

Recent Legal Developments Affecting Small and Veteran Owned Firms

May 10, 2017

Bill Hughes

Emily Constantine

Kingdomware Technologies v. U.S.

(June 16, 2016)

- The VA must give preference to VOSBs for all contracts where the “rule of two” is satisfied
- The VA Office of Small and Disadvantaged Business Utilization (OSDBU) has presented a series of webinars to help VOSBs understand the potential impact of the decision:
http://www.va.gov/osdbu/verification/veterans_first_contracting_program_adjustments_to_reflect_the_supreme_court_kingdomware_decision.asp

What is the Rule of Two?

- VA contracting officers “shall award contracts on the basis of competition restricted to small business concerns owned and controlled by veterans, if the contracting officer has a reasonable expectation that two or more small business concerns owned and controlled by veterans will submit offers, and that the award can be made at a fair and reasonable price that offers the best value to the United States.” 38 USC § 8127(d).
- Exceptions
 - Contracts under the simplified acquisition threshold
 - Contracts worth between \$150k-\$5M if certain criteria are met

Introduction – Affiliation Changes

- Many procurements are set aside in whole or in part for “small business concerns”
- Eligibility as a “small business concern” is determined under SBA’s size regulations, 13 CFR part 121.
- SBA recently issued rules implementing the 2013 National Defense Authorization Act, which will impact these rules.
- Final rule regarding FAR changes implementing SBA regulatory changes issued on July 14, 2016

Understanding Affiliation

- Identifying “affiliates” is critical in identifying whether an entity or concern meets the requirements for a small business concern eligible for SBA assistance
- The focus is on the power to control and involves a fact-intensive analysis of ownership, management, and contractual relations
- Size is determined by evaluating measures such as receipts and employees of both foreign and domestic, as well as for-profit and not-for-profit, affiliates

Presumption of Affiliation

- Affiliation can also be found based on “identity of interest”
- When firms or individuals have “identical or substantially identical business or economic interests,” they can be “treated as one party with such interests aggregated”
- This presumption can be overcome, however, by showing that these interests are separate

New Rule Regarding Affiliation and Identity of Interest

- The new rule created bright-line tests for determining identity of interest based on either relationships or economic dependence
- It did not fundamentally alter standing practice; rather, it codified precedent set and followed by the Office of Hearings and Appeals

Personal/Familial Relationships

- If the firms are owned or controlled by a married couple, individuals joined by civil union, parents, children, or siblings, they are presumed to have an identity of interest if they conduct business with each other
- Examples includes “subcontracts or joint ventures or share or provide loans, resources, equipment, locations or employees”
- This presumption can be rebutted by establishing “a clear line or fracture between the concerns”
- Other types of relationships (e.g., cousins, grandparents) do not create such a presumption

The 70% Rule

- An identity of interest may also be presumed on the basis of economic dependence if the concern derived at least 70% of its receipts from another concern over the prior three fiscal years
- This presumption can be overcome by showing that the concern in question is not, in fact, wholly dependent on the other
- A business concern owned and controlled by (or a wholly-owned entity of) an Indian Tribe, ANC, NHO, or CDC is not considered to be an affiliate of another concern owned by that entity based only on the existence of a contractual relationship

The 70% Rule: Overcoming the Presumption Example

- If the firm in question is fairly new, for example, and only has two or three contracts—one of which is greater than 70% of its receipts—this presumption will likely be rebutted (absent other evidence of affiliation or identities of interest) because the firm has been in business for only a brief amount of time and presumably has not had the opportunity to secure a large number of contracts

Affiliation and Joint Ventures: Definition

- “A joint venture is an association of individuals and/or concerns with interests in any degree or proportion consorting to engage in and carry out no more than three specific or limited-purpose business ventures for joint profit over a two year period, for which purpose they combine their efforts, property, money, skill, or knowledge, but not on a continuing or permanent basis for conducting business generally.”

Affiliation and Joint Ventures

- Generally, entities in a joint venture will be considered affiliates if any one of them seeks financial assistance from the SBA
- There is an exception, however, if the joint venture submits an offer as a small business for federal procurement and each individual business concern is considered small under the applicable standard related to the NAICS code assigned to that contract
- The new rule eliminated the requirement that the proposed procurement be bundled or large

Affiliation and Joint Ventures:

Old Rule vs. New Rule

- The new rule eliminated the requirement that the proposed procurement be bundled or large
- Previously, the procurement must have been considered bundled or consolidated or, if not bundled/consolidated, must have been valued at least \$10 million for employee-based size standards or at least half the size standard corresponding to the NAICS code assigned to the contract for receipts-based size standards

Limitations on Subcontracting

- Key Change: Similarly Situated Entities
 - Shift from concept of a required percentage of work to be performed by a prime contractor to the concept of limiting a percentage of the award amount to be spent on subcontractors
 - Only first-tier contractors may be “similarly situated”
 - Similarly-situated independent contractors may count towards applicable limitations on subcontracting
- Changes to formula for calculating the limitations on subcontracting
 - Now based on contract value
 - No major modifications to percentage limitations
- “Mixed contract”
 - Contracting officer must select the “single NAICS code which best describes the principal purpose of the product or service being acquired.”
 - Examples in rule
- Exemptions

Limitations on Subcontracting

- New concept: Similarly Situated Entities
 - Similarly situated = participant of the same set-aside program that qualified as the prime
 - Must also qualify as small for the subcontract under size-standard for prime contract
- Amounts paid to similarly situated entities are not considered subcontracts
- For purposes of determining whether the prime/sub performed the required amount of work, any work that a similarly situated first-tier subcontractor subcontracts will be regarded as subcontracted to a non-similarly situated entity
- Independent contractors

Non-Manufacturer Rule

- NMR = exception to limitation on subcontracting rules for certain contracts
- 2016 NDAA clarified that NMR applies only to contracts that are principally for supplies
 - Simplifies bidding on contracts for services and construction
- Waivers typically granted before issuance of solicitation
- Post award waivers may be awarded in some circumstances; notice required
- Contracts between \$3.5-\$150k exempt
- Applicability to commercially available software

Subcontracting Plans

- Prime contractors must provide written notice to a subcontractor of intent to identify the small business by name as a potential subcontractor in a bid, proposal, offer, bid, or subcontracting plan
- Contracting agency must collect, report, and review data regarding compliance with goals and objectives of subcontracting plan
- Implements reporting requirements
- Failure to provide a written corrective action plan after receiving a marginal or unsatisfactory rating for its subcontracting plan performance or failure to make a good faith effort to comply with its subcontract plan constitutes a material breach that will be considered in past performance evaluations

General Overview-Changes to Mentor-Protégé Program

- Effective August 24, 2016
- SBA has issued a final rule establishing an expanded mentor-protégé program, under which all types of small businesses can qualify as protégés
- Mentor-protégé teams can compete for set-asides for which the protégé firm is qualified
- The program is designed to enhance the capabilities of protégé firms by requiring approved mentors to provide business development assistance to protégé firms and to improve the protégé firms' ability to successfully compete for federal contracts
- Based on the 8(a) program, but constitutes a distinct program.
 - While there are some similarities with the 8(a) program, there are also some key differences
- Apply electronically at certify.sba.gov (applications accepted beginning in October)

Existing Mentor-Protégé Programs

- Other agency mentor-protégé programs can continue until August 24, 2017
- To continue programs after that date, other federal department or agency programs carrying out a small-business mentor-protégé program must obtain SBA approval to do so
- Exception: DoD mentor-protégé program, Small Business Innovation Research Program, and Small Business Technology Transfer Program are not affected

Benefits

- A protégé and mentor may joint venture as a small business for any government prime contract or subcontract, provided the protégé qualifies as small for the procurement.
 - Such a joint venture may seek any type of small business contract (i.e., small business set-aside, 8(a), HUBZone, SDVO, or WOSB) for which the protégé firm qualifies
 - Example: A protégé firm that qualifies as a WOSB could seek a WOSB set-aside as a joint venture with its SBA-approved mentor
- Exclusion from affiliation provided that requirements are met

Types of Assistance

- Types of mentor → protégé assistance include:
 - Technical or management assistance in the form of equity investments or loans
 - Mentor ownership in protégé limited to 40%
 - Subcontracts
 - Can be from mentor to protégé or protégé to mentor
 - Trade education
 - Assistance in performing prime contracts with the Government through joint ventures

Mentors

- Any concern that meets the requisite qualifications and demonstrates a commitment and the ability to assist small business concerns may act as a mentor and receive the benefits of the mentor-protégé program. This includes other than small businesses.
- Must be a for-profit business (difference from the 8(a) mentor protégé program).

Mentors (continued)

- To qualify as a mentor, a concern must demonstrate that it:
 - Is capable of carrying out its responsibilities to assist the protégé firm under the proposed mentor-protégé agreement
 - Possesses good character
 - Does not appear on the federal list of debarred or suspended contractors
 - Can impart value to a protégé firm due to lessons learned and practical experience gained or through its knowledge of general business operations and government contracting

Mentors (continued)

- To demonstrate its capability of fulfilling its responsibilities under the mentor protégé agreement a prospective mentor must submit to the SBA copies of the federal tax returns it submitted to the IRS, or audited financial statements, or SEC filings (if publicly traded entity)
- Once approved, a mentor must annually certify that it continues to possess good character and a favorable financial position
- Generally, a mentor will have only one protégé at a time, but SBA can authorize a concern to mentor more than 1 protégé at a time (up to 3 maximum) provided the mentor can demonstrate that doing so will not adversely affect any of the preexisting mentor-protégé relationships

Protégés

- In order to qualify as a protégé firm, a concern must qualify as small for the size standard corresponding to its primary NAICS code OR
- identify that it is seeking business development assistance with respect to a secondary NAICS code and qualify as small for the size standard corresponding to that NAICS code
- Protégés need not obtain a size status determination before participating in the small business mentor-protégé program; changes to a protégé's size status will generally not impact contracts that were already awarded to a mentor-protégé joint venture

Written Agreement

- The mentor and protégé firms must enter a written agreement setting forth an assessment of the protégés needs and providing a detailed description and timeline for the delivery of assistance the mentor commits to provide to address those needs (e.g., management and/or technical assistance, loans and/or equity investments, cooperation on joint venture projects, or subcontracts under prime contracts being performed by the mentor).
- SBA must approve the mentor-protégé agreement BEFORE the two firms may submit an offer as a joint venture on a particular government prime contractor subcontract in order for the joint venture to receive the exclusion from affiliation.

Written Agreement (Continued)

- The written agreement must also:
 - Address how the assistance will be provided through the agreement and how it will help the protégé firm meet its goals as defined in its business plan
 - Establish a single point of contact in the mentor concern who is responsible for managing and implementing the mentor-protégé agreement and
 - Provide that the mentor will provide such assistance to the protégé firm for at least one year

Written Agreement (Continued)

- A firm seeking SBA's approval to be a protégé must identify any other mentor-protégé relationship it has through another federal agency or SBA and provide a copy of each such agreement to SBA
 - The small business mentor-protégé agreement must identify how the assistance to be provided by the proposed mentor is different from assistance provided to the protégé through another mentor-protégé relationship, either with the same or a different mentor
 - A firm seeking SBA's approval to be a protégé may terminate a mentor-protégé relationship it has through another agency and use any not yet provided assistance identified in the other mentor-protégé agreement as part of the assistance that will be provided through the small business mentor-protégé relationship. Any assistance that has already been provided through another mentor-protégé relationship cannot be identified as assistance that will be provided through the small business mentor-protégé relationship.

Written Agreement (Continued)

- The written agreement must be approved by the Associate Administrator for Business Development (AA/BD) or his/her designee.
- The agreement will not be approved if SBA determines that the assistance to be provided is not sufficient to promote any real developmental gains to the protégé, or if SBA determines that the agreement is merely a vehicle to enable the mentor to receive small business contracts.
- The agreement must provide that either the protégé or the mentor may terminate the agreement with 30 days advance notice to the other party to the mentor-protégé relationship and to SBA

Written Agreement (Continued)

- SBA must approve all changes to a mentor-protégé agreement in advance, and any changes made to the agreement must be provided in writing.
- If the parties to the mentor-protégé relationship change the mentor-protégé agreement without prior approval by SBA, SBA will terminate the mentor-protégé relationship and may also propose suspension or debarment of one or both firms, if appropriate.

Term of Mentor-Protégé Relationship

- SBA will review the mentor-protégé relationship annually to determine whether to approve its continuation for another year.
- Unless rescinded in writing as a result of the review, the mentor-protégé relationship will automatically renew without additional written notice of continuation or extension to the protégé firm.
- The term of the mentor protégé agreement may not exceed three years, but may be extended for a second three years.
 - A protégé may have two three-year mentor-protégé agreements with different mentors, and each may be extended an additional three years provided the protégé has received the agreed-upon business development assistance and will continue to receive additional assistance thorough the extended mentor-protégé agreement.

Reporting Requirements

- Annual report:
 - Within 30 days of the anniversary of SBA's approval of the mentor-protégé agreement, the protégé must report to SBA for the preceding year:
 - All technical and/or management assistance provided by the mentor to the protégé;
 - All loans to and/or equity investments made by the mentor in the protégé
 - All subcontracts awarded to the protégé by the mentor and all subcontracts awarded to the mentor by the protégé, and the value of each subcontract

Reporting Requirements (Continued)

- All federal contracts awarded to the mentor-protégé relationship as a joint venture (designated each as a small business set-aside, small business reserve, or unrestricted procurement), the value of each contract, and the percentage of the contract performed and the percentage of revenue accruing to each party to the joint venture;
- A narrative describing the success such assistance has had in addressing the developmental needs of the protégé and addressing any problems encountered

Reporting Requirements (Continued)

- The protégé must report the mentoring services it receives by category and hours
- The protégé must annually certify to SBA whether there has been any change in the terms of the agreement
- SBA will review the protégé's report on the mentor-protégé relationship, and may decide not to approve continuation of the agreement if it finds that the mentor has not provided the assistance set forth in the mentor-protégé agreement or that the assistance has not resulted in any material benefits or developmental gains of the protégé

Reporting Requirements (Continued)

- In order to assess the results of a mentor-protégé relationship upon its completion, the protégé must report to SBA whether it believed the mentor-protégé relationship was beneficial and describe any lasting benefits to the protégé
- Where a protégé does not report the results of a mentor-protégé relationship upon its completion, SBA will not approve a second mentor-protégé relationship under the small business or 8(a) program.

Consequences of Noncompliance

- Where SBA determines that a mentor has not provided the protégé firm with the assistance set forth in its mentor-protégé agreement, SBA will notify the mentor of such determination and afford the mentor an opportunity to respond.
- The mentor must respond within 30 days of the notification, explaining why it has not provided the agreed upon assistance and setting forth a definitive plan as to when it will provide such assistance.

Consequences of Noncompliance

(Continued)

- If the mentor fails to respond, does not supply adequate reasons for its failure to provide the agreed upon assistance, or does not set forth a definite plan to provide the assistance:
 - SBA will terminate the mentor-protégé agreement;
 - The firm will be ineligible to again act as a mentor for a period of two years from the date SBA terminates the mentor-protégé agreement; and
 - SBA may recommend the relevant procuring agency to issue a stop work order for each federal contract for which the mentor and protégé are performing as a small business joint venture
 - SBA may consider a mentor's failure to comply with the terms and conditions of an SBA-approved mentor protégé agreement as a basis for debarment