

MEMORANDUM

To: Clients and Friends

From: Pamela J. Mazza
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Date: April 1, 2011

Re: OHA Overturns Prior Decisions Regarding SDVO Joint Ventures

On March 31, 2011, the U.S. Small Business Administration's ("SBA") Office of Hearings and Appeals ("OHA") issued a decision of great significance for service-disabled veteran-owned ("SDVO") firms that are interested in forming joint ventures for SDVO set-aside contracts. OHA's ruling, which granted an appeal filed by PilieroMazza, permits SDVO firms to form joint ventures as limited liability companies ("LLCs") and corporations. This Client Alert examines OHA's key rulings regarding SDVO joint ventures and discusses the impact of OHA's March 31st decision.

Joint ventures are a popular contracting tool for many small businesses in the SBA's procurement programs. However, for SDVO firms, joint ventures have been less attractive because of two OHA rulings. These cases, cited as *IITS-Nabholz, LLC*, SBA No. VET-114 (2007) and *Cooper-Glory, LLC*, SBA No. VET-166 (2009), held that SDVO firms could not form joint ventures as "separate legal entities." As a result, SDVO firms have been unable to take advantage of the protections in an LLC or corporation when forming a joint venture.

The *IITS-Nabholz* and *Cooper-Glory* decisions turned on the requirement in the SDVO regulations that legal entities such as LLCs must be directly owned by a service-disabled veteran ("SDV"). When two companies form a joint venture as an LLC, the two companies (rather than an SDV) own the LLC. Thus, OHA concluded that a joint venture LLC does not satisfy the direct SDV ownership requirement and is not eligible for contracts set aside for SDVO firms.

We have long believed that the *IITS-Nabholz* and *Cooper-Glory* cases were wrongly decided. Last summer, we examined the flaws in these cases in an article featured in our quarterly newsletter, *Legal Advisor*, entitled *The Curious Case of SDVO Joint Ventures*.¹ But, until recently, we did not have an opportunity to challenge the *IITS-Nabholz* and *Cooper-Glory* decisions on appeal to OHA.

¹ This article was published in *Legal Advisor* Vol. 11, Issue 3. You can access the article on our website at: <http://www.pilieromazza.com/includes/content/downloads/download.php?id=377>.

On March 4, 2011, we filed an appeal with OHA challenging the SBA's finding that an SDVO joint venture was ineligible for an SDVO set-aside contract with the Navy because the joint venture was set up as an LLC. The appeal argued that the SBA did not properly interpret the SDVO regulations because its decision was based solely on the rules found at 13 C.F.R. §§ 125.9 and 125.10, which contain the eligibility criteria for SDVO firms. The SBA improperly ignored the separate regulation, found at 13 C.F.R. § 125.15(b), which specifically addresses the eligibility of SDVO joint ventures for contracting purposes. Notably, the joint venture regulation at 13 C.F.R. § 125.15(b) does not require an SDV to have direct ownership in a joint venture.

Additionally, our appeal challenged the suggestion in *IITS-Nabholz* and *Cooper-Glory* that an SDVO can create a joint venture that is not a separate legal entity. Many states treat joint ventures as separate legal entities regardless of the parties' intention or what is stated in the joint venture agreement. We also asserted that the SBA's interpretation of the SDVO joint venture regulations was not in harmony with the similar regulations for 8(a) joint ventures. The SBA has long permitted 8(a) and small business joint ventures to be formed as LLCs. Lastly, we argued that the SBA was wrong to prevent SDVO firms from forming joint ventures as LLCs because doing so diminishes the usefulness of joint ventures for SDVO firms, thereby undermining the statutory goal of "enabling [veterans] to realize the American dream that they fought to protect."

The SBA opposed our appeal on the grounds that this issue had already been settled by OHA in *IITS-Nabholz* and *Cooper-Glory*. The SBA also asserted that its interpretation of the SDVO rules was reasonable.

In the March 31st decision, OHA agreed with our arguments and granted our appeal. The ruling, which is cited as *Construction Engineering Services, LLC*, SBA No. VET-213 (2011), reversed OHA's prior holdings in *IITS-Nabholz* and *Cooper-Glory* and held that,

[P]ursuant to 13 C.F.R. § 125.15(b), a joint venture between an eligible SDVO SBC and another small business – *regardless of whether the venture is structured as a separate legal entity* – need not meet the SDVO eligibility requirements in Subpart B of Part 125 to obtain an SDVO contract, but must *only* meet the specific requirements governing joint ventures set forth in 13 C.F.R. § 125.15(b).

(Emphasis added.) This means that the SBA can no longer find that an SDVO joint venture is ineligible for an SDVO contract simply because the joint venture is an LLC or a corporation.

OHA got it right and we applaud the ruling in *Construction Engineering*. Now that the erroneous OHA precedent has been reversed, SDVO firms and their prospective joint venture partners will have greater flexibility when making business decisions regarding the formation of their joint ventures. If you are considering a joint venture and have questions about how this decision might impact you, or if you would like a copy of OHA's ruling, please contact Jon Williams, Steve Koprince, or Ryan Bradel at 202-857-1000.