Key Changes in SBA's Proposed Rule: Cross-Program Uniformity

Key Notes:

- SBA's Proposed Rule provides major updates and clarifications to regulations governing negative control and size and status recertification for small business contractors.
- The proposed changes reflect SBA's goal of cross-program uniformity.

The U.S. Small Business Administration (SBA) recently published a proposed rule, "HUBZone Program Updates and Clarifications, and Clarifications to Other Small Business Programs" (Proposed Rule), which will broadly and significantly impact all federal government socioeconomic set-aside contracting programs if adopted. In this first installment in our series of client alerts examining the Proposed Rule, we highlight proposed changes that will affect programs including the 8(a) Business Development, Women-Owned Small Business (WOSB), and Service-Disabled Veteran-Owned Small Business (SDVOSB) programs. Below we discuss SBA's effort to promote uniformity across programs by modifying size and status recertification standards as well as negative control considerations.

Negative Control – Uniform List of Exceptions

SBA is proposing to make a uniform list across programs of certain minority owner rights that would *not* be deemed to confer "control."

Under the general principles of affiliation, control may be negative in instances where a minority shareholder has the ability, pursuant to the concern's bylaws or shareholders agreement, to block action by the concern's board of directors or shareholders. 13 C.F.R. § 121.103(a)(3). SBA regulations do not specify instances where this type of action is permitted by a minority shareholder without giving rise to negative control. However, the regulations governing the SDVOSB program list five *extraordinary* circumstances where a minority shareholder has the right to block the action of a concern without giving rise to negative control:

1) Adding a new equity stakeholder
2) Dissolution of the company
3) Sale of the company or all assets of the company
4) Merger of the company
5) Company declaring bankruptcy

13 C.F.R. § 128.208(j).

Currently, the regulations do not expressly apply these five extraordinary circumstances to the 8(a) Business Development or WOSB programs.

In the Proposed Rule, SBA acknowledges that the lack of uniformity across programs has created confusion regarding issues like negative control. To rectify this, it proposes that these five extraordinary circumstances now apply uniformly to socioeconomic programs and *all* other small businesses. SBA also proposes adding a sixth action to the list that permits a minority shareholder to amend a concern's corporate governance documents for the purpose of removing the concern's authority to block any of the actions listed in items (1)–(5).

This proposed change may eliminate confusion, as SBA intends, but it may also create new challenges for small businesses that impact the structuring of their corporate governance. This, in turn, could affect small businesses' ability to attract certain investors, the balance of power between majority and minority owners, and the extent to which different models of control are eligible for set-aside status certification.

Size and Status Recertification

SBA proposes to harmonize program-specific size and status recertification requirements. If a business is decertified, the impact on awards and orders would depend on what triggered the recertification process; for example, whether it was an acquisition, the end of the award cycle, or a contracting officer's request to recertify.

The current regulations and interpretations by the Government Accountability Office and SBA Office of Hearings and Appeals provide that, in most circumstances, a concern's size and status is determined at the time of an initial offer. The concern usually maintains the benefit of its size and status for the remainder of the contract and for subsequent orders under the contract, regardless of whether it continues to meet those certification criteria later during the contract term, unless some special circumstance triggers a requirement to recertify during the contract term. Recertification requirements are triggered, for example, when a small business undergoes a merger or acquisition and contract novation. Upon recertification, if the concern is determined to be other than small or no longer eligible for a socioeconomic program, SBA regulations do not prevent the concern from receiving subsequent orders under preexisting contracts, even if the concern is no longer eligible for new set-aside contracts.

In the Proposed Rule, SBA intends to make drastic changes involving recertification. To continue its mission of cross-program uniformity, it proposes to remove the program-specific size and status recertification requirements and add a new section (13 C.F.R. § 125.12) to the regulations in order to consolidate the requirements in one location. Beyond relocation of the requirements, SBA also proposes to clarify when a concern must recertify and the effect of disqualification upon recertification.

Under the Proposed Rule, 13 C.F.R. § 125.12(a)–(c) clarifies that a concern would have to recertify:

- Within 30 days of an approved novation, merger, acquisition, or sale, including agreements in principle. Size status would be determined as of the date that the merger, sale, or acquisition occurred.
- For contracts and orders exceeding five years, no more than 120 days prior to the end of the fifth year of the award, and no more than 120 days prior to exercising any option thereafter. Size status would be determined as of the date of the size recertification.
- Upon request by the contracting officer in response to a solicitation for a set-aside or reserved order or agreement. Size status would be determined as of the date of the initial offer (or other formal response to a solicitation), including price, for that specific order or agreement only.

If a concern is disqualified upon recertification, the effect of the disqualification varies based on the circumstances. 13 C.F.R. § 125.12(e)(2).

- *Pending set-aside or reserved award*: If a novation, merger, acquisition, or sale disqualifies a concern and occurs within 180 days after the date of an offer but prior to award, the concern is ineligible to receive the pending small business set-aside or reserved award. If the disqualifying event occurs more than 180 days after the date of an offer but prior to award, the concern is eligible to receive a pending single award or reserved award. However, the concern will be ineligible for a multiple-award small business set-aside or reserved award.
- *Future set-aside or reserved award:* If a concern is disqualified in response to a contracting officer's request to recertify for a specific order, the concern is ineligible for that specific order but remains eligible for set-aside or reserved awards and unrestricted awards. If a concern is disqualified in response to any other event triggering recertification, the concern is ineligible to submit an offer for a set-aside or reserved award under a multiple-award contract after the triggering event occurs. The concern remains eligible for unrestricted awards under a multiple-award contract and orders issued under a single-award small business contract.
- *Options*: A concern that is disqualified upon recertification will remain eligible for options under a single-award small business set-aside or reserved award or any unrestricted award.

If adopted, the proposed changes to negative control requirements and size and status recertifications will have far-reaching implications for small business contractors going forward, including impacting the landscape of mergers and acquisitions for small businesses, eliminating the exception to size and status recertification permitted under the General Services Administration Federal Supply Schedule, and increasing monitoring of small business affiliates.

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