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Recent OHA Ruling Impacts Joint Ventures for Small Business Contracts

Whether your business is large or small, if it performs or seeks small business contracts in an SBA-approved 8(a) mentor/protégé joint venture ("JV") arrangement, you need to know about a recent ruling by the U.S. Small Business Administration's ("SBA") Office of Hearings and Appeals ("OHA"). The case, Size Appeal of SES-TECH Global Solutions, SBA No. SIZ-4951 (2008), clarified several important points regarding the regulations and precedent governing mentor/protégé JVs for small business contracts. This article discusses OHA's decision and how it is likely to impact your business.

Background

The SES-TECH decision stems from an SBA size determination finding a mentor to be affiliated with its 8(a) protégé because their JV agreement did not fully comply with SBA's 8(a) JV regulations. SBA came to this conclusion even though the JV pursued a small business contract, not an 8(a) contract. Additionally, SBA relied on OHA's decision in Size Appeal of Lance Bailey & Associates, Inc., SBA No. SIZ-4817 (2006), reviewed the mentor/protégé and JV agreements, applied SBA's "ostensible subcontractor" rule to the JV, and sought deference for its interpretation of governing regulations.

Highlights of the SES-TECH Decision

Late last year, PilieroMazza appealed the size determination to OHA on behalf of the JV. In May 2008, OHA granted our appeal and reversed the size determination. The following summarizes the highlights from OHA's ruling.

1. JVs for small business contracts are not governed by the 8(a) JV regulations.

The key argument in our appeal to OHA, and the most important aspect of the SES-TECH decision, pertains to the scope of the 8(a) JV regulations (found at 13 C.F.R. section 124.513). Prior to OHA's ruling, SBA appeared to be instituting a policy which required that all JVs between large business mentors and their 8(a) protégés comply with 13 C.F.R. section 124.513 to qualify for the exception from affiliation, even if the JV was not seeking an 8(a) contract. Significantly, this policy is not supported by SBA's regulations.

In the SES-TECH decision, OHA rejected SBA's broad application of the 8(a) JV regulations. Specifically, OHA held that the 8(a) program is "unique" and its governing rules "do not apply to a procurement that is not within the 8(a) program." Therefore, SBA lacks the authority to review a JV agreement under the 8(a) JV regulations unless the procurement at issue is an 8(a) set-aside.

In so ruling, OHA made clear that a JV for a small business contract is governed only by SBA's small business affiliation regulations. These regulations are found at 13 C.F.R. section 121.103, and with respect to JV requirements, are noticeably less extensive than their 8(a) counterparts. In fact, 13 C.F.R. section 121.103(h)(3)(iii) simply provides that two firms in an SBA-approved mentor/protégé arrangement may form a JV for any Federal Government procurement and will be exempt from the normal rules of affiliation so long as the protégé qualifies as a small business for the size standard applicable to the small business contract. (Note that a separate condition applies for 8(a) sole source procurements and requires the protégé to be below the dollar limits in 13 C.F.R. section 124.519.)

Consistent with this ruling, OHA found that the Lance Bailey decision is inapplicable to JVs for small business contracts. This is because Lance Bailey dealt with an 8(a) contract, not a small business contract. As discussed, the type of contract at issue is a critical factual distinction given the different regulations for small business and 8(a) contracts.

In summary, the SES-TECH decision instructs that when SBA assesses whether an 8(a) mentor/protégé JV is exempted from affiliation for a small business contract, the only question it should consider is whether the protégé is a small business under the applicable size standard.

2. SBA area offices and OHA do not have the authority to review mentor/protégé and JV agreements.

In rejecting SBA's attempt to expand the scope of the 8(a) JV regulations, OHA also noted that neither SBA area offices nor OHA have the authority to review mentor/protégé eligibility issues (including mentor/protégé and JV agreements). OHA relied on another recent decision for this conclusion, Size Appeal of White Hawk/Todd, A Joint Venture, SBA No. SIZ-4950 (2008). In the White Hawk/Todd decision, OHA held that only SBA's Office of Business Development has authority to review a mentor-protégé agreement. Thus, concerns regarding whether a mentor/protégé relationship fully complies with the applicable regulations should be dismissed if raised in a size protest to an SBA area office or on appeal to OHA.

3. The ostensible subcontractor rule does not apply to JVs.

In the size determination, SBA applied the principles of the ostensible subcontractor rule to a mentor/protégé JV. Adopting the argument PilieroMazza made on appeal, OHA found that this was improper because the ostensible subcontractor rule is used to determine whether a prime contractor and its subcontractor are engaged in a JV. Clearly, in the case of a mentor/protégé JV, the existence of the JV is a given. Consequently, OHA held that the SBA "may not use an ostensible subcontractor analysis to review an 8(a) mentor-protégé joint venture."

4. An area office's regulatory interpretation is not entitled to deference.

Another important point that emerged from the SES-TECH decision is that an SBA area office's interpretation of SBA regulations is not entitled to deference by OHA. In the size

determination, SBA argued it would be "remiss" if it permitted 8(a) firms to enter into JVs on non-8(a) contracts without complying with the 8(a) JV regulations, even though the regulations did not provide for this. SBA further suggested that its interpretation of its regulatory obligations was entitled to deference by OHA. OHA rejected SBA's argument because it found that deference is reserved for notice and comment rulemaking or other final agency action on review in Federal court. Conversely, "[a]gency interpretations contained in policy statements, positions in litigation, or determinations by an agency's subordinate office are not entitled to this deference."

How the SES-TECH Decision Will Impact Your Business

OHA's reversal of the size determination is good news for large and small businesses because it confirms the application of less-stringent regulatory requirements to mentor/protégé JVs for small business contracts. Indeed, so long as the protégé is a small business under the applicable size standard, the JV would be entitled to the exception from affiliation for the contract. The SES-TECH decision also indicates that JVs for small business contracts are not subject to the Lance Bailey decision or the ostensible subcontractor rule, and the agreement itself cannot be challenged via a protest to an SBA area office or on appeal to OHA.

However, please keep in mind that prior to the SES-TECH decision, mentor/protégé arrangements faced greater scrutiny. Additionally, the SES-TECH decision was rendered very recently, so it may take some time before it is fully understood and implemented by SBA area offices and contracting officers throughout the government. For these reasons, we recommend being proactive to educate your customers about how the SES-TECH decision impacts your mentor/protégé JV for small business contracts. By doing so, you may be able to foreclose a size protest from a party unfamiliar with the regulations and OHA's recent rulings.