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Taking note

Examining the changes to the rules governing SBA's 8(a) program

Within the last year, comprehensive changes to the Small Business Administration ("SBA") regulations went into effect. These new rules are wide-ranging and will significantly impact SBA's 8(a) Business Development ("BD") program, SBA's mentor-protégé program and SBA's joint venture regulations. The final rule can be found here.

Especially noteworthy are the new rules as they relate to SBA's joint venture regulations. Firms seeking to joint venture with 8(a) contractors for set-aside work under any of the designated regulations now should be aware that the 8(a) partner to the joint venture agreement is no longer required to receive 51 percent of the profits. Instead, under the new rules, "the 8(a) Participant(s) must receive profits from the joint venture commensurate with the work performed by the 8(a) Participant(s)." 13 CFR § 124.513(c)(4).

Firms seeking to joint venture with an 8(a) contractor also need to familiarize themselves with the self-performance requirements under the new rules.

Under 13 CFR § 124(d), "[f]or an unpopulated joint venture or a joint venture populated only with one or more administrative personnel, the 8(a) partner(s) to the joint venture must perform at least 40 percent of the work performed by the joint venture."

Therefore, the 8(a) contractor now can be limited to 40 percent of the profits under the joint venture agreement if it performs only 40 percent of the work. In its comments to the final rule, SBA clarified this change and the reasons for it.

> [T]he majority of commenters supported the proposal that 8(a) Participant(s) to an 8(a) joint venture must receive profits from the joint venture commensurate with the work they performed. Those in support believed that this provision makes sense in light of the change specifying that the 8(a) partner(s) to a joint venture must perform at least 40 percent of the work performed by the joint venture. In a situation where the joint venture performs 100 percent of the contract, 40 percent by an 8(a) Participant and 60 percent by a non 8(a) firm, these commenters believed that it was not reasonable for the 8(a) firm to receive 51 percent of the profits when it performed only 40 percent of the work. SBA continues to agree. SBA believes that requiring an 8(a) firm to receive 51 percent of the profits in all instances could discourage legitimate non-8(a) firms from participating as joint venture partners in the 8(a) BD program, or encourage creative accounting practices in which a significant amount of revenues flowing to a non-8(a) joint venture partner would be counted as costs to the contract instead of profits in order to meet the SBA requirement. SBA does not believe that either of those outcomes is positive. As such, this provision is retained in this final rule.

It is important to be mindful, however, that this change applies only to a joint venture that has not been formed as a separate legal entity. **13 CFR § 124.513(d)**. In the case of a joint venture between an 8(a) contractor and its non-8(a) partner that is formed as a separate legal entity, the 8(a) contractor still is required to own at least 51 percent of the joint venture entity. ***13 CFR § 124.513(c)(3)***.

Thus, in this case, the profits received by the 8(a) contractor need not be commensurate with the percentage of work performed by that 8(a) contractor but, rather, must be "commensurate with [the 8(a) contractor's] ownership interests in the joint venture" – i.e., the 8(a) contractor will receive at least 51 percent of the profits regardless of the percentage of work it performs for the separate legal entity joint venture. ***13 CFR § 124.513(c)(4)***.

Therefore, a firm seeking to joint venture with an 8(a) contractor for set-aside work must be aware that if it elects to construct the joint venture as a separate legal entity, then it can only receive up to 49 percent of the profits of the joint venture – regardless of whether or not the 8(a) contractor only performs 40 percent of the work.

Firms seeking to joint venture with an 8(a) contractor also need to familiarize themselves with the self-performance requirements under the new rules. In order to seek a full or partial small business set-aside construction contract or an 8(a) construction contract under a joint venture agreement, the 8(a) contractor or the 8(a) concern must "perform at least 15 percent of the cost of the contract with its own employees (not including the costs of materials)." ***13 CFR § 125.6(a)(3);***

see also 13 CFR § 124(d)(1); 13 CFR § 124.510(a); 48 CFR § 52-219.14(c)(3). The phrase "cost of the contract" means "[a]ll allowable direct and indirect costs allocable to the contract, excluding profit or fees." ***13 CFR § 125.6(e)(1)***.

To illustrate this self-performance requirement, consider the example of a large business and its small 8(a) partner who have an SBA-approved written mentor-protégé agreement and are seeking to venture together to perform an 8(a) contract.

Assuming their joint venture agreement for the particular contract is approved by SBA, then the joint venture taken as a whole will be considered an 8(a) concern for that contract (provided that the 8(a) protégé "qualifies as small for the size standard corresponding to the NAICS code assigned to the procurement and has not reached the dollar limit set forth in ***[13 CFR] § 124.519."). 13 CFR § 124.513(b)(ii)(B)(3)***.

This means that the protégé firm and its approved mentor firm together must perform at least 15 percent of the cost of the contract with their own employees. Keep in mind, however, that the 8(a) protégé firm still must perform 40 percent of the total work being performed by the joint venture.

It should be remembered that joint venture eligibility and self-performance requirements for construction contracts are different with respect to other SBA programs.

For example, with respect to SBA's Service-Disabled Veteran-Owned Small Business ("SDVO SBC") Program, an SDVO SBC seeking a service-disabled veteran-owned small business set-aside construction contract must agree that, "at least 15 percent of the cost of the contract performance incurred for personnel will be spent on the [SDVO SBC's] employees or the employees of other service-disabled veteran-owned small business concerns." ***13 CFR § 125.6(b)(2); see also 13 CFR § 124.513(d)(1); 13 CFR § 124.510(a); 48 CFR § 52-219.27(d)(3)***.

The phrase "cost of contract performance incurred for personnel" means "direct labor costs and any overhead which only direct labor as its base, plus the concern's general and administrative rate multiplied by the labor cost." ***13 CFR § 125.6(e)(2).***

This standard – i.e., "15 percent of the cost of the contract performance incurred for personnel" – is the same standard for HUBZone small business concerns in SBA's HUBZone Program. ***13 CFR § 125.6(c)(2).*** ■

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