



Column: VA's SDVOSB Regulations in Limbo

By Tony Franco, senior partner, PilieroMazza PLLC

The Department of Veterans Affairs (VA) recently withdrew the long awaited amendments to its regulations governing the VA's Service-Disabled Veteran-Owned Small Business (SDVOSB) program.

This leaves in place ownership and control requirements for SDVOSBs that the department had proposed to relax almost two years ago.

Maintaining the status quo for eligibility, service-disabled veterans will need to wait until the Small Business Administration (SBA) issues new rules governing the VA's SDVOSB program.

With the SBA generally taking a stricter approach to eligibility, SDVOSBs will need to reconsider whether the regulatory environment in the future will be as friendly as many foresaw, particularly if they were looking for minority investors. And they should begin advocating at the SBA for many of the proposed changes.

What was in the proposed rule?

The VA's now-withdrawn, proposed rule had been welcomed by many veterans, hoping it would encourage minority investors in their businesses.

The way the VA has been interpreting its current regulations, service-disabled veterans were hard-pressed to find investors with the resources to help them grow their businesses. For example, the unconditional control rules have been construed as prohibiting minority investors from having any say in major decisions of an SDVOSB.

Although intended to reduce the risk of a non-eligible minority owner controlling an SDVOSB, the overly restrictive interpretation has dampened the willingness of well-heeled investors and valuable business partners in SDVOSBs.

Recognizing that the unconditional ownership and control requirements were unduly burdensome, the VA proposed to allow "commercially reasonable" conditions on a veteran's ownership interest, prohibiting only those that

created a risk of fraud.

Under the proposed rule, the VA would have conducted a case-by-case analysis of the condition in question. If the condition was consistent with commercially reasonable business practices, it would not be prohibited.

In undertaking this analysis, the VA would consider the general use of such conditions by concerns within similar lines of business.

The proposed rule also added an exception for when veterans need not have unfettered control over certain "extraordinary business decisions," such as the acceptance of new capital contributions, the addition of members, amendments to operating agreements or partnership agreements, or the sale of substantially all of an SDVOSB's assets. The VA's explicit recognition of the exception for such decisions provided more clarity while encouraging investments in SDVOSBs.

Why was the rule withdrawn?

According to the VA, the proposed rule was withdrawn because of the many adverse comments it received, particularly from the SBA. One of the SBA's comments was that the proposed rule did not contain specific citations to a law or legal authority for the proposed changes. The VA also referred to other comments from the public critical of the proposed rule; none, however, seemed to relate to the proposed relaxed ownership and control requirements.

Looking forward

With the VA's more lenient approach to the ownership and control requirements abandoned, SDVOSBs are left to contend with the SBA's much stricter ownership and control requirements. Why? Because Congress mandated last year that the SBA take the lead in determining the eligibility of SDVOSBs for both the SBA's and VA's programs.

And if the SBA's current regulations serve as a roadmap of where the VA's SDVOSB regulations are

heading, service-disabled veterans may be even more hamstrung in their ability to bring investors into their businesses.

The SBA does not currently recognize an exception for commercially reasonable conditions on a veteran's ownership interest. In addition, the veteran must have control over all company decisions, including the ability to overcome any supermajority voting requirements, making an entity ineligible for the SBA's SDVOSB program even if it only gives minority owners control over fundamental business decisions.

The SBA is supposed to be working on the new regulations. Unfortunately, it could be some time before they are issued given the Trump Administration's anti-regulatory agenda, not to mention the time rule-making takes even in a pro-regulatory environment.

Regardless, having commented on the VA's proposed rule, the SBA is not only familiar with it, but also has the benefit of the public's comments on how the regulations could be improved.

Time for advocacy

With the Trump Administration advocating for veterans, this presents a particularly opportune time to advocate for new, better and more consistent rules for both programs – the VA's and SBA's. Working together, SDVOSBs should let the SBA know that the regulations for both programs should allow them to attract investors just like any other successful business.

Tony Franco is a senior partner with PilieroMazza PLLC in the Government Contracting Group. For over 25 years, PilieroMazza has helped businesses successfully navigate a diverse array of legal matters, including government contracting, SBA's procurement programs, litigation, labor and employment and corporate law. Visit www.pilieromazza.com.