ProTorÆ Law PLLC

Mentor-Protégé Agreements and Joint Ventures

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ACCOUNTING • TAX • ADVISORY

THE IMPORTANCE OF COMPLIANT GOVERNMENT PROCUREMENT

Public money ought to be touched with the most scrupulous conscientiousness of honor. It is not the product of riches only, but of the hard earnings of labor and poverty.

Thomas Paine, February 1792

Mentor-Protégé agreements and Joint Ventures help small businesses become better Government contractors, enabling them to address the Government's requirements with the agility and economy of a small business, with the resources of a large business. These types of resources help to ensure the prudent expenditure of public monies.

AGENDA

- Overview, Definitions, and Considerations
- 8(a) Business Development Program
- 8(a) Mentor-Protégé Program
- Joint Ventures
- Affiliation
- Joint Venture Advantages/Disadvantages
- Joint Venture Requirements/Characteristics
- Proposed Rules
- Wrap Up
- References/Resources

Overview, Definitions, and Considerations

OVERVIEW

The U.S. Small Business Administration (SBA) has proposed new Mentor-Protégé program rules:

- Patterned on the existing 8(a) Mentor-Protégé Program – similar in form and function
- The new rules would implement the Mentor-Protégé program for all small businesses, not just small, disadvantaged firms under the 8(a) Business Development Program
- The new Mentor-Protégé program will be in addition to the existing 8(a) Mentor-Protégé program

WHAT IS A SMALL BUSINESS?

- A business that meets certain U.S. Small Business Administration (SBA) "size standards"
- Size standards correspond to "codes" published by the North American Industrial Classification System (NAICS) (Census Bureau NAICS Home Page)
- For most industries, SBA defines a "small business" either in terms of average number of employees or average annual receipts over the past 3 years
- Additionally, a small business must:
  - Be organized for profit
  - Have a place of business in the U.S.
  - Operate primarily within the U.S. or make a significant contribution to the U.S. economy
  - Be independently owned and operated
  - Not be dominant in its field on a national basis

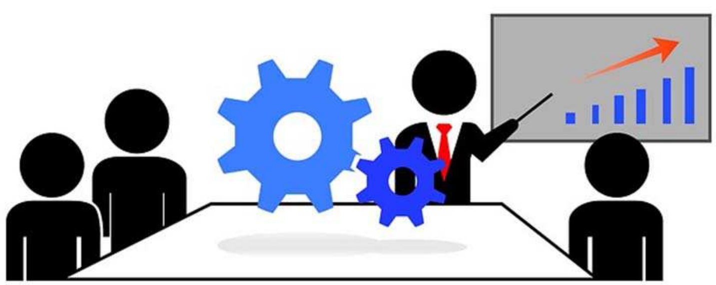
SBA 8(a) Business Development Program

8(a) BUSINESS DEVELOPMENT PROGRAM

- To help small disadvantaged businesses (SDBs) compete in the marketplace, SBA created the 8(a) Business Development Program
- The 8(a) Business Development Program is a business assistance program for SDBs that offers a broad scope of assistance to firms that are at least 51% owned and controlled by socially and economically disadvantaged individuals
- Participation in the program is divided into 2 phases over 9 years: a 4 year developmental stage and a 5 year transition stage
- Participants can receive sole-source contracts up to a ceiling of $4M for goods and services and $6.5M for manufacturing
- 8(a) firms are also able to form Joint Ventures (JVs) with “other than small businesses” to bid on contracts. This enhances the ability of 8(a) firms to perform larger prime contracts and overcome the effects of contract bundling.

8(a) BUSINESS DEVELOPMENT PROGRAM

- The overall goal is to develop and graduate 8(a) firms that will go on to thrive in a competitive business environment
- Primary requirements:
  - Maintain a balance between commercial and Government business
  - Limit the total dollar value of sole-source contracts that an individual 8(a) participant can receive while in the program: $100M or 5 times the value of its primary NAICS code



SBA 8(a) Mentor-Protégé Program

8(a) MENTOR-PROTÉGÉ PROGRAM

- Alliance between an 8(a) program participant (Protégé) and a "large business" as defined by NAICS (Mentor)
- Protégé has identified needs for business development and Mentor has the capacity to address those needs
- A Mentor-Protégé relationship must be approved by SBA *before a joint venture: 1) is created, and 2) submits an offer/proposal to the Government*
- A Mentor can have no more than 3 Protégés at one time
- A Protégé cannot have a Mentor if the Protégé is in its last 6 months of the 9 year 8(a) program term

8(a) MENTOR-PROTÉGÉ PROGRAM

- The Mentor-Protégé relationship is between a small business “Protégé” and an “other than small business” “Mentor.”
- The purpose of the 8(a) Mentor-Protégé relationship is to:
  - Enhance the capabilities of the Protégé (an 8(a) program participant)
  - Assist the Protégé with meeting the goals established in its SBA-approved business plan
  - Improve the Protégé’s ability to successfully compete for Government contracts

8(a) MENTOR-PROTÉGÉ PROGRAM

BENEFITS

- Mentor's expertise, resources, and capabilities are made available to the Protégé
- Mentors can provide assistance relevant to performance of non-8(a) contracts so that Protégé firms more fully develop their competitive abilities
- Mentors can enter into JV arrangements with Protégés to compete for and perform on Government contracts set aside for small businesses
- Mentors can own up to 40% of the Protégé to help it raise capital

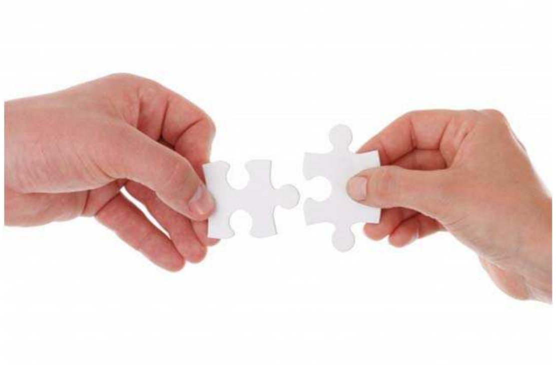
Joint Ventures

WHAT IS A JOINT VENTURE?

- A JV is a business agreement in which the parties agree to develop, for a finite time, a new entity and new assets by contributing equity. The parties control the enterprise and, consequently, share revenues, expenses, and assets.
- Key Characteristics:
  - A separate legal entity
    - Usually a partnership (informal) or Limited Liability Company (formal)
  - Includes "members" with proportionate interests in the entity
  - Limited in duration
  - Special purpose (i.e., pursuit of contract award)
  - Sharing of profits and losses among members

WHAT IS A JOINT VENTURE?

- A JV can include 2 or more companies and could include:
  - Only small businesses or other special classes
  - Only large businesses
  - A mix of both
- With limited exceptions, a JV of a small business and a large business cannot qualify as “small” due to “affiliation”



SBA DEFINITION OF JV

- When 2 or more businesses enter a temporary partnership, usually associated with a specific contract or series of contracts, that is mutually beneficial to both businesses
  - Association of individuals or companies that come together to combine resources and bid on contract opportunities
- Allowed 3 contract awards per JV within 2 years
  - Known as the “3 in 2” rule

SBA PROPOSED RULE

NO JV REQUIRED!

Under the proposed SBA rule, if a procurement is a small business set-aside, the small business prime contractor and any "similarly situated" small business teaming partner (subcontractor) together can satisfy the 51% performance/revenue requirement without having to form a JV

- This can result in substantial savings in time and dollars spent creating the JV agreements for the small businesses

Affiliation

AFFILIATION

- Members of a JV that submit an offer on a procurement are presumed to be affiliated with one another for the purposes of that procurement
- If a small business is determined to be "affiliated" with another company, SBA will aggregate the size of the 2 companies in determining the small business' "size"
- If the aggregate of the affiliated members exceeds the size standard of the NAICS code for a small business ***set-aside procurement***, the JV will ***not be eligible for the set-aside award***; there are exceptions

EXCEPTIONS TO AFFILIATION

- When ALL members are "small" under the size standard for the NAICS code of the solicitation, ***and***
- The procurement is a bundled requirement

or

The procurement value is:

- More than $10M for employee-based size standards
- More than ½ the applicable size standard for revenue-based size standards

EXCEPTIONS TO AFFILIATION

The procurement value is:

- More than ½ the applicable size standard for revenue-based size standards

EXAMPLE: SMALL BUSINESS SET-ASIDE

NAICS SB Size Standard	$20M
Solicitation Value	$16M
JV of 3 SB Contractors: Annual Revenues	Contractor A: $7M Contractor B: $10M Contractor C: $5M
Total Aggregated Revenue of JV	$23M

- Aggregated contractor annual revenue ($23M) exceeds the applicable NAICS small business size standard ($20M), which would normally disqualify the team for this small business set-aside opportunity
- However, the procurement value ($16M) is more than ½ the applicable NAICS small business size standard ($20M) – this affiliation exception allows the team to pursue this opportunity

EXCEPTIONS TO AFFILIATION

- The members are in an approved SBA 8(a) Program Mentor-Protégé agreement
- Certain special conditions apply to SBA 8(a) Mentor-Protégé agreements (see Slides 35 and 36)

SBA Mentor-Protégé Joint Ventures Advantages/Disadvantages

LARGE BUSINESS/SMALL BUSINESS JV ADVANTAGES

- JV may be "populated" or "unpopulated"
  - Populated: Formal entity with its own employees (JV hires employees, leases space, owns equipment, etc.)
  - Unpopulated: Shell company with only administrative employees and members as de facto subcontractors (JV exists only on paper and members provide employees, facilities, equipment, etc. as subcontractors to JV)
- Members may form another JV and receive another 3+ contract awards
- Large business (Mentor) member can perform and receive profits from up to 60% of the work awarded to the unpopulated JV

OTHER JV ADVANTAGES

A JOINT VENTURE:

- Provides “one-stop shopping” to the Government for the combined resources of the members (technical and other)
- Has performance history that combines that of each member
- Allows each member to cite the contract as past performance in future proposals
- Allows a small business to be competitive as a prime contractor

OTHER JV ADVANTAGES

- JV allows the Mentor greater control over prime contract performance that it would have as a subcontractor
- Under the Mentor-Protégé program, provides a large contractor with access to work set aside for small businesses

JV ADVANTAGES TO PROTÉGÉ

- Small business may pursue opportunities broader than it would otherwise qualify for
- Small business gets “prime” past performance record and may use past performance record of partners
  - Advantageous when solicitation says past performance of subcontractors will not be considered
- Small businesses qualify as “small” longer
  - Small businesses must include in receipts or headcount its proportionate share of joint receipts or joint employees

JV ADVANTAGES TO MENTOR

- Large business may pursue set-aside opportunities for which it is otherwise ineligible
  - Large business can perform up to 60% of the work, as opposed to 49% as a subcontractor to a small business prime contractor
- Large businesses may have more control over contract performance than if it were a subcontractor
  - For JVs under SBA-approved Mentor-Protégé agreements, control over performance will not lead to "affiliation"
- Large businesses can gain entry to new agency or program where small business has history

J V D I S A D V A N T A G E S

- Some Government officials are not familiar with the model; concerns arise about responsibility for contract performance or non-performance
- Can be a challenge for members to “speak with one voice”
- Depending on the JV structure, a member may receive less work than it would as a subcontractor or a single prime contractor

JV DISADVANTAGES

- More paperwork and more complicated to set up a JV; can be more expensive
- All the liabilities are shared by all JV members
- JV relationships are harder to exit if they do not work

SBA 8(a) Joint Venture Requirements/Characteristics

8(a) JV REQUIREMENTS

- JV must be reflected in writing, generally by an operating agreement if JV is an LLC
- 8(a) JV must be approved by 8(a) concern's SBA District Office to be entitled to an 8(a) contract award, but not for a small business set-aside contract award
  - JV must follow 8(a) JV requirements even if offer is submitted for small business (v. 8(a)) set-aide
- Nature of JV relationship must be disclosed in proposal
- JV may be "populated" or "unpopulated"

8(a) JV WORK PERFORMANCE REQUIREMENTS

- 8(a) JV must comply with FAR Clause 52.219-14, Limitations on Subcontracting
  - For services, the JV must perform 51% of the cost of labor; work of non-8(a) JV member included in 51% calculation
- If 8(a) JV is "unpopulated," 8(a) member must perform at least 40% of the total work performed by the JV members (at any tier)
- If 8(a) JV is "populated," 8(a) member must be able to demonstrate that it will benefit from its participation in the JV
  - If 8(a) JV is "populated," the non-8(a) JV member, or any of its affiliates, cannot be a subcontractor to the JV at any tier

RESPECTIVE JV MEMBER RIGHTS/RESPONSIBILITIES

- 8(a) must be "Managing Member"
- Program Manager must be employed/appointed by the 8(a)
- Non-8(a) member cannot exercise "negative control" over 8(a) member
- If populated, 8(a) member must get 51% of the profits of the JV
  - If unpopulated, JV is a pass-through and no profits remain in JV entity
- Both members required to ensure performance of Government contract; no withdrawal from JV permitted
- Separate bank account for overall JV, *joint signatures required*
- Managing Member must physically maintain JV records
- SBA reporting requirements apply

UNPOPULATED SBA MENTOR-PROTÉGÉ JOINT VENTURE

JOINT VENTURE
Unpopulated

- Acts as a pass-through
- JV must perform at least 51% of the cost of the JV contract incurred for personnel

PROTÉGÉ

- *De facto* subcontractor
- Must perform at least 40% of JV contract
- Must receive profits according to % of work performed

MENTOR

- *De facto* subcontractor
- Can perform up to 60% of JV contract
- May receive up to 60% of JV profits because no profit remains in unpopulated JV

SUBCONTRACTORS

- Can only perform up to 49% of cost of JV contract incurred for personnel
- Can be Mentor or Mentor affiliate under certain conditions

POPULATED SBA MENTOR-PROTÉGÉ JOINT VENTURE

JOINT VENTURE
Populated

JV must perform at least 51% of the cost of the JV contract incurred for personnel

PROTÉGÉ

- No minimum percentage of work obligation, but Protégé must demonstrate how it is benefitting from allocation of work
- Must receive 51% of JV profits

MENTOR

- No restriction on performance of work
- But restricted to 49% of JV profits

SUBCONTRACTORS

- Can only perform up to 49% of cost of JV contract incurred for personnel
- Cannot be Mentor or Mentor affiliate

Proposed Rules

SBA PROPOSED MENTOR-PROTÉGÉ RULES

- Per the Small Business Jobs Act of 2010 and the FY2013 National Defense Authorization Act (NDAA), the Mentor-Protégé program would be authorized for all small businesses (not just 8(a) firms)
- Small Business Mentor-Protégé Program/Misc., issued February 5, 2015, 80 Fed. Reg. 6618, comments filed in May
  - New Mentor-Protégé program will be in addition to existing 8(a) Mentor-Protégé program
  - Applies to all small businesses other than 8(a) concerns
  - SBA will verify that company applying for participation in the program is "small" (no self-certification)
  - Two separate tracks for Mentor-Protégé applications [8(a) and other], but may be consolidated into one office
  - May institute "open" and "closed" application periods

SBA PROPOSED MENTOR-PROTÉGÉ RULES

- **MENTORS**
  - A Mentor in either the small business or 8(a) Mentor-Protégé program may have a total of 3 Protégés, spread among the two programs
  - Mentors may own up to 40% equity interest in Protégés
- **PROTÉGÉS**
  - SBA proposes to **eliminate the restrictions on the types of small businesses** that can participate in both the 8(a) and small business Mentor-Protégé programs
    - Concern would qualify:
      - Regardless of its size relative to its primary NAICS code
      - At any stage of program participation
      - As a Protégé even though it had already won a small business or 8(a) contract

SBA PROPOSED MENTOR-PROTÉGÉ RULES

OTHER AGENCY MENTOR-PROTÉGÉ PROGRAMS

- Other agencies or departments (except DoD) cannot continue agency-/department-specific Mentor-Protégé programs unless program plans are submitted to and approved by SBA
- Agency may operate existing Mentor-Protégé program for 1 year following SBA issuance of final rules for small business Mentor-Protégé program
- SBA requests comments on whether there will be a continuing need for other agency Mentor-Protégé programs (such as the VA program)
- SBA requests comments on whether its small business Mentor-Protégé program should include subcontracting incentives authorized by other agency Mentor-Protégé programs
- Written agreement must identify other Mentor-Protégé relationships and show how assistance provided is different

SBA PROPOSED MENTOR-PROTÉGÉ RULES

OTHER

- SBA seeks comments on whether it should require JVs to be separate legal entities
- A separate legal entity JV cannot have its own employees; eliminates "populated" JV option
- Impact of proposed change to Limitations on Subcontracting rule
    - A prime contractor may satisfy the applicable limitations on subcontracting either by performing a sufficient percentage of the work itself, or by subcontracting a portion of the work to 1 or more "similarly situated entities"
    - Similarly Situated Entity: A small business concern subcontractor that is a participant of the same SBA program that qualified the prime contractor as an eligible offeror and awardee of the contract

SBA PROPOSED RULE

FROM FEDERAL REGISTER VOL. 80, NO. 193, PG. 60300 (10/6/15)

A proposed amendment would allow an other than small prime contractor that has an **individual subcontracting plan** for a contract to receive credit towards its small business subcontracting goals for ***subcontract awards made to small business concerns at any tier***.

- The prime contractor shall incorporate the lower-tier subcontracting performance into its subcontracting plan goals. Currently, other than small business prime contractors establish small business subcontracting goals at the first-tier level, and receive credit toward their subcontracting plan goal performance at the first-tier level.

SBA PROPOSED RULE

FROM FEDERAL REGISTER VOL. 80, NO. 193, PG. 60300 (10/6/15)

The rule also proposes to implement the statutory requirements related to subcontracting plans of all subcontractors that are required to maintain such plans

- Where a prime contractor or subcontractor is required to have an individual subcontracting plan, the prime contractor or the subcontractor will review and approve subcontracting plans submitted by their subcontractors; monitor their subcontractors' compliance with the subcontracting plans; ensure that reports are submitted by their subcontractors; acknowledge receipt of subcontractors' reports; monitor subcontractor performance; and discuss subcontractor performance with subcontractors when necessary.

PROPOSED CONGRESSIONAL RULE

H.R. 4322, MENTOR-PROTÉGÉ COOPERATION REFORM ACT OF 2016

The rule proposes to clarify the prohibition on affiliation under the DoD Mentor-Protégé program and to amend the Small Business Act to improve cooperation between SBA and DoD Mentor-Protégé programs

- Prior to approving a DoD Mentor-Protégé agreement, SBA must first determine that there is no affiliation between the Mentor and Protégé firms
- DoD exemption to the requirements of the Small Business Act would be removed, thus eliminating the stand-alone DoD Mentor-Protégé program
  - Mentor-Protégé agreements issued by DoD would be subject to the same requirements of the Small Business Act as other non-DoD agencies

Wrap Up

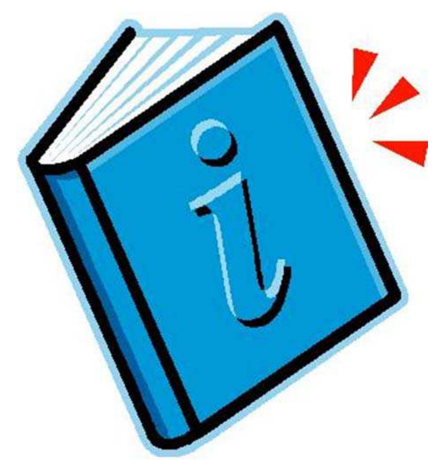
WRAP UP

- Mentor-Protégé JV is a win/win for small and other than small businesses
  - Small businesses can bid on larger contracts
  - Small businesses can get prime past performance
  - Large businesses can perform up to 60% of work set-aside for small businesses
  - Large businesses also can get equity in 8(a) concern
- Mentor-Protégé JV is a win for the Government
  - One-stop shopping
  - Get small business credit, but performance of sophisticated, large business
- Mentor-Protégé JV must follow strict guidelines
- Mentor-Protégé program will extend to all stripes of small businesses

References/Resources

REFERENCES/RESOURCES

- SBA Getting Started: SBA Getting Started Home Page
- SBA Blogs: Venturing into a Joint Venture - Need-to-Know Basics
- SBA Mentor-Protégé Program: SBA Mentor-Protege Program Home Page
- SBA 8(a) Business Development Program:
  SBA 8(a) Business Development Program Home Page
- SBA NAICS Codes: SBA NAICS Codes Home Page



QUESTIONS/COMMENTS

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