Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

SMALL BUSINESS ADMINISTRATION

13 CFR Part 126

RIN: 3245–AF44

HUBZone and Government Contracting

AGENCY: Small Business Administration.

ACTION: Proposed rule.

SUMMARY: This rule proposes to amend the U.S. Small Business Administration's (SBA or Agency) Historically Underutilized Business Zone (HUBZone) program's definition of the term ''employee.'' SBA believes that the proposed amendment will simplify the existing definition and increase employment of HUBZone residents.

DATES: Comments must be received on or before February 26, 2007.

ADDRESSES: You may submit comments, identified by RIN 3245–AF44 by any of the following methods: (1) Federal Rulemaking Portal: *http://www.regulations.gov.* Follow the instructions for submitting comments; (2) E-mail: *hubzone@sba.gov.* Include RIN number in the subject line of the message; (3) Fax: (202) 481–5593; or (4) Mail or Hand Delivery: Michael McHale, Associate Administrator for the HUBZone Program, 409 Third Street, SW., Washington, DC 20416.

FOR FURTHER INFORMATION CONTACT: D.J. Caulfield, HUBZone Program Office, at (202) 205–6457 or by e-mail at: *david.caulfield@sba.gov.*

SUPPLEMENTARY INFORMATION:

Statutory Authority and Background

The HUBZone program was established pursuant to the HUBZone Act of 1997 (HUBZone Act), Title VI of the Small Business Reauthorization Act of 1997, Pub. L. 105–135, enacted December 2, 1997. The stated purpose of the HUBZone program is to provide for Federal contracting assistance to qualified HUBZone small business concerns. 15 U.S.C. 657a(a). The HUBZone Act authorizes the Administrator of SBA to publish regulations implementing the program. Pub. L. 105–135, sec. 605.

On January 28, 2002, SBA published a proposed rule seeking to amend several regulations including the definition of the term ''employee'' for the HUBZone program. 67 FR 3826. In this proposed rule, SBA sought to remove the provision concerning full-time equivalents. In addition, SBA proposed allowing leased or temporary employees to be counted as employees of the HUBZone small business concern (SBC).

SBA decided not to implement any of the proposed changes to the definition of employee as a result of the comments received and issues raised by those comments. Instead, on May 13, 2004, SBA published an Advance Notice of Proposed Rulemaking (ANPRM) and sought further public comment on the definition of the term ''employee'' as it related to the HUBZone program. 69 FR 26511.

Summary of Comments to ANPRM and Response to Comments

SBA received 9 comments to its ANPRM on this issue. All of the comments offered recommendations and creative approaches for defining the term ''employee'' for HUBZone program purposes. SBA reviewed each of the comments in drafting its proposed regulation and addresses its reasons for accepting or not accepting the comment when drafting the proposal. SBA notes that it has issued this rule as proposed and therefore will review again all comments received on the proposal, including any comments that are the same or similar to those received on the ANPRM. In addition, SBA notes that this proposed definition applies only to the HUBZone program, and the eligibility requirements of that program, with the exception of size. To be eligible for the HUBZone program and for a HUBZone contract, the SBC must be a small business as set forth in 13 CFR part 121 (this includes the calculation of number of employees for size purposes in 13 CFR 121.106).

One comment noted that the full-time equivalent requirement is a good concept and should not be changed because it ensures that a maximum number of good jobs are created in the HUBZones. The commenter does not believe that the definition of full-time equivalent is confusing. Three commenters, however, supported any change that would allow part-time employees to be counted the same as full-time employees. These commenters believed it would be beneficial to those SBCs in the construction or services industry, since both industries employ part-time and temporary workers.

In response to these comments, SBA has proposed mirroring, in general, the current size definition of the term ''employee'' and counting all individuals employed on a full-time, part-time, or other basis. SBA believes that it is important to have consistency among its various programs to the maximum extent practicable, unless a valid policy reason exists for differing policies. Thus, SBA has proposed some deviations from the size regulations regarding part-time and temporary employees, which is discussed in further detail in the next section of this preamble.

SBA received one comment stating that subcontractors must be excluded from the definition of the term ''employee.'' The Agency notes that, generally, subcontractors are not treated as employees of a concern. However, there may be instances where the employees of a subcontractor are treated as employees of the HUBZone SBC based upon the totality of circumstances. This might occur, for example, if the prime and subcontractor are affiliated and the subcontractor had recently hired the HUBZone SBCs' former employees, so that the HUBZone SBC could maintain its HUBZone eligibility. Thus, SBA believes that there is no need to discuss the issue of subcontractor employees or to provide a specific exclusion for them in the regulations.

One comment argued that SBA should exclude employees hired to perform on specific construction contracts from the calculation of the 35% HUBZone residency requirement because construction contractors typically perform work in non-HUBZone locations and must hire workers from those areas. As a result, the comment stated that those in the construction industry have a difficult time meeting the 35% HUBZone residency requirement.

SBA understands the concerns expressed by the SBC. However, the purpose of the program is to infuse HUBZones with revenue by hiring residents of the HUBZones and having

businesses located in HUBZones. If the SBC does not count a large percentage of its workforce toward the HUBZone residency requirement, the purpose of the program could be thwarted. In addition, SBA notes that the statute and implementing regulations allow the HUBZone SBC to ''attempt to maintain'' the requisite HUBZone residency requirement during the performance of a HUBZone contract. Thus, the statute recognizes that qualified HUBZone SBCs performing construction and service contracts may have a difficult time meeting the residency requirement during the performance of the HUBZone contract and has already addressed the issue. Therefore, SBA does not believe it is necessary to address this issue again in its regulations, in the definition of the term ''employee.''

One comment stated that the definition of the term ''employee'' should include a requirement that HUBZone SBCs pay its HUBZone and non-HUBZone employees the same or ''classify'' them the same. The commenter believes this would create a firewall against manipulation of employee status to qualify for HUBZone contracting preferences. In response to the comment, SBA notes that it does not have the authority to require companies to pay its employees certain amounts or to internally ''classify'' their employees a certain way. These are business decisions to be made by the company.

The Agency received several comments addressing the issue of temporary and leased employees. The current definition provides that temporary and leased employees are not considered employees of a HUBZone SBC. SBA received one comment stating that SBA should delete the requirement that only ''permanent'' employees be considered employees of the HUBZone SBC. The comment stated that there was no clear meaning of ''permanent.''

Similarly, SBA also received comments recommending that SBA allow qualified HUBZone SBCs to count temporary employees as employees of the concern (or, at a minimum, to define the term ''temporary employee''). One comment stated that temporary employees should be deemed employees of the HUBZone SBC only if they have been employed for at least 180 consecutive days. The comment stated that several SBCs, such as those dealing with agricultural commodities, retain a fluctuating number of temporary, leased employees to supplement a core of full-time employees. Because these employees generally have a history of transitory residences, and because they are not ''permanent'' but temporary, it is difficult for the HUBZone SBC to keep track of and maintain its HUBZone status. Specifically, the comment states it is difficult to keep track of and maintain the 35% residency requirement. The comment believes that counting a temporary worker as an employee only if they have worked a minimum of 180 consecutive days would ease this burden and allow the HUBZone SBC to take appropriate steps to ensure that its employees meet the program's residency requirement.

Another commenter recommended that SBA add the concept of seasonal employee since many HUBZone SBCs need to add a large number of personnel for a very short period, such as agricultural crop harvesters during a short harvest season. These seasonal employees would be employed for less than 90 days at a time and their work requirement would be driven by a seasonal event. In addition, this commenter believed that the HUBZone SBC should be allowed to decide for itself whether or not to count the seasonal employees as employees of the concern.

Similarly, one commenter supported including in the definition of employee those workers employed through a co-employee arrangement with a Professional Employer Organization (PEO). According to this comment, such an amendment to the HUBZone regulations would provide consistency with SBA's size rules set forth at 13 CFR 121.106. That regulation provides that for purposes of determining the size of a business concern, SBA generally considers employees obtained from a PEO as employees of the concern.

In addition, this commenter noted that the HUBZone SBC with the PEO arrangement still has the ability to hire and fire the co-employees, as well as supervise them. In fact, the commenter stated that if a PEO fires an employee, the employee is still considered an employee of the HUBZone SBC. Therefore, this commenter believed that the HUBZone regulations should recognize that workers of a PEO employed by a qualified HUBZone SBC are ''employees'' of the HUBZone SBC.

In comparison, one commenter suggested that the determination of whether someone is an employee of a HUBZone SBC should be based solely upon whether the SBC issues that person a W–2 form. This would exclude leased or co-employees who may work for the HUBZone SBC but receive their W–2's from another source.

SBA agrees with most of these comments, and has proposed deleting the requirement that only ''permanent'' employees be considered employees of the HUBZone SBC. Thus, SBA proposes allowing HUBZone SBCs to count temporary employees, employees obtained from a temporary agency, leased employees, and co-employees of PEOs as employees of the HUBZone SBC. As discussed in more detail in the next section, many SBCs are using PEO and leasing arrangements for economic and business reasons. Ultimately, the leased or co-employees are truly employees of the HUBZone SBC (hired and fired by the HUBZone SBC, receive wages from the HUBZone SBC, etc.). Thus, SBA believes that, in general, they should be considered employees of the HUBZone SBC and has proposed a regulation addressing this issue. The Agency also proposes to address those cases where employees have union contracts, but ultimately work for the HUBZone SBC. SBA believes that because these individuals perform work for the HUBZone SBC, they should therefore be considered employees of the concern, not the union.

However, the Agency believes that requiring a minimum or maximum number of workdays for temporary or ''seasonal'' or any other type of employee would create a burden because the SBC would have to calculate the HUBZone residency, full-time equivalency, principal office requirement *and* an additional minimum/maximum work requirement. This would likely be a great burden to a HUBZone SBC and it is not clear how such an additional requirement would prevent abuse of the program, further the mission of the HUBZone program or help HUBZone SBCs. One of the purposes of the program is to stimulate job growth in HUBZones. SBA believes that if the HUBZone SBC hires a HUBZone resident, even on a temporary basis, then this purpose is met.

SBA received one comment stating that employees should be ''grandfathered.'' In other words, if an employee resides within a former HUBZone area, the employee should nonetheless still be considered a HUBZone resident for a minimum number of years. SBA does not believe it can make this change. The statute specifically defines the term HUBZone and requires, in general, that HUBZone SBCs meet a 35% HUBZone residency requirement. We do note that if the employee resides within a redesignated area (an area that was formerly a HUBZone but that remains a HUBZone for three years after it loses its HUBZone status), then the employee is considered to reside within a HUBZone. Thus, there is already a ''grandfathering'' provision for certain HUBZone areas and their residents.

Proposed Regulation

The current definition of the term ''employee'' for the HUBZone program (*i.e.*, principal office and 35% HUBZone residency requirement) reads as follows:

Employee means a person (or persons) employed by a HUBZone SBC on a full-time (or full-time equivalent), permanent basis. Full-time equivalent includes employees who work 30 hours per week or more. Full-time equivalent also includes the aggregate of employees who work less than 30 hours a week, where the work hours of such employees add up to at least a 40 hour work week. The totality of the circumstances, including factors relevant for tax purposes, will determine whether persons are employees of a concern. Temporary employees, independent contractors or leased employees are not employees for these purposes.

Example 1: 4 employees each work 20 hours per week; SBA will regard that circumstance as 2 full-time equivalent employees.

Example 2: 1 employee works 20 hours per week and 1 employee works 15 hours per week; SBA will regard that circumstance as not a full-time equivalent.

Example 3: 1 employee works 15 hours per week, 1 employee works 10 hours per week, and 1 employee works 20 hours per week; SBA will regard that circumstance as 1 full-time equivalent employee.

Example 4: 1 employee works 30 hours per week and 2 employees each work 15 hours per week; SBA will regard that circumstance as 1 full-time equivalent employee.

13 CFR 126.103. SBA is proposing to revise the definition of the term ''employee'' to: (1) Delete the phrase ''permanent'' basis and the full-time equivalency requirement; (2) allow HUBZone SBCs to count leased or temporary employees or employees obtained through a temporary agency, PEO arrangement or union agreement, as employees; (3) specifically state that SBA relies on the totality of circumstances as further defined by Size Policy Statement No. 1 when determining whether individuals are employees of a concern; (4) explain that volunteers are not employees; (5) define volunteers as those persons that receive no compensation; and (6) address the status of individuals that own all or part of the SBC but receive no compensation for work performed.

First, SBA proposes to allow HUBZone SBCs to count full-time, part-time and those employed on an ''other basis,'' as well as leased and temporary employees, and employees obtained through temporary agencies, co-employer agreements and union agreements as employees, rather than only count employees hired on a ''full-time,'' ''full-time equivalency'' or ''permanent'' basis. We note that this would be consistent with SBA's size regulations, which state that in determining a concern's number of employees, SBA counts such persons, including persons obtained from a temporary employee agency, PEO or leasing concern. 13 CFR 121.106(a).

However, SBA has proposed some deviations from the treatment of ''employee'' as compared to the size regulations. While all part-time and temporary employees are counted equally for size purposes, this proposed rule will count only those employees employed by the businesses concern for at least 40 hours per month (*e.g.*, 40 hours in January, 40 hours in February etc.), for HUBZone program purposes. SBA does not want a firm to be able to claim HUBZone eligibility (*e.g.*, the 35% residency requirement) where it merely hired a few HUBZone residents to work one or two hours a week. SBA believes that this minimum work requirement provides flexibility to the HUBZone SBCs and the employees who choose to work part-time, but at the same time minimizes possible abuses of the rule.

With respect to leased and temporary employees, it is our understanding that for many reasons, including rising employee health care costs, small businesses are increasingly hiring temporary or leased employees, or co-employees from a PEO. *See e.g.*, ''Putting a band-aid on small firm's health care costs,'' *USA Today* (April 18, 2006) (available at *http://www.usatoday.com/money/smallbusiness/2006-04-18-health-costs-usat_x.htm?csp=34*). Thus, SBA believes that counting such persons as ''employees'' for HUBZone Program purposes will fulfill the statutory purpose and intent of the HUBZone Act by providing more job opportunities for HUBZone residents.

Further, SBA notes that SBCs could qualify for the HUBZone program under the current regulations by claiming only a few employees, when in reality they have many employees, all of whom are leased and very few of whom live in a HUBZone. SBA believes that counting leased and temporary employees, as well as persons obtained through a PEO arrangement, will prevent such an abuse.

SBA notes that if the totality of circumstances, however, dictates otherwise, then the individuals employed on a temporary or leased basis (or co-employees or union employees) may not be considered employees of the HUBZone SBC. Because of the numerous types of agreements in the public domain concerning these types of employees, SBA cannot state definitively that each of those types of employees are ''employees'' of the HUBZone SBC. However, in general, those employees are counted if the HUBZone SBC can hire and fire the employee, pays the employees' wages, supervises the employee, and meets any or all of the factors set forth in SBA's Size Policy Statement No. 1 (discussed in detail below).

Second, SBA's HUBZone regulations state that the totality of the circumstances, including factors relevant for tax purposes, will determine whether persons are employees of a concern. 13 CFR 126.103. That means that SBA will review the totality of circumstances to determine whether those persons who ''work'' for another company are truly employees of the HUBZone SBC. The totality of circumstances language set forth in the HUBZone regulations can also be found in SBA's size regulations. When determining the size of a particular concern under an employee-based size standard (*i.e.*, the number of employees that the concern has), SBA's size regulations require that the Agency count all individuals employed by the concern, including those employed on an ''other basis.'' 13 CFR 121.106(a). Like the HUBZone regulations, the size regulations also direct SBA to consider the totality of the circumstances when determining whether certain individuals are to be considered employees of the concern in question. *Id.*

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 FR 6099. Size Policy Statement No. 1 gave notice of SBA's intended application and interpretation of the definition of number of employees. *Id.* According to Size Policy Statement No. 1, the intended application of the regulation was to broaden SBA's authority to find that certain individuals be considered employees of the concern on an ''other basis.'' *Id.* Specifically, SBA stated its concern that administrative precedent had interpreted the size regulation in an overly mechanical way and therefore could subject SBA's size determinations to abuse.

Size Policy Statement No. 1 directs that SBA 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 directs SBA to consider the ''totality of the circumstances,'' including the following eleven factors:

Did the company engage and select the employees?

Does the company pay the employees wages and/or withhold employment taxes and/or provide employment benefits?

Does the company have the power to dismiss the employees?

Does the company have the power to control and supervise the employees' performance of their duties?

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?

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?

Are the individual employees supplied by any employment contractor involving the same individuals that were dismissed by the company?

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)?

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?

Were the employees procured through an employment contractor to do other than fill in for regular employees of the company who are temporarily absent?

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 does not necessarily support a finding that the employees should be attributed to the business whose size (or HUBZone status) is an issue. *Id.* at 6101.

SBA uses the guidance set forth in this Size Policy Statement in determining whether a person is an employee of a HUBZone SBC under the totality of circumstances test. At least one court has ruled that this is permissible and consistent with the HUBZone regulations. *Metro Machine Corp.* v. *SBA,* 305 F.Supp.2d 614 (E.D.Va. 2004), *aff'd,* 102 Fed.Appx. 352 (4th Cir. 2004). Thus, SBA intends to clarify in the regulations that it uses the guidance set forth in SBA's Size Policy Statement No. 1 in determining who is an employee of a HUBZone SBC.

Third, SBA's proposed definition of the term ''employee'' provides that volunteers or any person who does not receive compensation for work performed for the HUBZone concern are not considered employees of the concern. SBA proposes to define the term ''volunteer'' to mean a person who receives no compensation, including no in-kind compensation, for work performed. Thus, a person who receives food, housing or other non-monetary compensation in exchange for work performed would not be considered a volunteer, and thus included as an employee of the HUBZone SBC. This proposal would make the HUBZone regulations consistent with SBA's size regulations, which provide the same. In addition, SBA believes that allowing volunteers to be counted as employees would not fulfill the purposes of the HUBZone Act—job creation and economic growth in underutilized communities.

Along the same lines, SBA proposes to address the treatment of owners of a company who often work many long hours for the SBC, but refrain from receiving monetary compensation until the SBC is making a profit. SBA proposes to allow such owners to be considered ''employees'' of the concern, regardless of whether they receive compensation from the SBC. SBA believes that although these owners are not necessarily receiving monetary compensation for their work, they are nonetheless investing considerable time and energy into the SBC with the hope and expectation that their efforts ultimately will be rewarded. Therefore, SBA believes these persons should be considered an employee for HUBZone program purposes so long as they work a minimum of 40 hours a month. This would be consistent with the proposed general requirement that only persons employed by the HUBZone SBC and that work at least 40 hours per month are counted as employees of the concern.

SBA seeks comments on these proposed amendments to the HUBZone definition of the term ''employee.'' The SBA would specifically like comments addressing the following: (1) Whether 40 hours per month is a suitable minimum work requirement; and (2) whether temporary employees should be employed for a specific period of time (*i.e.*, 6 months) in order to be considered employees.

Compliance With Executive Orders 12866, 12988, and 13132, the Paperwork Reduction Act (44 U.S.C. Ch. 35), and the Regulatory Flexibility Act (5 U.S.C. 601–602)

SBA has determined that this proposed rule does not impose additional reporting or recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C., chapter 35. Further, this proposed rule meets applicable standards set forth in §§ 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. This action does not have retroactive or preemptive effect.

This proposed rule will not have substantial direct effects on the States, on the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, for the purposes of Executive Order 13132, SBA determines that this rule has no federalism implications warranting preparation of a federalism assessment.

OMB has determined that this rule constitutes a ''significant regulatory action'' under Executive Order 12866. SBA's Regulatory Impact Analysis is set forth below.

Regulatory Impact Analysis

1. Is There a Need for the Regulatory Action?

SBA's statutory mission is to aid and assist small businesses through a variety of financial, procurement, business development, and advocacy programs. To assist the intended beneficiaries of these programs, SBA must establish distinct definitions regarding eligibility for its various programs. In the present case, SBA issued a proposed rule, and an ANPRM, to determine whether there was a need to amend the definition of the term ''employee'' for HUBZone program purposes. SBA received several responses to both the proposed rule and ANPRM. After evaluating these responses, as well as reviewing application of the current regulation in the certification, protest and appeal, and program examination processes, SBA has determined that the definition of employee must be amended to better serve the needs of SBCs and advance the goals of the HUBZone Act. The reasons for each of the proposed amendments is set forth in the preamble.

2. What Are the Potential Benefits and Costs of This Regulatory Action?

The baseline for measuring the potential benefits of the rule is the status quo, *i.e.*, no change in the regulation. SBA believes that the proposed rule will maximize the net benefits to society, including potential economic advantages. Specifically, the benefits of these proposed amendments would accrue to those SBCs that utilize part-time, temporary or leased employees (as well as PEOs and union workers) because they would no longer be ''penalized'' for using those types of workers. If the rule is finalized as proposed, SBCs that utilize such workers would be able to count them toward the HUBZone program's 35% residency and principal office

requirements. In addition, this proposed rule would aid small, start-up companies where the owner works for the company but receives no compensation for his/her efforts.

SBA also believes that the Historically Underutilized Business Zones—the areas that the HUBZone program are meant to help—will benefit from the rule. HUBZone SBCs can now hire leased and temporary employees in order to ''circumvent'' the 35% HUBZone residency and principal office requirement. In other words, these companies hire only a few employees and then lease or hire several temporary workers. Because SBA does not count the leased and temporary workers as ''employees,'' these workers are not part of the 35% residency calculation or principle office calculation. This means that there are fewer jobs and other benefits flowing to the HUBZones. SBA believes the proposed rule would increase the number of jobs and other benefits to HUBZones.

SBA believes that if the proposed rule is published as final, there may be current qualified HUBZone SBCs that no longer qualify for the program because they hire leased and temporary employees that are non-HUBZone residents, and would have to count those personnel as employees of the concern. However, SBA also believes that this rule will allow other SBCs to qualify for the program. SBA believes that if there are increases in the number of concerns participating in the HUBZone program and in the number of HUBZone contract dollars awarded, there may be attendant cost increases to the government in terms of the costs of goods and services sold and administrative costs. However, existing provisions of the Federal Acquisition Regulation concerning the determination of ''fair and reasonable'' pricing will mitigate any significant monetary costs to the government as a result of this proposed rule.

In addition, SBA believes that the rule will provide greater administrative efficiency and program integrity. Because the amendments in this proposed rule clarify some of the program's requirements, the rule will likely streamline and improve the effective administration of the HUBZone program. It will also enhance SBA's ability to administer the program with existing resources and better focus the program benefits on the businesses that operate in areas of low income or high unemployment. Further, as explained in detail above, SBA believes that allowing SBCs to count temporary and leased employees (as well as co-employees and union employees) will protect the integrity of the program.

Overall, projecting winners and losers from regulatory changes in the HUBZone program cannot be done with certainty. SBA believes that increasing the efficiency and access to the HUBZone program will, over time, result in increased use of the program and a higher probability that the HUBZone Program will meet its original objectives to create jobs and increase capital investment in HUBZone communities. Thus, SBA believes that the benefits of the proposed rule outlined above, including the benefits to the HUBZone areas (and the fact that many new HUBZone SBCs will employ HUBZone residents) maximizes the net benefits to society.

3. Were Any Alternatives Considered?

SBA considered many alternatives to the rule proposed. First, SBA considered not amending the rule. However, during the certification, protest and appeal, and program examination process, the same issues would materialize. These issues relate to the use of temporary or leased employees, as well as co-employees. In addition, issues arise concerning start-up companies and whether their owners who work many long hours for the company could be counted as an employee despite the fact the owner receives no compensation. Thus, SBA considered issuing policy notices, for example, rather than amending the regulations. These notices, however, are generally not published material like regulations, and would hinder a SBC's access to this needed information.

In addition, SBA considered amending the definition of the term ''employee'' by retaining the provision regarding full-time equivalents. SBA received several comments on the issue of full-time equivalent in response to its prior proposed rule and the ANPRM, which are discussed above, including at least one stating the use of full-time equivalents is appropriate. SBA, however, believes that this provision has caused confusion amongst SBCs and therefore, the SBCs may not be strictly following the full-time equivalent requirement.

SBA had also considered deleting the full-time equivalent requirement with the caveat that the individual work a minimum of 10 hours per week. However, SBA was concerned that SBCs could easily circumvent the regulation and have employees, including those that do not reside in a HUBZone work, less than 10 hours for just one week, and not be counted toward the principal office or 35% HUBZone residency requirement.

SBA also considered requiring the employees work a minimum of 10 hours per week averaged over a single payroll period. However, one problem with this alternative is that businesses have different payroll periods and thus, a person could be an employee of one concern, but not another, depending on how the company defines the term payroll period.

SBA also considered calculating a HUBZone SBCs employees similar to the requirements set forth for size in 13 CFR part 121 (*e.g.*, total hours for year divided by 2080). However, SBA believed this would conflict with the HUBZone definition of principal office.

In addition, SBA had considered setting forth all eleven criteria considered under the totality of circumstances test set forth in Size Policy Statement No. 1. However, SBA reviewed the Size Policy Statement and believes that the entire policy statement must be reviewed, in addition to the eleven criteria, in order to determine whether or not a person is an ''employee.'' Thus, SBA believes it would be best to simply reference the policy notice, which is a publicly available document, rather than set forth all of the criteria and other factors in the regulation.

Initial Regulatory Flexibility Analysis for the HUBZone Proposed Regulations

SBA certifies that this proposed rule may have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act (RFA), 5 U.S.C. 601, *et seq*. Thus, SBA has prepared this Initial Regulatory Flexibility Analysis (IRFA).

The RFA provides that when preparing such an analysis, an agency shall address all of the following: the reasons, objectives, and legal basis for the proposed rule; the kind and number of small entities that would be affected; the projected recordkeeping, reporting, and other requirements; Federal rules that may duplicate, overlap, or conflict with the proposed rule; and any significant alternatives to the proposed rule. This IRFA considers these points and the impact of these proposed regulations on small entities.

1. Reasons for and Objectives of the Proposed Rule

The HUBZone Program was established pursuant to the HUBZone Act of 1997 (HUBZone Act), Title VI of the Small Business Reauthorization Act of 1997, Pub. L. 105–135, enacted December 2, 1997. The purpose of the HUBZone Program is ''to provide for

Federal contracting assistance to qualified HUBZone small business concerns.'' 15 U.S.C. 657a(a). The HUBZone Act directed SBA's Administrator to promulgate regulations to implement the HUBZone Program. SBA's HUBZone regulations are set forth in 13 CFR part 126. Part 126 sets forth key definitions, eligibility criteria for certification into the HUBZone Program, and information on HUBZone contracts, among other things.

Since the inception of the program, SBA has received thousands of applications for certification into the HUBZone Program and has certified over 13,000 concerns into the program. In addition, Federal agencies have awarded thousands of HUBZone contracts. As a result, SBA has become aware of amendments that should be made to the program's regulations. These amendments include a revised definition for the term ''employees.''

SBA believes that the proposed amendment to the definition of the term ''employee'' will ease program eligibility requirements perceived to be burdensome on concerns, and streamline the operation of the HUBZone Program.

2. Legal Basis

This action, including publication of proposed rules, is authorized pursuant to Pub. L. 105–135, sec. 601 *et seq.*, 111 Stat. 2592 and 15 U.S.C. 632(a).

3. Definition of Small Entity

In making its determination that this proposed rule may have a significant economic impact on a substantial number of small entities, SBA used the definition of small business set forth in section 3 of the Small Business Act, 15 U.S.C. 632(a)(1) & (2). According to that section, a ''small business concern'' is one that: (1) Is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by SBA. *Id.* SBA has established such additional criteria in its regulations at 13 CFR part 121. SBA used this criteria for its analysis as well.

4. The Small Entities to Which the Proposed Rules Will Apply

a. Description and Estimate

The RFA directs agencies to provide a description of, and where feasible, an estimate of the number of SBCs that may be affected by the proposed rule, if adopted. The specific group of SBCs affected the most by this proposed rule are those who participate in Federal Government contracting and are in the services or construction industry.

While there is no precise estimate for the number of SBCs that will be affected by this proposed rule, SBA has reasoned the following. SBA believes that over 30,000 SBCs will apply for certification as qualified HUBZone SBCs over the life of the program. This number is based upon 1992 census data, the number of HUBZone SBCs registered in Central Contractor Registration (CCR), and a reasonable extrapolation of this data to account for growth.

In the past few years, SBA has received thousands of applications for the HUBZone Program and has certified over 13,000 SBCs into the program. SBA believes that the incentives available through participation in the program, *i.e.*, HUBZone set-asides and price evaluation preferences, will result in additional SBCs relocating to HUBZones. SBA is unable to predict the number of SBCs that will relocate to HUBZones and be eligible for the program, but estimates that approximately 30,000 SBCs are now eligible or will become eligible.

Of the 30,000 SBCs that have a principal office located in a HUBZone, SBA believes that most will be directly affected by this proposed rule. This is based on the fact that of the over 13,000 HUBZone SBCs listed in CCR, over 11,000 list services and construction as the general nature of their business. Thus, it appears that most qualified HUBZone SBCs are in those industries. According to the comments received, SBCs in the construction and services industries use temporary and leased employees.

The proposed amendment to the definition of the term ''employee'' will allow leased and temporary employees to be considered employees of a concern. These leased and temporary employees would be counted toward the 35% HUBZone residency and principal office requirements. At one point, such employees comprised approximately 2–5% of the work force in the U.S. economy. *Labor Shortages, Needs, and Related Issues in Small and Large Businesses*, Nov. 2, 1999 (report prepared for the Office of Advocacy) (available at *www.sba.gov/advo/research/rs195atot.pdf*). In addition, the report stated that small businesses accounted for the employment of about 40% of such employees. Id. Although SBA does not know exactly how many SBCs eligible for the HUBZone Program use leased or temporary employees, this data further evidences that many concerns may be affected by this rule.

b. How Each Small Entity Will Be Affected

As discussed above, the SBCs that will be affected by this rule are those who participate in federal government contracting, and use leased or temporary employees. For those SBCs that participate in Federal Government contracting and use leased or temporary employees, the proposed rule will allow the concern to count these employees toward the 35% HUBZone residency and principal office requirement. Thus, a larger portion of the concern's workforce would have to be counted toward this requirement.

5. Projected Recordkeeping, Reporting and Other Compliance Requirements

The proposed rule does not impose new reporting or recordkeeping requirements on concerns applying to be certified as qualified HUBZone SBCs or concerns already certified. The regulations have always required an application for certification and re-certification.

6. Relevant Federal Regulations Which May Duplicate, Overlap or Conflict With the Proposed Rule

SBA's size regulations also define the term ''employee.'' The proposed amendments to the HUBZone program's definition of the term ''employee'' will overlap, but will be consistent with, the size regulations because both will count leased and temporary employees as well as co-employees. In addition, both will address volunteers, and define the term.

7. Significant Alternatives

In general, one alternative is not to amend the current regulations. SBA believes, however, that amendments to the current regulations are necessary because it would be in the best interest of SBCs to streamline the regulations and clarify the definition of the term ''employee.''

SBA also reviewed several alternatives to specific amendments. The current HUBZone definition of the term ''employee'' states that an employee of a SBC includes full-time equivalents. 13 CFR 126.103. Full-time equivalents are defined as employees who work 30 or more hours a week. It also includes the aggregate of employees who work less than 30 hours a week, where the work hours of such employees add up to at least a 40-hour work week. SBA does not currently consider leased or temporary employees, or independent contractors, to be employees of a concern for HUBZone program purposes. SBA had several choices when amending this definition, including: (1) Keeping the

definition the same; (2) including leased and temporary employees as HUBZone employees, but keeping the use of full-time equivalents; or (3) not including leased and temporary employees as HUBZone employees, and not using full-time equivalents. (For a detailed discussion on the alternatives considered, see the discussion above in the Regulatory Impact Analysis.)

The purpose of the current definition of employee is to focus on those jobs that best fulfill the statutory purpose of the HUBZone Act. That is why SBA proposes to allow a concern to count part-time employees, but only if the part-time employees work a minimum of 40 hours per week. SBA believes that counting part-time, leased and temporary and full-time equivalents as employees of the HUBZone SBC will still fulfill the statutory purpose and intent of the HUBZone Act by providing more job opportunities for HUBZone residents, albeit temporary ones.

For example, if a concern has 15 employees and 5 are temporary or leased employees, then, under the current rule, 35% of 10 of the concern's employees must be HUBZone residents. Under the proposed rule, 35% of all 15 of the concern's employees must be HUBZone residents. Thus, this proposed definition would impose a more stringent standard on the concern, which SBA believes will increase employment opportunities in HUBZones.

Finally, SBA believes that this definition of employee is similar to the definition set forth in its size regulations, 13 CFR part 121. The size regulations define employee as all individuals employed on a full-time, part-time, or other basis. 13 CFR 121.106(a). SBA will consider the totality of the circumstances, including factors relevant for tax purposes, in determining whether individuals are employees of the concern in question. This totality of the circumstances language stems from SBA Size Policy Statement No. 1, published in the **Federal Register** on February 20, 1986, 51 FR 6099. Basically, Size Policy Statement No. 1 states that SBA will consider temporary or leased employees to be employees of a SBC on an ''other basis'' if the SBC is deriving the usual benefits incident to employment of such individuals and the totality of the circumstances requires so. 51 FR 6099–6101.

SBA decided to refer to this Size Policy Statement, rather than include all of the criteria and factors, in the regulation. SBA believes that referring SBCs and the general public to the policy document on the issue would provide everyone with a better understanding of the totality of circumstances.

In sum, the proposed definition of employee chosen by SBA for its HUBZone program is similar to SBA's size regulations and this should be less confusing and less of a burden on small businesses. However, we note that while the SBA is seeking comments on all aspects of this proposed rule, the Agency would specifically like comments addressing whether 40 hours per month is a suitable minimum work requirement.

8. Cost Analysis

The proposed rule may impact those qualified HUBZone SBCs that hire temporary and leased employees and do not count them toward their 35% HUBZone residency requirement or principal office requirement. These HUBZone SBC may or may not still be eligible for the program, once the rule becomes final. If these HUBZone SBCs are no longer qualified for the program, they will lose future HUBZone contract opportunities. However, the proposed rule will allow other SBCs to become eligible for the program. These HUBZone SBCs will have the opportunity to compete for future HUBZone contracts.

The proposed rule will not impact substantially SBA's costs. SBA does not know the economic impact or costs of the proposed rule on other Federal agencies. Federal agencies issuing HUBZone contracts will have to train and educate their employees on the proposed rule, if adopted. This cost should be minimal. The increase in the number of HUBZone SBCs in the program will increase competition and this may result in lower prices/awards, thereby reducing Federal procurement costs.

9. Conclusion

Based upon the foregoing, SBA has determined that this proposed rule has a significant economic impact on a substantial number of small entities within the meaning of the RFA.

List of Subjects in 13 CFR Part 126

Government procurement, Small businesses.

For the reasons set forth above, SBA proposes to amend 13 CFR part 126, as follows:

PART 126—HUBZONE PROGRAM

1. The authority citation for 13 CFR part 126 continues to read as follows:

Authority: 15 U.S.C. 632(a), 632(j), 632(p) and 657a.

2. Amend § 126.103 by revising the definition of the term ''employee'' to read as follows:

§ 126.103 What definitions are important in the HUBZone program?

* * * * *

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, professional employee organization, leasing concern, or through a union 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 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.

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Dated: September 21, 2006.

Steven C. Preston,

Administrator.

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA–2007–27016; Directorate Identifier 2006–NM–176–AD]

RIN 2120–AA64

Airworthiness Directives; Bombardier Model DHC–8–400 Series Airplanes

AGENCY: Federal Aviation Administration (FAA), Department of Transportation (DOT).

ACTION: Notice of proposed rulemaking (NPRM).

SUMMARY: The FAA proposes to supersede an existing airworthiness directive (AD) that applies to certain Bombardier Model DHC–8–400 series airplanes. The existing AD currently