SBA Consolidation of Mentor-Protégé Programs

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Implications of Rule Changes on the Industry

In response to government-wide regulatory reform aimed at reducing costs, the Small Business Administration (SBA) published a final rule, Consolidation of Mentor-Protégé Programs and Other Government Contracting Amendments, on October 16, 2020 that will go into effect on November 16, 2020. This new rule merges the 8(a) Business Development (BD) Mentor-Protégé program and the All Small Mentor-Protégé program, which provide many benefits for small and large businesses. The new rule aims to eliminate confusion surrounding the perceived differences in the programs and streamline the mentor-protégé application process by removing duplicative functions within the SBA and establishing one staff system for optimized program coordination.

This article covers the effects of the historical perspective of the different mentor-protégé programs, effects of the consolidation of the mentor-protégé programs, the new "Two Year Rule" for affiliation, the benefits and disadvantages, along with implications of the final rule on the industry.

> ***Businesses interested in participating in a mentor-protégé program no longer have to worry about choosing between the 8(a) and the All Small program, which had nearly identical regulations and purposes that caused confusion over whether one program was more beneficial.***

Historical Perspective: The Last 20 Years

The SBA first established an 8(a) mentor-protégé program just over 20 years ago in order to encourage business development of 8(a) Participants through the assistance of SBA-approved mentors. 63 FR 35726, 35764 (June 30, 1998).

In September 2010, Congress enacted the Small Business Jobs Act of 2010 (Jobs Act) authorizing the SBA to establish separate mentor-protégé programs for other types of business concerns. Public Law 111-240. The Jobs Act led to the creation of mentor-protégé programs for Service-Disabled Veteran-Owned Small Business Concerns (SDVOSB), the HUBZone Program, and the Women-Owned Small Business (WOSB) Program—each of which was modeled after the 8(a) mentor-protégé program. See Jobs Act § 1347(b)(3). Congress drafted the Jobs Act as a means to increase opportunities and business development for small businesses in federal contracting through greater use of mentor-protégé programs.

Then, in January 2013, Congress enacted the National Defense Authorization Act for Fiscal Year 2013 (2013 NDAA), which authorized the SBA to establish a mentor-protégé program for all other small business concerns. Public Law 112-239. Section 1641 of the 2013 NDAA required the small business mentor-protégé program to mirror the 8(a) Mentor-Protégé Program, but gave the SBA authority to modify each program to the extent necessary, considering the types of concerns to be included as protégées.

In 2016, the SBA published a final rule that combined authorities found in the Jobs Act and the 2013 NDAA to create a mentor-protégé program that included all small business concerns. 81 FR 48558 (July 25, 2016). The 2016 final rule opened the door for all small business concerns to form mentor-protégé teams with SBA-approved mentors and create joint ventures that could compete for small business set-aside contracts. Before the 2016 final rule, only 8(a) mentor-protégé teams were shielded from affiliation in their joint venture endeavors.

Overview of the Final Rule

One of the greatest changes to SBA regulations in the 2020 final rule is the elimination of the 8(a) Mentor-Protégé Program by consolidating the program into the All Small Program. The SBA believes this change will eliminate confusion associated with having to separate small business mentor-protégé programs that provide identical benefits. The new rule amends 13 C.F.R. 124.520 (rules governing the SBA's Mentor-Protégé Program) to acknowledge that those in the 8(a) Program may participate in the Mentor-Protégé Program, just like any other small business concern. Existing SBA-approved 8(a) Mentor-Protégé relationships do not need to recertify—they will continue to operate with the same remaining time under the All Small Program. Any current 8(a)-approved relationship will now count toward the one of the two lifetime mentor-protégé relationships a small business may engage in under the All Small Program.

Despite its name, the final rule does significantly more than consolidate the 8(a) Mentor-Protégé Program. The most impactful changes will affect:

Certifications and Recertification Requirements: The final rule adds size and socioeconomic status recertification requirements to orders under Multiple Award Contracts (MACs). If a business is qualified as "small" at the time of a MAC award with a duration of no more than five years, that business will be considered "small" throughout the life of a MAC, even with respect to MACs set aside for small businesses. However, after the five-year mark on a long-term, small business set-aside contract, awardees must recertify their size status. The final rule revises current regulations, which leave size and socioeconomic status recertification of MAC awardees to the discretion of the Contracting

1 Most recently, in January 2017, President Trump issued Executive Order 13771, "Reducing Regulation and Controlling Regulatory Costs", which aimed to reduce costs associated with unnecessary and burdensome regulations. It directs all agencies to repeal at least two existing regulations for each new regulation issued in FY 2017 and thereafter. In response to this Executive Order, the SBA initiated a review of its regulations to determine which provisions it could amend or eliminate. Based on this internal review, the SBA issued its most recent final rule, Consolidation of Mentor-Protégé Programs and Other Government Contracting Amendments.

Officer issuing orders under the MAC. Under the new 13 C.F.R. 121.404(g)(3), a Contracting Officer must request that a concern recertify its small business status no more than 120 days: (1) before the end of the contract's fifth year, and (2) before exercising any option after the fifth year of the contract.

Multiple Award Contracts (MACs): In addition, a NAICS code will be assigned to each order issued under a MAC that accurately reflects the supplies or services required under the order. This is a change from the current system, where one NAICS code is assigned to a MAC contract that is then flowed down to each order regardless of whether that code appropriately describes what is delivered under the order. Under the final rule, a Contracting Officer must assign a single NAICS code (that is associated with the underlying MAC) for each order. For example, set aside orders that require supplies should be assigned a manufacturing/supply NAICS Code in order to more fully comply with the nonmanufacturer rule.

Nonmanufacturer Rule: The nonmanufacturer rule coincides with the requirement that prime contractors who supply goods in small business set-aside contracts cover at least 50% of the manufacturing costs of the products supplied to the government. Specifically, the nonmanufacturer rule provides an exception to this requirement by permitting a small business to provide supplies it did not manufacture as long as those supplies came from another small business. The final rule's requirements that each MAC order specify a related NAICS code ensures the nonmanufacturer rule will apply in MACs that require both supplies and services.

Tribally Owned Applicants and Participants: The final rule makes changes to regulations governing tribally owned Applicants and Participants. The SBA adds clarifying language to reaffirm that an individual may be responsible for the management and daily business operations of two tribally owned concerns at the same time. In the event the primary NAICS code of a tribally owned Participant is changed, the tribe can submit an application that substitutes another tribally owned firm under the same NAICS code for participation in the 8(a) Program. Additionally, a Participant owned by a tribe, the Alaska Native Corporation (ANC) or Community Development Corporation does not need to request a change of ownership from the SBA when the ANC or tribe inserts or removes an intermediary company between the ANC/tribe and the 8(a) Participant. The SBA believes the underlying ownership of the Participant in such circumstances is not sufficiently changed and does not justify the request for change of ownership—a process that can be burdensome and take several months.

Joint Ventures: The New Two-Year Rule and Other Significant Changes The SBA believes that a joint venture is not an ongoing business entity, but rather something that is formed for limited purpose and duration. The former definition described a joint venture as an entity that can be formed for no more than three contracts over a two-year period (the "three-in-two" rule). Previously, if a joint venture was awarded more than three contracts over a two-year period, the parties to the joint venture would be considered affiliated and lose their small business status.

The SBA final rule changes the definition of a joint venture in 13 C.F.R. 121.103(h) to more adequately reflect its limited purpose. Now, the duration of an SBA joint venture cannot exceed two years from the date of its first contract award, regardless of how many contracts the entity performed in the two-year period. Parties may still form a new joint venture at the expiration of the two-year period if they wish to continue to jointly seek work on federal contracts. Then, that new joint venture could pursue additional contracts for two years from the date of the new entity's first award. However, if two or more businesses form an entity that exists on a continuing, unlimited basis, the SBA will view the partner businesses as affiliated with each other under a separate business concern.

Under 13 C.F.R. 121.103(h), (non-mentor-protégé) joint ventures will qualify as small so long as each of the partners is small as of the date of the offer. Further, the size of the joint venture will not change if one venturer becomes "other than small" during the course of contract performance. This is good news for those in the 8(a) Program, who will no longer have to worry about a small business joint venturer "graduating" out of the Program during contract performance. In the case of unrestricted MACs and government-wide acquisition contracts, size is determined as of the date the joint venture submits its offer for a specific small business set-aside order under the MAC. Unlike single-award contracts, if one joint venture partner has grown to be "other than small" at the time the joint venture submits its offer for an order under a MAC, the joint venture will not be eligible as a small business for the set-aside order.

The new rule also clarifies the SBA's intent with respect to a novation to the joint venture, i.e., when a partner to the joint venture steps out of the agreement to be replaced with a third party, but the joint venture agreement remains unchanged. A novation restarts the two-year clock if that was the first award received by the joint venture. Additionally, the new rule permits a novation after the two-year period as long as the joint venture submitted its novation package to the Contracting Officer for approval before the expiration of the two years. Similarly, joint ventures that submit offers for their first contract award near the end of the two-year mark may still qualify for that contract even if the award occurs after the two-year period.

The new rule permits joint ventures that are separate legal entities to be populated by administrative personnel. Prior to the new rule, a joint venture could not be populated, meaning the joint venture itself could not hire its own employees to perform the government contract. Instead, each joint venturer would provide its own employees to perform the contract work on behalf of the joint venture as an "unpopulated" joint venture. This unpopulated setup enables the SBA to track the performance of each venturer on the contract to ensure the small business lead partner receives benefit from the joint venture arrangement. The new rule changes these requirements slightly to allow a joint venture to hire its own administrative personnel, including one or more Facility Security Officers. 13 C.F.R. of § 121.103(h).

The new rule revises 13 C.F.R. 125.8(b)(2) to provide joint venture partners greater control over how joint venture profits are distributed. Joint venture partners may now agree to distribute profits from the joint venture to the small business participant(s) in excess of the percentage commensurate with the work performed.

The new rule confirms that a protégé must perform at least 40% of the work performed by the joint venture; however, the protégé cannot include work subcontracted to a similarly situated entity in reaching that calculation. The new rule updates 13 C.F.R. 125.8(c) to require application of the rules of 13 C.F.R. 125.6 governing supplies, construction, and mixed contracts in determining the 40% protégé workshare. For example, this cross-reference to 13 C.F.R. 125.6 requires protégés to refrain from paying out more than 50% of the amount paid by the government to other firms that are not "similarly situated," i.e., having the same small business status as the protégé. As for construction contracts, protégés cannot pay more than 85% of the amount paid by the government to firms that are not similarly situated. A protégé may not count costs of construction materials in making this calculation. Where mixed contracts are involved, the Contracting Officer selects the appropriate NAICS codes, and the protégé will be bound by the corresponding percentage limitations per 13 C.F.R. 125.6.

Benefits of the Final Rule

The final rule provides changes to the mentor protégé programs that will benefit small and large business. These changes include:

1. **8(a) Joint Ventures No Longer Require SBA Approval.** The 2020 final rule also presents big changes for small business joint ventures, including the elimination of the requirement that the SBA approve 8(a) joint venture agreements prior to award of competitive 8(a) set-aside contracts (as opposed to 8(a) sole-source contracts, which will still require pre-award approval). Previously, as soon as a solicitation was released, 8(a) protégés and mentors were off to the races to obtain specific approval of their joint venture in the pursuit of a specific project or looking or an addendum to an already approved joint venture agreement. Oftentimes, this approval process takes 6 to 10 weeks, causing serious risk that SBA approval will not be granted in time for contract award. This was a serious issue in Alutiiq-Banner Joint Venture, B-412952 et al. (July 15, 2016). In this instance, the GAO sustained a protest challenging an 8(a) joint venture's eligibility for award where that joint venture had not previously sought (or received) SBA's approval for an addendum to its joint venture agreement. Ultimately, the GAO recommended that NASA terminate the award and make a new source selection decision, confirming that the selected awardee is an eligible 8(a) participant. Failure of this 8(a) joint venture to have SBA approval to chase this specific solicitation caused it to lose the contract award. Fortunately this change to the final rule eliminates the need for SBA approval. This means businesses participating in the Program will no longer have to deal with delays or factor in SBA determination timeframes for joint venture approval when preparing to submit a bid or offer for award.
2. **Reapplication Period.** The amended 13 C.F.R. 124.207 generally allows firms that have been rejected from the 8(a) BD participation program to correct application deficits and reapply after 90 days instead of one year. The SBA believes this change will reduce the number of appeals to the Office of Hearings and Appeals (OHA) and their associated costs. However, if the SBA denies a concern's 8(a) application three times within 18 months of first application submission, the disappointed concern must wait one year from the date of the third ineligibility finding to resubmit its application.
3. **Lifetime Limit.** The SBA will not count mentor-protégé relationships terminated within 18 months of SBA approval of the mentor-protégé agreement against the protégé firm's two-mentor lifetime limit. This revision to 13 C.F.R. 125.9(e) provides a clear timeframe in which a protégé may end its relationship with its mentor without negatively impacting the protégé's lifetime mentor limit. However, if a small business protégé appears to be abusing this 18-month grace period and enters into many short-term mentor-protégé relationships as a means of extending its Program eligibility, the SBA may find the small business has exhausted its participation and refuse to approve additional mentor-protégé relationships. These additions, found at 13 C.F.R. 125.9(e)(6)(ii), strike a balance between providing the flexibility protégés may need when selecting an appropriate mentor and protecting mentors from small businesses that may try to abuse the 18-month "trial period."
4. **Intervention.** Revised 13 C.F.R. 125.9(g) allows a protégé to request the SBA to intervene on the protégé's behalf to address an underperforming mentor. Protégés may now request SBA intervention at any time when the protégé believes its mentor has not provided the level of business development assistance promised in the mentor-protégé agreement. When a protégé makes such a request, the SBA will notify the mentor and provide the mentor an opportunity to respond to the protégé's adverse report of the mentor's performance in the Program. If the mentor cannot overcome the reported allegations, the SBA will terminate the mentor-protégé agreement and provide the protégé the opportunity to substitute a different firm to be its mentor for the time remaining under the agreement. If the SBA terminates a mentor-protégé agreement on these grounds, the substitute mentor will not count towards the two-mentor lifetime limit. In the event two years already elapsed on the mentor-protégé agreement, the substituted firm could then serve as mentor to the protégé for a total of four years.

   The SBA will review mentor-protégé relationships annually and request a protégé to provide an assessment of how the relationship is working and whether the protégé would recommend its mentor to other small businesses in the future. These revisions put power in the hands of a small business protégé and help better ensure that the mentor-protégé relationship is benefitting the protégé.

Disadvantages of the Final Rule

Despite providing greater clarity and certainty, the final rule has created several issues that may spark risk for industry. These disadvantages include:

1. **Recertification.** The new regulation under 13 C.F.R. 121.404(g) expressly states that a required recertification (e.g., as a result of a novation, merger, sale, acquisition, or at the 5-year mark of a long-term contract) may change a firm's status for future options and orders. This poses risks for small business concerns that grow to be "other than small" during the course of a long-term contract.
2. **Non-8(a) Business Activity.** Under the revised 13 C.F.R.

   124.509(d)(4), if a Participant fails to make good faith efforts to meet its applicable non-8(a) business activity target, the SBA may prohibit the award of any new, sole-source 8(a) contracts. These business activity targets require 8(a) Participants to have minimum non-8(a) revenue goals as a percentage of a Participant's total revenue. The amount of non-8(a) revenue in proportion to a Participant's total revenue increases each year the Participant spends in the transitional stage, pushing Participants to seek business opportunities outside the 8(a) Program.

   If the SBA determines a Participant has failed to make good faith efforts to reach non-8(a) business activity goals, the Participant may be ineligible for sole-source awards in the current program year. When a Participant is notified of ineligibility on these grounds, it may either (1) wait until the end of the current program year and demonstrate it has met the activity target as part of its normal annual review, or (2) make quarterly submittals of non-8(a) revenue throughout the program year in an attempt to come back into compliance before the current program year ends.
3. **Limit of $100M.** Under 13 C.F.R. 124.519, an 8(a) Participant may not receive sole-source 8(a) contracts where it has received a combined total of 8(a) competitive and sole-source contracts in excess of $100 million during its participation in the Program.

Implications of the Final Rule on the Industry

The new final rule provides significant and sweeping changes that overall are to the benefit of industry. The final rule provides clarity and certainty, which allows business, both small and large, to better evaluate risk, and determine a path forward based on those risk factors.

We can expect to see the following changes in the industry:

- Elimination of the 8(a) Joint Venture may increase competition for 8(a) set-aside contracts;
- Mentors stepping up to the plate and playing more meaningful roles in the All Small Business Mentor-Protégé Program; and
- Greater scrutiny during the mergers and acquisitions of small business caused by the recertification requirements that may affect business valuations.

Businesses interested in participating in a mentor-protégé program no longer have to worry about choosing between the 8(a) and the All Small program, which had nearly identical regulations and purposes that caused confusion and concern over whether one program was more beneficial than the other. Industry will now just focus on the one program and this will hopefully help create a level playing field for small businesses regardless of socioeconomic classification. This parity was one of the kick-starters for the implementation of the All Small Mentor-Protégé program.

Industry will no longer have concerns that an 8(a) joint venture may not obtain SBA specific approval for a solicitation prior to contract award. This change in the final rule will eliminate bid protests based on SBA approval as a precondition of awarding 8(a) set-aside contracts. Additionally, this change may help protégés and mentors be more flexible in their decisions to pursue certain contracts without this requirement. Thus, industry may see more competition in 8(a) set-aside contracts.

The mentor-protégé programs have always been highly sought after for their economic benefits. While the All Small Business Mentor-Protégé program previously had less oversight that the 8(a) Mentor-Protégé Programs, by giving the SBA the ability to intervene on behalf of the protégés, businesses that decide to participate in the program as mentors will be held accountable. The final rule should reduce the frequency of underperforming mentors in these programs.

Additionally, recertification will impact potential mergers and acquisitions in the industry. Small businesses performing long-term contracts may find challenges in marketability to larger “other than small” businesses because the recertification process may affect the newly acquired company’s continued eligibility. While this may be a disadvantage to some, it is a welcome change to others who want to limit the participation in long-term small business set-aside contracts to those business concerns that remain small businesses in future option years.

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A versatile attorney with a background in construction, Diana concentrates her practice on government contracts, focusing on Federal construction. Diana provides consulting services to government contractors who need support with work acquisition, project management, FAR flowdown requirements, small business utilization and contract compliance. She has experience preparing REAs and claims; handling disputes litigation; reviewing government contracts and solicitations; creating policy and internal audits to mitigate risk and exposure while maintaining profitability; managing small business DBE/MBE/SWAM subcontracting plans; drafting joint venture and teaming agreements; and providing implementation procedures for tax incentive programs.

Diana is well versed in False Claims Act (FCA) matters, providing risk mitigation against FCA violations and advising companies in multiple industries on compliance programs to reduce exposure to false statements. Diana has managed more than 1,400 cases related to FCA causes of action in the Eastern District of Virginia. With eight years’ experience as a government contracts construction program manager and Small Business Liaison Officer for a leading U.S. construction firm, Diana brings an insider’s perspective to construction and government procurement matters. She holds an active U.S. Secret Security Clearance and is qualified to work on highly sensitive government projects.