

New SBA Rules re: the Mentor-Protégé Program, Limitation on Subcontracting, and Joint Ventures

Andy Watson

awatson@maynardcooper.com
(256) 512-0116

Jon Levin

jlevin@maynardcooper.com
(256) 512-5713

Matthew Moore

mmoore@maynardcooper.com
(256) 562-1165



MAYNARDCOOPER.COM

Topics Covered

- ▼ **New Small Business Mentor-Protégé Program**
- ▼ **Changes to Limitation on Subcontracting Rule**
- ▼ **Changes to Joint Venture Rules**

New Small Business Mentor-Protégé Program

Effective as of August 24, 2016



MAYNARDCOOPER.COM

Overview of the Program

- ▼ **Purpose**: To enhance the capabilities of protégé firms by encouraging larger, more experienced firms to provide business-development assistance and to enhance the protégé's ability to capture and perform federal contracts. See 13 CFR § 125.9(a).
- ▼ **Effect**: The SBA's new Small Business Mentor-Protégé Program expands the benefits of the 8(a) Mentor-Protégé Program to all small businesses.

Mentor Qualifications

- ▼ “Any concern that demonstrates a commitment and the ability to assist small business concerns may act as a mentor” 13 CFR § 125.9(b).
 - ▼ A mentor may be any size.
- ▼ A mentor must demonstrate that it:
 - ▼ Is capable of performing its responsibilities under the mentor-protégé agreement,
 - ▼ Can impart value to the protégé from its knowledge/experience,
 - ▼ Has good character, and
 - ▼ Is not debarred or suspended.

Mentor Qualifications (cont.)

- ▼ A mentor may submit tax returns, audited financials, or (for public companies) SEC filings to demonstrate its ability to meet its obligations and impart value to the protégé. See 13 CFR § 125.9(b)(2).
 - ▼ While not a requirement under the regulation, the SBA has discretion to require any relevant information.

Mentor Qualifications (cont.)

- ▼ An approved mentor must re-certify annually that it continues to possess good character and adequate financial resources. See 13 CFR § 125.9(b)(3).
- ▼ If control of an approved mentor changes (e.g., through a merger or stock sale), the mentor-protégé relationship may continue only if, after the change in control, the mentor acknowledges the mentor-protégé agreement in writing to the SBA and certifies that the mentor will continue to abide by its terms. See 13 CFR § 125.9(e)(7).

Mentor Qualifications (cont.)

- ▼ Generally, a mentor will have only 1 protégé at a time.
- ▼ However, the SBA may authorize 2 or even 3 protégés at the same time, provided that the mentor can demonstrate that none of the subsequent relationships will adversely affect the prior relationships. See 13 CFR § 125.9(b).
 - ▼ The 3-protégé cap includes any protégés under the 8(a) Program. See 81 FR 48563 (comments to 13 CFR § 125.9(b)).

Protégé Qualifications

- ▼ To qualify as a protégé, the firm must be small under its primary NAICS code or under a specified secondary NAICS code. See 13 CFR § 125.9(c).
 - ▼ In order for a firm to qualify as a protégé under a secondary NAICS code, the protégé must demonstrate the new industry is a logical business progression and will further develop its current capabilities.

Protégé Qualifications (cont.)

- ▼ E.g., if the protégé was large under its primary NAICS code (Engineering Services – 541330) but small under a secondary NAICS code (R&D 541712) with a different/higher size standard, the protégé may be able to demonstrate that this is a logical extension of its current business.
 - ▼ However, the SBA will not approve a mentor-protégé relationship in a secondary NAICS code in which the protégé has no experience.
- ▼ A protégé may self-certify as to its size. 13 CFR § 125.9(c).

Protégé Qualifications (cont.)

- ▼ Generally, a protégé will have only 1 mentor at a time. 13 CFR § 125.9(c)(2).
- ▼ However, the SBA may authorize up to 2 mentors at the same time, provided that second relationship will not adversely affect the first relationship and either:
 - ▼ (a) the second relationship pertains to an unrelated NAICS code, or
 - ▼ (b) the protégé is seeking to obtain expertise that the first mentor lacks.

Protégé Qualifications (cont.)

- ▼ SBA may authorize a small business to be both a protégé and a mentor at the same time when the firm can demonstrate that the second relationship will not adversely affect the first. 13 CFR § 125.9(c)(3).

Protégé Qualifications (cont.)

- ▼ **Once the protégé outgrows the size standard for its primary NAICS code, it will no longer be eligible for any contracting benefits from the mentor-protégé relationship. 13 CFR § 125.9(d)(1).**
 - ▼ **But note: Most contracts previously awarded to a mentor-protégé joint venture would continue in place as if awarded to a small business.**
 - ▼ **Also note: This is somewhat inconsistent with the authorization of mentor-protégé relationships under secondary NAICS codes.**

Benefits

- ▼ **The primary benefit is the ability of the parties to enter into joint ventures and pursue contracts based solely on the size/program status of the protégé. 13 CFR § 125.9(d)(1).**
 - ▼ To be discussed later!
- ▼ **Exception to affiliation: No affiliation between the parties will be found on the basis of the mentor-protégé relationship. 13 CFR §§ 121.103(b)(6); 125.9(d)(4).**
 - ▼ However, affiliation may still be found for other reasons (e.g., family relationships between the owners, overlapping boards).

Agreement Requirements

- ▼ The mentor-protégé must be in writing. 13 CFR § 125.9(e).
- ▼ The Agreement must be approved by the SBA before it becomes effective.
- ▼ Any changes must be submitted to the SBA in writing and approved in advance.

Agreement Requirements (cont.)

▼ Term:

- ▼ The mentor must agree to fulfill its obligations for at least 1 year. 13 CFR § 125.9(e).
- ▼ The maximum term is 3 years. However, an agreement may be extended for 1 additional 3-year period.
 - ▼ Although not expressly addressed, the renewal would likely need to be treated as an amendment and, thus, approved by the SBA in advance.
 - ▼ Note: The SBA will be reviewing the protégé's annual reports for compliance and may terminate the relationship at any time.

Agreement Requirements (cont.)

- ▼ **The Agreement must include (13 CFR § 125.9(e)):**
 - ▼ an assessment of the protégé's needs,
 - ▼ a detailed description and timeline for the mentor's delivery of assistance,
 - ▼ How the assistance will address the protégé's goals, as defined in its business plan, and
 - ▼ Note: Protégé's should have a written business plan
 - ▼ A right of termination by either party upon 30 days' notice to the other party and the SBA.

Reporting/Monitoring

- ▼ **Annually, within 30 days of the anniversary of the SBA's approval of the mentor-protégé relationship, the protégé must submit a report for the previous year on (13 CFR § 125.9(g)):**
 - ▼ All technical/management assistance provided by the mentor (by hours),
 - ▼ All loans or equity investments from the mentor,
 - ▼ All subcontracts awarded from the mentor to the protégé (and vis versa),
 - ▼ All federal contracts awarded to the pair as a joint venture, and all material details, and
 - ▼ A narrative describing the successes the mentor's assistance has had in helping the protégé's development, and any problems.

Reporting/Monitoring (cont.)

- ▼ Also annually, within 30 days of the anniversary of the SBA's approval of the mentor-protégé relationship, the protégé must certify to SBA whether there has been any change in the terms of the agreement. 13 CFR § 125.9(g).
 - ▼ Note: If there has been, it should have been approved in advance by SBA.

Reporting/Monitoring (cont.)

- ▼ SBA will review the protégé's annual reports.
- ▼ If SBA determines that a mentor has not provided the assistance set forth in the agreement or that the assistance has not resulted in a material benefit to the protégé, the SBA may terminate the relationship.
 - ▼ No news is good news. See 13 CFR § 125.9(e)(5). But the Agreement will automatically terminate upon the end of the 3-year term.

Reporting/Monitoring (cont.)

- ▼ If SBA determines that a mentor has not met its obligations under the agreement, SBA will notify the mentor and give it 30 days to respond. 13 CFR § 125.9(h).
- ▼ If the mentor fails to respond or its response is inadequate,
 - ▼ The SBA will terminate the agreement,
 - ▼ The mentor will be ineligible to act as a mentor for 2 years,
 - ▼ The SBA may recommend stop-work orders be issued under each contract that the mentor and protégé are performing as a joint venture, or recommend a substitution of the protégé for the joint venture, and
 - ▼ The SBA may also consider debarment or suspension.

Reporting/Monitoring (cont.)

- ▼ Upon completion of a mentor-protégé relationship, the protégé must report to SBA “whether it believed the mentor-protégé relationship was beneficial and describe any lasting benefits to the protégé.” 13 CFR § 125.9(i).

Application Logistics

- ▼ The SBA will establish a separate unit within the Office of Business Development to process applications under the new Mentor-Protégé Program.
- ▼ Applications will be submitted electronically.
- ▼ The earliest that applications may be submitted is October 1, 2016. See <https://www.sba.gov/contracting/government-contracting-programs/all-small-mentor-protege-program/how-apply>.

Application Logistics (cont.)

▼ Required materials:

- ▼ Mentor-Protégé Agreement,
- ▼ All other materials/information required by 13 CFR § 125.9(e).

▼ Recommended materials:

- ▼ Any joint venture agreement the parties intend to enter into, subject to the SBA's approval of the mentor-protégé relationship.

▼ **Note:** The SBA may request any relevant information it needs to process the application.

Transfer of 8(a) Mentor-Protégé Agreements

- ▼ A protégé firm that graduates or otherwise leaves the 8(a) Program, but that remains small, may convert its 8(a) mentor-protégé relationship to a small business mentor-protégé relationship. 13 CFR § 124.520(d).
- ▼ The protégé need only notify SBA in writing of its intent to convert.

Changes to Limitation on Subcontracting Rule

Effective as of June 30, 2016



MAYNARDCOOPER.COM

Key Concept: “Similarly situated entity”

- ▼ A “similarly situated entity” (SSE) is a subcontractor that has the same small business program status as the prime contractor. See 13 CFR § 125.1.
 - ▼ E.g., for an 8(a) requirement, a subcontractor that is an 8(a) certified Program Participant concern will be an SSE.
- ▼ The SSE concept has been in use for the HUBZone Program and the SDVOSB Program. The new rules expand it to small business, 8(a), and WOSB/EDWOSB.

Key Concept: “Similarly situated entity”

- ▼ An SSE obviously must be small.
 - ▼ However, an SSE need not be small for purposes of the size standard applicable to the prime contract.
 - ▼ Instead, an SSE must be small under the size standard assigned by the prime contractor to the subcontract. See 13 CFR § 125.1.
- ▼ It will be critical for prime contractors in set-aside contracts to assign a NAICS code/size standard to their subcontracts.

Summary of New Rule

- ▼ Instead of requiring the prime contractor to perform a minimum % of the set-aside contract, the new rule limits how much of the contract can be performed by non-SSEs.
- ▼ The new rule shifts the focus from the cost to the prime contractor to the amount paid to non-SSEs.

Summary of New Rule

- ▼ Effectively, the work performed by SSEs is treated as if it was performed by the prime. See 13 CFR § 125.6(a).
- ▼ Any second-tier subcontracting by an SSE is counted toward the % that cannot be exceeded, regardless of whether the second-tier subcontractor would have qualified as an SSE if it had performed the work as a first-tier sub. See 13 CFR §§ 125.6(a), (c), (e)(3).

New Rule (for Services Contracts)

- ▼ In order to be awarded a set-aside contract for services, the prime contractor must agree that it will not pay more than 50% of the amount paid by the government to the prime to firms that are not SSEs. See 13 CFR § 125.6(a)(1).
- ▼ E.g., in the case of a services contract, valued at \$2,000,000, the prime may not pay more than \$1,000,000 to non-SSEs.

New Rule (for Supplies Contracts)

- ▼ For supplies contracts, the prime contractor must agree that it will not pay more than 50% of the amount paid by the government to the prime to firms that are not SSEs. See 13 CFR § 125.6(a)(1).
 - ▼ Costs of materials are not considered for purposes of determining compliance.
- ▼ E.g., in the case of a supplies contract, valued at \$2,000,000 with material costs equal to \$500,000, the prime may not pay more than \$750,000 to non-SSEs.

New Rule (for Mixed Contracts)

- ▼ For mixed contracts (supplies and services), the contracting officer selects the NAICS code applicable to the contract's principal purpose (greatest percentage of the contract value). See 13 CFR § 125.6(b).
- ▼ The corresponding limitation on subcontracting applies only to that portion of the contract.
- ▼ E.g., a contract consisted of \$1,500,000 for services and \$500,000 for supplies.
 - ▼ The CO would select a services NAICS code.
 - ▼ The prime would be prohibited from paying more than \$750,000 to non-SSEs for the services.
 - ▼ However, the prime could pay the entire \$500,000 to companies of any size.

Relation Between New Rule and “Ostensible Subcontractor” Rule

- ▼ Primes and their SSE subcontractors are immune from affiliation based on the “ostensible subcontractor” rule. See 13 CFR §§ 121.103(h)(4), 125.6(c).

Very Limited Exemption

- ▼ **Small-business set-aside contracts, valued between \$3,500 and \$150,000 are exempt from the limitations on subcontracting. See 13 CFR § 125.6(f).**
- ▼ **Note, however, that this exemption only applies to small-business set-asides.**
 - ▼ **E.g., an 8(a) set-aside valued at less than \$150,000 is still subject to the limitations on subcontracting.**

Penalties

- ▼ Compliance with the limitation on subcontracting is an element of responsibility; not size eligibility. See 13 CFR § 125.6(e)(2).
- ▼ Penalties include:
 - ▼ Suspension or debarment,
 - ▼ Fines (If a fine is imposed, it must be the greater of (a) \$500,000 and (b) the amount spent in excess of the permitted limitation.), or
 - ▼ Even imprisonment. See 13 CFR § 125.6(h).

Changes to Joint Venture Rules

Effective as of August 24, 2016



MAYNARDCOOPER.COM

New Form of Joint Venture

- ▼ Prior to the recent rule changes, the SBA's rules authorized joint ventures (JV) under the various small-business programs (small-business, 8(a), SDVOSB, HUBZone, and WOSB) only for JVs between a program participant and another small business.
- ▼ In recognition of the new Mentor-Protégé Program, the SBA has authorized a new form of JV between an approved mentor-protégé pair.
- ▼ In either case, the joint venturers will not be deemed affiliated because of forming the JV. See 13 CFR § 121.103(h).

Requirements for JV Agreement

- ▼ For JVs between two small businesses in pursuit of a small-business set-aside contract, there are no specific requirements for the form or terms of the JV agreement. See 13 CFR § 125.8(b)(1).
- ▼ However, there are numerous requirements for JV agreements for all other JVs, including:
 - ▼ Under all other programs, all JVs between a program participant and another small business; and
 - ▼ Under all programs (including small-business), all mentor-protégé JVs.

Required Terms

- ▼ **The terms required to be included in most JVs are as follows (see 13 CFR § 125.8(b)(2)):**
 - ▼ **Setting forth the purpose of the JV;**
 - ▼ **Designating the small business or the program participant, as applicable, as the managing venturer of the JV, and designating an employee of the managing venturer as the project manager responsible for performance of the contract;**
 - ▼ **Stating, with respect to a separate legal entity JV, the small business or the program participant, as applicable, must own at least 51% of the JV;**

Required Terms (cont.)

- ▼ Stating that the small business or the program participant, as applicable, must receive profits from the JV commensurate with the work performed or, in the case of a separate legal entity JV, commensurate with the ownership interests in the JV;
- ▼ Providing for the establishment and administration of a special bank account in the name of the JV, which must require the signature of all parties to the JV for withdrawal;
- ▼ Itemizing all major equipment, facilities, and other resources to be furnished by each party to the JV, with a detailed schedule of cost or value of each;
- ▼ Specifying the responsibilities of the parties with regard to contract negotiation, source of labor, and contract performance, including how the parties will ensure the work performance requirements;

Required Terms (cont.)

- ▼ Obligating all parties to the JV to ensure performance of the contract and to complete performance despite withdrawal of any member;
- ▼ Designating that accounting and other administrative records relating to the JV be kept in the office of the managing venturer;
- ▼ Requiring that the final original records be retained by the managing venturer upon completion of the contract that was performed by the JV;
- ▼ Stating that quarterly financial statements showing cumulative contract receipts and expenditures must be submitted to SBA not later than 45 days after each operating quarter of the JV; and
- ▼ Stating that a project-end profit and loss statement, including a statement of final profit distribution, must be submitted to SBA no later than 90 days after contract completion.

Certification vs. SBA Approval of the JV Agreement

- ▼ For mentor-protégé JVs under all SBA Programs other than 8(a), the program participant must submit a certificate of compliance, certifying that the requirements for the JV Agreement have been met. See 13 CFR § 125.8(d).
- ▼ For all JVs (mentor-protégé and other) under the 8(a) Program, the JV Agreement must be approved by SBA prior to award. See 13 CFR §§ 124.503, 124.507, and 124.513. No certificate of compliance is required.

Contract Performance

- ▼ For all of the SBA's programs:
 - ▼ The JV must satisfy the limitation on subcontracting applicable to the contract; and
 - ▼ The program participant must perform at least 40% of the work performed by the JV. See 13 CFR § 125.8(c).
- ▼ Note, however, the JV will not, itself, perform any of the work. This is because “populated” JVs have been prohibited. See 13 CFR § 121.103(h).
- ▼ The work performed by the program participant must be substantive (i.e., not administrative or ministerial).

Reporting Requirements

- ▼ For mentor-protégé JVs under the small-business program, the program participant must submit reports annually and upon completion of the contract, showing how it is meeting or has met the applicable work-performance requirements. See 13 CFR § 125.8(h).
- ▼ For all JVs (mentor-protégé and other) under all other programs, the program participant must submit these reports annually and upon contract completion. See, e.g., 13 CFR § 125.18(b)(8).

Penalties

- ▼ For all programs, the Government may consider any of the following as a ground for suspension or debarment:
 - ▼ Failure to enter into a JV Agreement meeting the applicable requirements;
 - ▼ Failure to perform the work in accordance with the applicable requirements (i.e., work share); and
 - ▼ Failure to submit the required certificate of compliance or to allow the Government access to the participant's records. See 13 CFR § 125.8(i).