PUBLICATION

Significant Amendments Consolidating SBA's Mentor-Protégé Programs and Revising SBA's Size Regulations Go into Effect on November 16, 2020

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On October 16, 2020 the Small Business Administration (SBA) published its Final Rule related to Consolidation of Mentor-Protégé Programs and Other Government Contracting Amendments (85 Fed. Reg. 66146) (the Final Rule), which goes into effect on November 16, 2020. The Final Rule makes substantial changes to the SBA's Mentor-Protégé programs, revises SBA's existing affiliation rules, and makes various other technical corrections to better clarify the SBA's intentions for its size regulations. Large and small government contractors should review and be aware of these changes in this Final Rule. In this alert, we have summarized some of the most significant items related to the SBA's mentor-protégé programs and joint venture regulations. We will publish additional alerts addressing other parts of the Final Rule in the near future.

Consolidation of SBA's Mentor-Protégé Programs

SBA originally created a mentor-protégé program solely for 8(a) small businesses in 1998. The primary purpose of that program was to encourage SBA-approved experienced businesses (mentors) to aid in the development of SBA-approved 8(a) small businesses (protégés). A related significant benefit of the 8(a) mentor-protégé relationship was that the mentor and protégé could joint venture as a small business for any government prime contract or subcontract provided that the protégé qualified as small for the procurement and, for purposes of 8(a) sole source requirements, the protégé had not reached the dollar limits that an 8(a) participant may receive. SBA's rules also confirmed that parties with an approved 8(a) mentor-protégé agreement would not be affiliated under SBA's affiliation rules solely based on the assistance that a protégé received from a mentor under the mentor-protégé agreement. Before October 1, 2016, the SBA's mentor-protégé program was available only to 8(a) small businesses.

However, on July 25, 2016, the SBA published a *Final Rule Creating the All-Small Mentor-Protégé Program*, 81 FR 48558, which went into effect on October 1, 2016. The All-Small Mentor-Protégé Program (ASMPP) expanded the SBA's mentor-protégé program from only 8(a) small businesses to all small businesses, including women-owned small businesses (WOSB), service-disabled veteran-owned small businesses (SDVOSB), Historically Under-Utilized Business Zone (HUBZone) small businesses, and any other qualifying small business. Similar to the previously-created 8(a) mentor-protégé program, the ASMPP also provides an exception to affiliation for assistance that a protégé firm receives under the approved mentor-protégé agreement, and allows two firms with an SBA-approved mentor-protégé agreement to joint venture as a small business for any federal government prime contract or subcontract, provided the protégé qualifies as small for the size standard corresponding to the NAICS code assigned to the procurement. The affiliation exceptions under the mentor-protégé program are important because SBA's regulations require a small business to count its own annual receipts or employees[1], *plus* the annual receipts or employees of each affiliate, when determining its size status.

The creation of the ASMPP greatly expanded mentor-protégé opportunities and opened the flood gates of small businesses seeking mentor-protégé relationships. Since the creation of the ASMPP, Baker Donelson has helped multiple clients evaluate and create these relationships and also has given several presentations on the topic to various government contracting industry groups and to other lawyers. As of the date of this publication, more than 1,200 active mentor-protégé agreements exist under the ASMPP. The program has been very

popular because it gives small businesses more capability to compete for larger and more sophisticated work while simultaneously giving mentors the opportunity to conduct up to 60 percent of the work on a federal government set-aside contract when that mentor may not otherwise qualify to do any of that small business work. *See* 13 C.F.R. § 125.8 & 13 C.F.R. § 125.9.

As a result of the success of the ASMPP and because the ASMPP and the 8(a) mentor-protégé program have very similar benefits and purposes, the SBA is ending the 8(a) program and consolidating it into the ASMPP on November 16, 2020. In its recently-published Final Rule, the SBA has confirmed that having two separate mentor-protégé programs is unnecessary and creates confusion in the small business community. *See* 85 Fed. Reg. 66147.

Notably, the elimination of the 8(a) mentor-protégé program also will change the SBA's required pre-approval of joint venture agreements between an 8(a) protégé and its mentor for competitive 8(a) awards. Under the 8(a) mentor-protégé regulations existing before November 16, 2020, mentors and proteges were required to get the SBA's approval of their joint venture agreements before award of an 8(a) contract on behalf of the joint venture. *See* 13 C.F.R. § 124.513(e) (*before November 16, 2020)*. Effective November 16, 2020, that pre-approval of joint venture agreements for competitive 8(a) awards will no longer be required. *See* 85 Fed. Reg. 66191 (showing changes to 13 C.F.R. § 124.513(e)). However, the SBA still will require pre-approval of the joint venture agreement prior to the award of a sole source 8(a) contract. *Id.*

Also, under the ASMPP, the mentor and protégé must get their mentor-protégé agreement approved by the SBA, but then typically are free to create joint ventures in accordance with SBA's regulations without getting any other approvals from the SBA. *See* 13 C.F.R. § 125.8 & 13 C.F.R. § 125.9. Of course, it is still essential to comply with the SBA's regulations for the contents of joint venture agreements as the size status of the concern can be challenged through the SBA's size protest process or through a size determination. 13 C.F.R. § 121.1001, *et. seq.*

In our experience, since 2016, most 8(a) businesses have already been choosing the ASMPP path instead of the 8(a) program because of its greater flexibility. For those parties with a mentor-protégé agreement that was previously approved under the 8(a) program, it will continue to operate as an SBA-approved mentor-protégé agreement under the ASMPP. The ending of the 8(a) program is a positive elimination of unnecessary redundancy and an overall improvement to SBA's size regulations.

Unpopulated Joint Ventures and Security Clearance

Beginning in 2016, SBA's regulations eliminated "populated" joint ventures, which means that joint ventures are not allowed to be "populated" with employees who are intended to perform contracts awarded to the joint venture. Under SBA's programs, a joint venture may hire employees to perform purely administrative functions, "but may not have its own separate employees to perform contracts awarded to the joint venture." 13 C.F.R. § 121.103(h). The SBA implemented this rule to better track the work done by each member to ensure that the protégé firm was getting real opportunities to grow through the joint venture's work.

However, after the implementation of this prohibition on "populated" joint ventures, several joint ventures have had challenges with security clearance because the prohibition did not expressly carve out language for a Facility Security Officer (FSO). Additionally, some agencies have been reluctant to award a contract requiring facility clearance to a joint venture if the joint venture itself does not have clearance, even though both joint venture members have such clearance.

To address this problem, the SBA's Final Rule confirms that joint ventures may employ an FSO and still be in conformance with the "unpopulated" requirements; however, that FSO cannot be an employee intended to perform contracts awarded to the joint venture. 85 Fed. Reg. 66149 & 66180. Additionally, the SBA is adding

language to 13 C.F.R. § 121.103(h)(4) confirming that "a joint venture may be awarded a contract requiring a facility security clearance where either the joint venture itself or the individual partner(s) to the joint venture that will perform the necessary security work has (have) a facility security clearance." The amendment further confirms that "[w]here a facility security clearance is required to perform primary and vital requirements of a contract, the lead small business partner to the joint venture must possess the required facility security clearance," and "[w]here the security portion of the contract requiring a facility security clearance is ancillary to the principal purpose of the procurement, the partner to the joint venture that will perform that work must possess the required facility security clearance." 13 C.F.R. § 121.103(h)(4) (November 16, 2020). This amendment provides much-needed clarity about the security clearance issues currently impacting joint ventures under SBA's programs.

Elimination of the "Three" From the "Three-in-Two" Rule

As noted above, one of the biggest benefits of the ASMPP is that a mentor and protégé with an SBA-approved mentor-protégé agreement will not be deemed affiliated for size purposes based on the assistance that a protégé received from a mentor under the agreement. This affiliation exception also allows the mentor and protégé to create joint ventures to perform federal government contracts and subcontracts, provided the protégé qualifies as small for the size standard corresponding to the NAICS code assigned to the procurement.

However, while SBA has encouraged joint ventures between businesses, its regulations also have included rules to prevent ongoing repeated work by the same joint venture. For example, SBA's "three-in-two" rule has prohibited "a specific joint venture entity" from being "awarded more than three contracts over a two-year period, starting from the date of the award of the first contract, without the partners to the joint venture being deemed affiliated for all purposes." 13 C.F.R. § 121.103(h) (before November 16, 2020). Therefore, under the pre-November 16, 2020 "three-in-two rule," once a joint venture received one contract, it needed to closely track the number of awards that it received after that, starting from the date of the award of that first contract. There were some exceptions for when the joint venture made its initial offer including price for the later contracts, but joint ventures who failed to closely comply with this sometimes complicated rule could be found affiliated and lose their small business size status.

The Final Rule, however, eliminates the "three" from the "three-in-two" rule by including the following language: "a specific joint venture entity generally may not be awarded contracts beyond a two-year period, starting from the date of the award of the first contract, without the partners to the joint venture being deemed affiliated for the joint venture." 85 Fed. Reg. 66148 & 66179 Therefore, the Final Rule eliminates the three-contract limit for joint ventures and allows it to win and perform more than three contracts in a two-year period.

In its comments about this change, the SBA confirmed that it still believes that a two-year rule is necessary because a joint venture is intended for a limited purpose and duration, but the SBA eliminated the three award limit. However, as with the old rule, it still applies to "a specific joint venture entity." Therefore, if a mentor or protégé have "a specific joint venture entity" whose time is expiring, they can simply create a new "specific joint venture entity" and the rule will apply anew to that separate entity.

Recertification Requirements When a Joint Venture Member is Acquired

The pre-November 16, 2020 recertification requirements for joint ventures at 13 C.F.R. 121.404(g)(2) required a joint venture to recertify its size when an acquired concern, acquiring concern, or merged concern was a participant in the joint venture that was awarded a contract or order as a small business. This requirement, however, was confusingly written and there was an open question of whether all parties to the joint venture were required to recertify in order for the joint venture to recertify, or if only the acquired or acquiring firm had to do so.

The Final Rule confirms that when one joint venture partner undergoes a merger or acquisition, *only that partner* must recertify its size in order for the joint venture to then recertify its size. 85 Fed. Reg. 66153 & 66180-66182. The new 13 C.F.R. 121.404(g)(2)(C), which becomes effective on November 16, 2020, confirms that the recertification will be required only "from any partner to the joint venture that has been acquired, is acquiring, or has merged with another business entity." Once that party recertifies, the joint venture can then recertify its own status to confirm that it is still small.

This change is especially significant for a joint venture whose size status is based on every member of the joint venture being a small business. Separate from joint ventures that are small based on the SBA's mentor-protégé program, SBA's affiliation rules at 13 C.F.R. § 121.103 confirm that a joint venture also is a small business concern when "each [partner] concern is small under the size standard corresponding to the NAICS code assigned to the contract." SBA's size standards also generally hold that a business that is small at the time of the initial offer including price will be considered small for the life of the contract so that firms are not penalized for naturally growing large as a result of performing federal contracts. Therefore, SBA clarified that only the acquired, acquiring, or merged joint venture member has to recertify, which protects the other uninvolved joint venture members from recertifying when they may have grown large naturally, but did not go through any acquisition or merger. This is another welcome change that provides further clarity for small businesses.

Counting Employees or Receipts From the Joint Venture

The Final Rule also includes important clarifications on how the joint venture members must account for the employees or receipts of the joint venture when calculating its size. The Final Rule confirms that "a concern must include in its receipts its proportionate share of joint venture receipts, unless the proportionate share already is accounted for in receipts reflecting transactions between the concern and its joint ventures (e.g. subcontracts from a joint venture entity to joint venture partners)." *See* 85 FR 66180. Significantly, the comments describing this change confirm that "SBA does not exclude revenues generated by subcontractors from the revenues deemed to be received by the prime contractor." *See* 85 FR 66149. Therefore, "[w]here a joint venture is the prime contractor, 100 percent of the revenues will be apportioned to the joint venture partners, regardless of how much work is performed by other subcontractors." *Id.* When calculating receipts, the appropriate proportionate share is the same percentage of receipts as the joint venture partner's percentage share of the work performed by the joint venture. This new language is consistent with 13 C.F.R. § 125.8(b)(2)(iv), which requires that each participant in the joint venture receive profits from the joint venture commensurate with the work performed by the concern.

As noted above, while a joint venture must be "unpopulated" and therefore cannot have employees intended to perform contracts awarded to the joint venture, it may employ people to perform purely administrative functions. This raises a question regarding how partners to a joint venture must account for those employees when determining their own size. The Final Rule confirms that for calculating employees, "the appropriate share is the same percentage of employees as the joint venture partner's percentage ownership share in the joint venture, after first subtracting any joint venture employee already accounted for in one of the partner's employee count." 85 FR 66180.

Conclusion

The amendments to the SBA's mentor-protégé programs and joint venture regulations in the Final Rule are significant and should be closely reviewed by all government contractors. In addition to these substantial changes, the Final Rule included several other significant amendments that we will write more about in the coming weeks. If you have any questions about the Final Rule or about SBA's small business programs generally, please contact your regular Baker Donelson attorney. Baker Donelson's Government Contracts Team has extensive experience assisting businesses regarding compliance with SBA's size and socioeconomic regulations, including the preparation of operating agreements or bylaws to comply with

requirements on ownership and control, mentor-protégé agreements, joint ventures under the SBA's Mentor-Protégé program, advice about SBA's affiliation rules, and handling SBA size protests.

[1] Under SBA's programs, a business is small by meeting either a size standard based on annual receipts (13 C.F.R. § 121.104) or an employee-based size standard (13 C.F.R. § 121.106).