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The Ins and Outs of Joint Venture and Mentor-Protégé Agreements

What You Need to Know to Effectively Structure Your Relationships

About PilieroMazza

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Overview

- What is a joint venture?
- Advantages and disadvantages of using a joint venture
- Starting a joint venture

  Step 1: Find the right partner

  Step 2: Ensure the JV satisfies the applicable set-aside requirements

  Step 3: Choose the legal form (partnership vs. LLC)

  Step 4: Determine the management structure/labor (populated vs. unpopulated)

  Step 5: Draft the joint venture agreement
- Mentor-Protégé programs and upcoming changes
- Questions

What Is a Joint Venture?

- A Joint Venture is:

  An association of individuals and/or concerns to combine their property, capital, efforts, skills, and knowledge to carry out no more than three specific or limited-purpose business ventures for joint profit over a two-year period

  13 C.F.R. § 121.103(h)

Joint Venture Basics

- Main Characteristics:
  - Co-management
  - Sharing profits and losses
  - Limited duration
- Competing as a Joint Venture:
  - Joint Ventures should be formed before submitting offer
  - Agreement should provide for contract performance
  - FAR requires disclosure in the proposal
- Forms of Joint Venture:
  - Partnership – referred to by SBA as "informal" joint venture
  - Limited Liability Company
  - Corporation

Advantages of Joint Ventures

- The Government can look to the resources of two (or more) companies to perform the work
  - The JV partners function as "co-primes" on the project
- Joint venture partners are able to perform a larger contract they might not otherwise have had the capability to perform on their own
- Stay small longer: JV revenue is attributed to the partners in proportion to their ownership interests in the JV
- A minority joint venture partner can exert more control over contract performance to protect its interests than in a traditional prime-sub relationship

DISADVANTAGES OF JOINT VENTURES

- ❖ Lead contractor gives up some control
- ❖ If the joint venture is a partnership (i.e., informal), the participating contractors are jointly and severally liable to third parties for the acts of their joint venture partners, including criminal acts
- ❖ The Government may have questions about:
  - Whether there is a clear point of contact
  - Who is performing the work and how the joint venture will satisfy the limitations on subcontracting
  - Past performance
- ❖ Terminating the JV can be more complicated than a subcontract

Starting a Joint Venture
Step 1: Find the Right Partner

- Carefully and thoroughly screen prospective JV partners
  - History of being a good teaming partner? Ask for references
  - Record of being fair, equitable, collaborative, and flexible in teaming relationships
  - Attitude of mutual dependence and benefit
  - Unblemished reputation with the agency
  - Strong technical capabilities to fulfill elements of the Statement of Work (SOW)
  - Proven record of covering elements of the SOW
  - Positive name recognition with the customer
  - Cost competitiveness
  - Proposal support resources
  - Strong infrastructure support

Step 2: Ensure the JV Meets the Set-Aside Requirements

- If the JV pursues a set aside contract:
  - Check the different JV requirements depending on the type of set-aside contract at issue
  - Ask your prospective JV partner to certify to you in writing that it is a small business and any other relevant status, and check SAM.gov to confirm
- Presumed Loss Rule considerations

HOW JVS QUALIFY AS SMALL

- SBA General Rule: JV partners are affiliated for a contract
  - This means a JV will be considered a small business if the combined size of the JV partners meets the size standard for
  - the contract
- Exceptions to joint venture affiliation:
  - When each JV partner is small under the applicable size standard and either: (1) the procurement is bundled or consolidated; or (2) the procurement exceeds one-half the size standard or $10 million (depending on the nature of the size standard)
    - In this scenario, the JV qualifies as small as long as each JV partner meets the applicable size standard, regardless of combined size of the JV partners
  - Joint ventures between 8(a) protégé and SBA-approved mentor
    - Look for new rules that may permit JVs with large mentors for SDVOSB, HUBZone, WOSB, and small business protégés as well

THE "3-IN-2 RULE"

- JV may not be awarded more than **three contracts** over a **two-year** period without a finding of general affiliation
  - JV may ultimately receive more than three contracts, as long as the JV submitted the winning proposals before it won its third contract and before expiration of the two-year period
  - Two-year period begins with the award of the first contract to the JV
- Same two entities may form additional joint ventures and each may be awarded three contracts over two years
  - Caution: multiple joint ventures and contracts may lead to a general affiliation over time

Performance of Work Requirements

- The JV must meet the applicable performance of work requirement (i.e., the limitations on subcontracting)
  - The work done by the JV (if populated) or through the JV partners (if unpopulated) counts toward satisfying the performance of work requirement
- For unpopulated JVs, how much of the JV's work must be done by each partner depends on whether the project is a small business set-aside, and if so, what type

JV Requirements for 8(a) Set-Asides

- The Government can award 8(a) sole source and competitive contracts to a joint venture if:
  - At least one firm is 8(a) certified
  - All partners are small businesses, unless in SBA-approved mentor-protégé relationship
- SBA must approve the JV Agreement before contract award
- JV Agreement must specify that the 8(a) firm will:
  - Manage the joint venture and the project
  - Provide an employee to be the project manager
  - Perform at least 40% of the work in an unpopulated JV
  - Benefit from the JV, but also bring something to the JV other than its 8(a) status
  - Among other requirements, see 13 C.F.R. § 124.513(c)

JV Requirements for SDVOSB Set-Asides

- SDVOSB must be managing partner
- Employee of SDVOSB must be project manager, and the individual must be named in the JV agreement
- SDVOSB must receive 51% of the net profits
- JV Agreement must specifically describe both parties' roles in contract performance and how SDVOSB will manage the project
  - Cannot use vague or boilerplate language
  - There is no mandated minimum work share for the SDVOSB, but the SDVOSB must clearly benefit from the JV
- Unique VA requirements:
  - The JV must be a separate legal entity (i.e., LLC)
  - CVE must verify JV prior to contract award

JV Requirements for HUBZone Set-Asides

- All partners must be HUBZone certified and small
- The contract must meet certain size requirements
  - Revenue-based size standard – contract must exceed one-half of the size standard
  - Employee-based size standard – contract must exceed $10 million
- If contract does not meet size requirements, joint venture may still qualify as long as the two firms, combined, are small
- No SBA approval required
- No required JV agreement provisions like for the other programs, but good idea to follow the other JV rules

JV REQUIREMENTS FOR WOSB/EDWOSB SET-ASIDES

- Lead partner must be designated as WOSB or EDWOSB in SAM.gov
- Written joint venture agreement must:
  - Designate WOSB as the managing party
  - Name a specific employee of WOSB as the project manager
  - Clearly describe how the WOSB and its project manager will manage the project, as well as the WOSB's responsibilities and role in contract performance – WOSB must clearly benefit
  - Specify that 51% of the net profits will go to the WOSB
  - Ensure the WOSB will maintain the JV's records
- WOSB must provide a copy of the JV agreement to the contracting officer, upload to SBA's repository

STEP 3: WHAT LEGAL FORM TO USE?

- Options:
  - Limited Liability Company
  - Partnership
  - Corporation
    - Double taxation
    - Almost never used

LLC STRUCTURE: PROS & CONS

- Pros:
  - Members not liable (beyond capital contributions) to third parties for actions of the LLC
  - May be treated as partnership (or like an S Corp)
  - SBA recognizes LLC structure
- Cons:
  - Requires capitalization
  - Filing/annual LLC fees, plus preparation of documents to obey corporate formalities

Forming the JV as an LLC

- File articles of organization with your home state to form the LLC
- Draft a joint venture/operating agreement between the parties
  - In some cases, you may want or need the joint venture agreement to be separate from the operating agreement
- Obtain a federal tax ID
- Register at SAM.gov
- Establish a bank account
- Register to do business in other states (if necessary)

Partnership Structure: Pros & Cons

- Pros:
  - Treated as a partnership (or like an S Corp)
  - Simple to set up
  - Informal
- Cons:
  - Partners are jointly and severally liable on debts of the partnership

STARTING THE JV PARTNERSHIP

- Draft a JV/partnership agreement
  - In some cases, you may want or need the joint venture agreement to be separate from the partnership agreement
- No state filing requirement to form the partnership
  - But, lack of filing could present issues in registering the JV elsewhere (such as with bank)
- JV still needs to register at SAM.gov

Step 4: Determine Management Structure and Labor

- How will the parties manage the joint venture?
  - Management Committee
  - Members
  - Project Manager
- Which party will be responsible for negotiating contracts and subcontracts?
- How will you communicate with the customer?
- What are the sources of labor to be employed?
- How do the parties envision the division of labor on contracts?
- Populated or unpopulated?

Populated Joint Venture

- A populated JV is one that has its own employees
- Less common than unpopulated JV
- Pros:
  - One seamless entity performs work
  - All employee benefits are from one organization
  - Possible competitive pricing edge
- Cons:
  - More costly and administratively burdensome to set up
  - JV (not the JV partners) earns past performance
  - Partners only receive proportionate share of the profits

Unpopulated Joint Venture

- An unpopulated JV does not have its own employees (except perhaps for admin personnel)
- Pros:
  - Each JV partner performs their portion of the work, essentially as subcontractors to the JV, earning their own fee on the work they perform
  - JV may charge handling fee on top of work done by JV partners
  - Easier to explain structure to the SBA for approval of JV agreement, if necessary
  - Simpler and less costly to set up
- Cons:
  - Procuring agency may not understand who is performing work
  - Companies may have different benefit packages
- Similarities: populated and unpopulated satisfy the performance of work requirements

STEP 5: DRAFTING THE JV AGREEMENT

- Common terms:
  - Purpose of the joint venture
  - Designation of small business as managing partner
  - For certain set-asides, not less than 51% of net profits earned by the JV must be distributed to the small business participant
  - Responsibilities of the parties
  - Both parties must ensure performance of the prime contract, even if the other party withdraws from the JV
  - Designation that accounting/administrative records are kept by managing venturer and requirement that managing venturer retain records of contracts completed by Joint Venture
  - Performance of work requirements
  - Disputes

Mentor-Protégé Programs

- Broad exclusion from affiliation for SBA and DOD Mentor-Protégé Programs. 13 C.F.R. § 121.103 (b)(6).
- Ostensible subcontractor rule may be applicable on prime/sub relationships
- 8(a) protégés may joint venture with their mentors, regardless of the size of the mentor.
  13 C.F.R. § 124.513 (b)(3).

COMMON GENERAL RULES

- Mentor may have more than one protégé; protégés may not have more than one mentor (except SBA program where protégé may have a second mentor if a different business line). 13 C.F.R. § 124.520 (b)(2); 13 C.F.R. § 124.520 (c)(3).
- Protégé = Subcontractor
- Expands the agency's pool of subcontractors
- Exemption from affiliation?
- Programs exist in many cabinet departments and agencies, not just SBA

SBA Mentor-Protégé Program

- Allows mentor to own up to 40% interest in 8(a) protégé firm. 13 C.F.R. § 124.504 (d)(2).
- Provides exemption from affiliation rules
  - Approved 8(a) M-P teams may joint venture as a small business if it follows the "3-in-2" rule. 13 C.F.R. § 121.103 (h).

SBA Mentor-Protégé Program

- Mentors must be in good financial condition. 13 C.F.R. § 124.520 (b)(1)(i).
- Potential protégés limited to 8(a) companies:
  - The developmental stage of the 8(a) program,
  - That have never received an 8(a) contract, or
  - Are less than half the size standard of primary NAICS code. 13 C.F.R. § 124.520 (c)(1)(i)-(iii)

DOD Mentor-Protégé Program

- ❖ Mentor is prime contractor with at least one active subcontracting plan. DFAR § 219.7102 (a).
- ❖ Provides mentor:
  - Reimbursement for developmental assistance costs up to $1 million, or
  - Subcontracting credit for unreimbursed assistance costs. DFAR § 219.7102 (a)
- ❖ Protégé must be:
  - 8(a) SDB, WOSB, SDVOSB or HUBZone;
  - Eligible for the award of Federal contracts; and
  - Small under the NAICS code applicable to subcontracts with mentor. DFAR § 219.7102 (b)

Changes Coming to the SBA's Mentor-Protégé Program

- One new mentoring program available to all small businesses
  - Patterned on existing 8(a) Mentor-Protégé Program
  - Designed as a business development tool to enhance protégé's capabilities
  - Would allow all small business protégés to joint venture with their large business mentors
  - Mentor could own up to 40% of the protégé
  - Also envisions assistance through loans, financing, prime contracts, and subcontracts

QUESTIONS?

Thank you for joining us today.

If you would like to speak with Cy or Katie about today's session, please contact them at:

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