA) architect who works on site at the VA. [REDACTED] owns his own business, and has clients other than [REDACTED]. The contract between [REDACTED] and [REDACTED] is specific to work on [REDACTED]'s VA subcontract; and specifically states that he is a subject matter expert hired as an independent contractor, not an agent of [REDACTED]. Invoices show that [REDACTED] works approximately 40 hours per week; billed at an hourly rate. He has not been issued an [REDACTED] business card. He does have an email address from [REDACTED], but uses a government-issued email address to conduct his daily client business and uses his personal email address to communicate with [REDACTED] – the [REDACTED]-issued email address is exclusively used for timekeeping, invoicing and subcontractor management systems. Therefore, after reviewing all of the information provided and applying the totality of the circumstances test, I have concluded that for the purpose of determining HUBZone eligibility [REDACTED] is not considered an employee of [REDACTED].

Therefore, of the four independent contractors, I find that one, [REDACTED], shall be considered an employee for HUBZone eligibility circumstances.

III. Analysis

As noted above, the HUBZone Act and the implementing regulations require that at least 35% of the HUBZone small business concern's (SBC's) employees reside in a HUBZone. 15 U.S.C. § 632(p)(5)(A)(i)(I)(aa); 13 C.F.R. § 126.200(b).

Therefore after applying the totality of circumstances test, and analyzing the payroll records and other documents provided for the pay period covering the date of offer, September 11, 2013, [REDACTED] had 15 employees (this number includes individuals that were on [REDACTED]'s payroll and the one individual treated as an employee under the totality of the circumstances test) who worked at least 40 hours in the month leading up to the date of offer. At least 6 of [REDACTED]'s employees must have resided in a HUBZone ($15 * 35\% = 5.25$, rounded up to 6¹) to meet the 35 percent HUBZone residency requirement. According to documentation provided, 7 employees resided in a qualified HUBZone. Therefore, [REDACTED] met the 35 percent residency requirement at the time of offer.

According to the payroll records and other documents for the pay period covering the present date, October 15, 2013, [REDACTED] had 18 employees who worked at least 40 hours in the month

¹ "When determining the percentage of employees that reside in a HUBZone, if the percentage results in a fraction, round up to the nearest whole number" 13 C.F.R. 126.200(b)(4).

leading up to the present day. At least 7 or [REDACTED]'s employees must have resided in a HUBZone (18 * 35% = 6.3, rounded up to 7) to meet the 35 percent HUBZone residency requirement. According to documentation provided, 8 employees resided in a qualified HUBZone. Therefore, [REDACTED] met the 35 percent residency requirement at the time of offer².

Appeal Rights

[REDACTED], the protester, or the contracting officer may appeal this decision pursuant to 13 C.F.R. § 126.805. All appeals must be made to the Associate Administrator for Government Contracting and Business Development (AA/GC&BD) within five business days from receipt of this letter. The appeal may be sent by facsimile, express delivery service, or U.S. mail (postmarked within the applicable time period), or via hand delivery. The AA/GC&BD may be reached at the U.S. Small Business Administration, 409 3rd Street, SW, Suite 8000, Washington, DC 20416, by facsimile at (202) 205-5206, or by e-mail at hzappeals@sba.gov. SBA will dismiss any appeal received after the five-day period. Pursuant to 13 C.F.R. § 126.805(d), the party bringing the appeal must provide a notice of the appeal to the contracting activity contracting officer and the protested concern. I have attached a copy of the appeal procedures.

Release of Decision

The SBA intends to make its HUBZone status protest and appeal decisions available to the public by posting them on its website at www.sba.gov/hubzone. As we noted in our initial letter, the Freedom of Information Act (FOIA), 5 U.S.C. § 552, requires the government to disclose records in its possession unless the information falls under one of the nine-enumerated exemptions, including that the information is a trade secret or is privileged or confidential commercial or financial information (5 U.S.C. § 552(b)(4)), or that the disclosure of the information would constitute an unwarranted invasion of individual privacy (5 U.S.C. § 552(b)(6)). We also explained in our initial letter that we will release in the protest decision the total number of employees of the protested concern, the total number of employees that are HUBZone residents, as well as the number of employees that work at a business' different offices.

The SBA has reviewed this decision letter and believes that no redactions to this document are necessary. However, each party to the protest shall refrain from releasing the decision until the end of the fifth business day following receipt of the decision by all parties. This permits parties to identify anything that they believe should have been redacted.

Small Business Regulatory Enforcement Fairness Act

² SBA notes that independent contractor [REDACTED], included residency information and does live in a qualified HUBZone area. Additionally, if the other three independent contracts had been considered employees, [REDACTED] still would have met the 35 percent requirement at both the time of offer and present day.

If you believe your small business has been the subject of excessive or unfair regulatory enforcement or compliance actions as a result of this decision, you have the right under the Small Business Regulatory Enforcement Fairness Act to file a complaint or comment with SBA's National Ombudsman at:

Office of the National Ombudsman
U.S. Small Business Administration
409 Third St. SW
Washington, DC 20416
PH: 1-888-734-3247
FX: 1-202-481-5719
EM: ombudsman@sba.gov

The right to file a complaint or comment with SBA's National Ombudsman is independent of any other rights you may have to contest this decision. The National Ombudsman may not change, stop, or delay a Federal agency's enforcement action or impede any administrative or criminal process.

Thank you for your cooperation with this matter. If you have any questions, please contact me at hzprotests@sba.gov.

Sincerely,

Mariana Pardo
Director, HUBZone Program

cc:

[REDACTED], Contracting Officer

Fax: [REDACTED]

[REDACTED]
Fax: [REDACTED]