



New rules governing size recertifications for small businesses: What you need to know before entering into a joint venture

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On Oct. 2, 2013, the SBA published its final rule amending the regulations pertaining to its policies and procedures for setting aside, partially setting aside, and reserving Multiple Award Contracts for small business concerns. *See 78 Fed. Reg. 61114 (Oct. 2, 2013).*

This final rule formalizes many of the SBA's policies regarding when a small business must recertify its size for a multiple award or long-term contract. *See 13 C.F.R. § 121.404 (effective Dec. 31, 2013).*

Recertification landscape

The new rule changes the recertification landscape with regard to certifications made by businesses after a merger or acquisition. These changes have special implications if you are a participant in a joint venture, as a sale, merger, or acquisition by any joint venture partner triggers the recertification requirement for the joint venture, and may jeopardize the exercise of options or task order awards on existing joint venture contracts or award of contracts on pending proposals.

Generally, the SBA's regulations require that size will be determined at one specific point in time – the date an entity self-certifies its size status as part of its initial offer including price. *13 C.F.R. § 121.404(a).*

If an entity originally represents that it is small in its initial offer (including price), then it is considered small for the life of that specific contract. There are a few catches to this blanket ability to remain small for the life of the contract, however. For long-term contracts (those that exceed five years), contractors are required to recertify their small business size status no more than 120 days prior to the end of the fifth year of the contract or prior to exercising any option thereafter. Further, small businesses are required to recertify their small business size status if they have undergone a merger, acquisition, or novation. *See 13 C.F.R. § 121.404(g).*

Issues for joint ventures

Prior to the release of the new rule, there was some confusion whether or not a joint venture, as a separate and distinct entity, would be subject to the same recertification requirements as outlined above when an individual joint venture member is involved in a merger or acquisition. The SBA's new rule, effective on Dec. 31, resolutely answers this question in the affirmative.

In broadening the requirements to explicitly provide for recertification when a participant in a joint venture is involved in a merger or acquisition, the SBA is signaling its unwillingness to treat joint ventures differently than any other small business contractor.

Moreover, the new rule also clarifies that recertification is required, regardless of whether the small business is the acquiring concern or has been acquired. This changes the prior regulation, which could be interpreted as only requiring recertification on the acquired company's contracts.

New rule raises issues

Looking forward, this new rule raises fairly complex issues in relation to the terms small businesses should include in their joint venture agreements. For example, if one member of a joint venture decides to acquire another business, or it itself becomes acquired, under the new rule the entire joint venture must recertify its small business size status for any federal contracts the joint venture is performing.

If the merger or acquisition tips the joint venture over the size standard, then the joint venture will likely be precluded from bidding on any new task orders under long term or multiple award contracts. Entering into joint venture agreements, small businesses must think through how they will protect themselves from their fellow members' actions, which could potentially jeopardize the entire joint venture.

To combat such an outcome, the joint venture agreement may include terms that would require any member that has undergone a merger or acquisition (from either side) to drop down to the subcontractor level. It may also include terms requiring all parties to provide fair notice if one member is entertaining a merger or acquisition, or a right of first refusal for remaining venturers to purchase the selling party's interest upon notice of a proposed sale.

Extra due diligence

From another standpoint, the new rule also requires concerns that are contemplating a merger or acquisition to perform extra due diligence on any contracts that have been awarded to the other party through a joint venture, as the joint venture may not be able to receive any additional task orders if it no longer meets the applicable size standard after the merger or acquisition goes through. An additional consideration is also whether the new deemed certification rule triggers the presumed loss rule if a joint venture fails to update its SAM certifications or submits new offers after one of these triggering events occur.

The new rules published by the SBA have changed the landscape regarding recertification for joint ventures. It is important going forward that your joint venture agreements recognize this new reality and include provisions to protect against your teammates' actions that could potentially jeopardize the ability of the joint venture to bid on new work under existing contracts.

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