THOMPSON HINE

Government Contracts Update

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Key Takeaways in SBA's Final Rule: Cross-Program Changes

Key Notes:

- The final rule expands minority shareholder's rights to protect their investment in small businesses following negative control updates.
- Mergers and acquisitions (M&A) activity with small businesses will undergo major shift following final rule updates.

On December 17, 2024, the U.S. Small Business Administration (SBA) issued its highly anticipated final rule outlining the comments addressed and changes adopted from its proposed rule, "HUBZone Program Updates and Clarifications, and Clarifications to Other Small Business Programs." The final rule, effective January 16, 2025, applies to existing contracts but will not be applied retroactively. Like the proposed rule, the final rule contains extensive updates and clarifications impacting SBA small business and socioeconomic programs.

In this first of multiple bulletins on this topic, we will explore the SBA's amendments aimed at harmonizing various program regulations and enhancing cross-program uniformity, including updates on negative control considerations and size and status recertifications. While the SBA adopted most of the provisions outlined in the proposed rule, it also carefully considered commenters' suggestions and implemented changes where appropriate.

Negative Control Considerations

In the proposed rule, the SBA addressed the lack of uniformity across program regulations regarding negative control. As a remedy, the SBA proposed implementing, in all program regulations, the five "extraordinary circumstances" governing negative control in the Service-Disabled Veteran-Owned Small Business (SDVOSB) program along with a sixth circumstance. In the final rule, the SBA adopted all six proposed circumstances and added a seventh catch-all circumstance based on a commenter's suggestion. The list in the final rule is as follows:

1. Adding a new equity stakeholder
2. Dissolution of the company
3. Sale of the company or its entire asset base
4. Merger of the company
5. Company declaring bankruptcy
6. Amendment of the company's governance documents to remove the majority shareholder's authority to block any of the actions listed in (1) through (5)
7. Any other extraordinary action designed to protect the minority shareholder's investment without impeding the majority shareholder's control over operations or business conduct

The seventh catch-all circumstance offers contractors much-needed clarity and flexibility by allowing commercially customary rights for minority shareholders. It is reasonable for minority shareholders to have a voice in decisions such as changing the business' tax status, encumbering, or mortgaging all company assets, or confessing a judgment. Granting minority shareholders involvement in such decisions—without undermining the majority shareholder's control over operations and business conduct—protects their interests and encourages greater capital contributions to these businesses.

The final rule applies the above list to small businesses and socioeconomic programs, including the 8(a) Business Development, Women-Owned Small Business (WOSB), and SDVOSB programs. Once the final rule takes effect, minority shareholders will be permitted to block any of the above-listed actions by a majority shareholder without a finding that negative control exists.

The final rule on negative control grants minority shareholders greater rights to safeguard their investments without violating regulations or triggering affiliation concerns. This change may appeal to investors who value having a degree of influence over decisions affecting their investments.

Size and Status Recertification

The proposed rule outlined the SBA's plan to eliminate program-specific size and status recertification requirements and add a new section (13 C.F.R. § 125.12) in the regulations that consolidates and uniformly applies the requirements for all programs. At the outset, the SBA agreed with commenters who suggested that rectification should not be required for "agreements in principle" because there is no guarantee that the agreement would ever be finalized or "the ultimate sale or merger may take a long time, conceivably beyond one or more additional fiscal years (upon which size status is based)." Thus, the final rule provides that a concern must recertify at the following times:

- Within 30 days of an approved novation, merger, acquisition, or sale of or by a concern or an affiliate of the concern resulting in a change in controlling interest.
- For contracts and orders with a duration 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 before exercising any option thereafter.
- Upon request by the contracting officer in response to a solicitation for a set-aside or reserved order or agreement.

Under the final rule, once a concern successfully recertifies, it is generally recognized as a small business or small business program participant for up to five years from the recertification date. During this period, the concern remains eligible for set-aside or reserved awards unless a subsequent disqualifying recertification occurs. The rules governing disqualifying recertifications, however, are far more complex, with the impacts varying based on the triggering event.

Pending set-aside or reserved award

If a novation, merger, acquisition, or sale disqualifies a concern within 180 days after the date of an offer but before the award, the concern becomes ineligible to receive the pending small business set-aside or reserved award. Conversely, if the disqualifying event occurs more than 180 days after the offer date but before the award, the concern remains eligible for the pending single or reserved award. However, it will be ineligible if the underlying contract is a multiple-award small business set-aside or reserved award.

Future set-aside or reserved award

If a concern is disqualified following a contracting officer's request to recertify for a specific order or agreement under a multiple-award contract set aside for small businesses, it becomes ineligible for that particular order. However, the concern remains eligible for other set-aside or reserved awards, as well as unrestricted awards.

- If a concern undergoes disqualifying recertification due to a long-term multiple-award contract requirement or a merger, acquisition, or sale involving a non-small business, it becomes ineligible to submit offers for set-aside or reserved awards after the triggering event.
- Conversely, if the disqualifying recertification follows a merger, acquisition, or sale involving another small business, the concern remains eligible for set-aside, or reserved orders issued under a multiple-award contract.

Options

A concern disqualified upon recertification remains eligible for options under a single-award small business set-aside or reserved award, as well as any unrestricted awards. However, under multiple-award contracts, a concern becomes ineligible for options if a disqualifying certification follows a merger, acquisition, or sale involving a non-small business. If the M&A activity involves another small business, the concern retains eligibility for options.

We will cover this in greater detail in a future client alert, but it is important to note that the final rule implements a delayed effective date for rectification following a merger or acquisition. A concern with a disqualifying size or status recertification due to M&A activity prior to January 17, 2026, remains eligible for orders issued under an existing small business multiple-award contract. Similarly, a concern with a disqualifying recertification before the end of the fifth year of a long-term contract remains eligible for options exercised before January 17, 2026.

The final rule addresses several other important updates, which we look forward to exploring in greater detail in upcoming client alerts.

FOR MORE INFORMATION

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