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Bulletin

To: Small Business Community

From: Laurel Hockey, Esq.

Date: May 21, 2004

Re: SBA's Issuance of a Final Rule Amending its Size Regulations
69 FR 29192 (May 21, 2004)¹

SMALL BUSINESS ADMINISTRATION ISSUES FINAL RULE AMENDING ITS SIZE REGULATIONS

On May 21, 2004, the Small Business Administration ("SBA") issued a final rule, which amends its size regulations.²³ The final rule is effective and will apply to all solicitations issued on or after **June 21, 2004**. While the specific amendments are too numerous to discuss herein, this Bulletin will identify certain amendments of widespread interest.

SUMMARY

Under the new regulations, SBA will continue to determine a business concern's size based on its average number of employees or annual receipts, depending on the applicable NAICS code. Consistent with its past practice and regulations, SBA will consider a concern's affiliates when determining its size. However, the new regulations amend and clarify the definition of affiliation in several respects, as briefly discussed below.

¹ Note that this is a separate and distinct rule from the proposed rule issued by SBA on March 19, 2004 (69 FR 13130), which seeks to overhaul's SBA size standards.

² The proposed rule was issued on November 22, 2002 at 67 FR 70339. The final regulations also amend certain procedures involving SBA's Office of Hearing and Appeals. However, this Bulletin will not address those amendments.

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- ? SBA deems concerns to be affiliated where one exerts control over the other. The new regulations emphasize that such control may be found if the power to control exists, whether or not exercised; control may be affirmative or negative; and control may be exercised indirectly through a third party. The regulations identify as an example of negative control, the ability of a minority shareholder, under its charter, by-laws, or shareholder agreement, to prevent a quorum or block action by the board of directors or shareholders.
- ? The new regulations provide that affiliation may be found if the totality of circumstances (rather than only a single factor) demonstrates that two firms are affiliated. While these principles of affiliation have long been applied under the 8(a) BD program, the new regulations make clear that the same principles now apply in any size determination.
- ? When affiliating two or more concerns, SBA aggregates the average number of employees and annual receipts of the affiliated concerns. The new regulations clarify that SBA calculates the averages of each concern separately and then adds the two averages together in determining a concern's size. SBA explains that this procedure has long been followed by SBA and that the new regulations simply codify that historical practice.
- ? The new regulations address the 8(a) mentor/protégé program and make clear that, in certain instances, despite an approved mentor/protégé relationship, a mentor and its protégé may still be affiliated for size purposes. The new regulations indicate that SBA may find affiliation with respect to the approved mentor/protégé relationship for reasons other than the mentor/protégé relationship. In the preamble to the new regulations, SBA explains that "other reasons" would exist if the mentor provides assistance that is not specifically identified in the mentor/protégé regulations as the type of assistance to be provided by a mentor to its protégé and that SBA's size regulations identify as indicia of affiliation. Thus, a mentor and its protégé must carefully evaluate the type(s) of assistance that the mentor can provide to its protégé and disclose that assistance to SBA in the mentor/protégé agreement.
- ? The new regulations restore the newly organized concern rule as an independent basis of affiliation under SBA's size regulations. Instead of considering whether a concern is newly organized as one of several relevant issues under the totality of circumstances test, SBA now can rely exclusively on that rule in concluding that two concerns are affiliated. Under the newly organized concern rule, affiliation may be found where former officers, directors, principal stockholders, managing members, or key employees of one concern organize a new concern in the same or related industry or field of operation, and serve as the new concern's officers, directors, principal stockholders, managing members, or key employees, and the one concern is furnishing or will furnish the new concern with contracts financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities, whether for a fee or otherwise.

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- ? SBA generally allows two firms to joint venture (“JV”) on a single procurement without being affiliated so long as each JV partner is small and the partners enter into a formal JV agreement approved by SBA. In the past, SBA has limited the exclusion from affiliation to JVs, which have entered into an agreement (approved by SBA) to perform work on a single procurement. Under the new regulations, the JV partners can enter into a JV agreement for multiple procurements without running afoul of the affiliation exclusion. However, the JV can not submit more than three offers over a two year period. Additionally, the JV cannot carry out more than three specific or limited-purpose business ventures.
- ? Other changes are made to the specific affiliation rules applicable to Indian tribes, ANCs, CDCs, and NHOs.

In addition to revising its definition of affiliation, SBA also amends other provisions in its size regulations.

- ? The new regulations amend the nonmanufacturer rule by no longer requiring that nonmanufacturers sell their products to the general public. Instead, the nonmanufacturer must be engaged in the retail or wholesale trade and normally sell the type of item being supplied.
- ? The new regulations finally correct the conflict between SBA’s size regulations, the 8(a) joint venture regulations, and the 8(a) mentor-protégé regulations as they relate to JVs between an 8(a) approved mentor and its protégé. They now consistently provide that a JV between an 8(a) approved mentor and its protégé will be deemed small if the protégé is itself small. The 8(a) mentor-protégé regulations no longer state that both the mentor and protégé must be small in order for the JV to be considered small. As such, the regulations now reflect SBA’s practice of allowing large businesses to act as 8(a) mentors.

SBA declined to implement several of its proposed amendments to the size regulations, which SBA presented in its proposed rule.

- ? In its proposed rule, SBA considered changing the definition of “receipts” to include specific items from a Federal tax return, using terminology from the Federal tax return. In its final rule, SBA indicates that more research on the definition is necessary and that SBA declines to implement the proposed changes. SBA emphasizes however that it would continue to require amounts received from any source to be counted in determining a firm’s annual receipts.
- ? Also with regard to the definition of “receipts,” SBA considered expanding the exclusion of receipts received by an agent for another. In the past, SBA has limited that exclusion to specifically identified industries. SBA’s proposed rule gave SBA the discretion also to exclude

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receipts received under similar agent-type relationships. SBA declines to adopt the proposed change on the basis that the change would increase the number of size protests and appeals.

This bulletin serves only as a summary of the final rule and is not intended to be all-inclusive. If you need further information regarding this final rule, please contact Laurel Hockey at (202) 342-2550 or by email at lhockey@cohenmohr.com.