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In January of this year, both the Department of Veterans Affairs (VA) and the Small Business Administration (SBA) issued proposed rules that would completely overhaul the regulations governing eligibility of veteran-owned small businesses (VOSB) and service-disabled veteran-owned small businesses (SDVOSB).

**Background**

To fully understand the revisions being made by the SBA and VA, it is important to know the full history and context of the VOSB and SDVOSB rules. Originally, the eligibility of SDVOSB companies was decided by the SBA—and the SBA alone. However, around 2010, the VA initiated its own VOSB and SDVOSB verification process in connection with its own (separate) “Vets First” veteran-owned small business program. The driving force behind the VA’s “Vets First” Program was to increase opportunities for VOSBs and SDVOSBs—a great and noble purpose, at least in theory. In reality, these dual-VOSB programs caused a great deal of confusion and inconsistency.

**Growing Inconsistency Between SBA and VA Veteran Owned Small Business Programs**

What made the fact of having two programs problematic? A number of things. As a threshold matter, while the VA program included both SDVOSBs and VOSBs, the SBA program provided only for SDVOSBs (also known in the SBA regulations as SDVOSB). Moreover, the VA program covered set-asides issued and administered by the VA, while the SBA program covered set-asides issued and administered by all other agencies. As a result, contractors who performed work for both the VA and other agencies had to worry about two different certification/verification processes and two different sets of regulations.

Take, for example, an SDVOSB construction contractor who regularly performs work for the U.S. Army Corps of Engineers (USACE), the General Services Administration (GSA), and the VA. There has been no consolidated or uniform way to be eligible for SDVOSB set-asides issued by all three agencies.

To be eligible for the set-asides issued by USACE and GSA, the contractor would self-certify as an SDVOSB in, for instance, the System for Award Management (SAM) and the SBA’s Dynamic Small Business Search (DSBS) as an SDVOSB. That eligibility would be governed by the SBA regulations located at 13 C.F.R. part 125. To be eligible for SDVOSB set-aside contracts issued by the VA, the contractor would have to apply to the VA—specifically, the VA’s Center for Verification and Evaluation (CVE)—seeking verification and

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**Attention all PTAC Counselors:**

Veteran-owned business eligibility requirements are about to change.

**PTAC Alert:** On May 21, 2018 CVE will suspend incoming case applications to facilitate the transition to the new case VIP interface. The suspension of incoming cases will last for approximately thirty 30 days and include both new applications and reverifications. **Click to read more.**
inclusion the VA’s Vendor Information Pages (VIP) or “VetBiz” database. This database has served as a repository of all VA-verified companies eligible to compete for VA-issued VOSB/SDVOSB set-aside contracts. VetBiz eligibility was governed by the VA small business regulations found at 38 C.F.R. part 74.

Both the VA and SBA required a business to be unconditionally owned and controlled by one or more service-disabled veterans to qualify as an SDVOSB. However, under this dual-regulatory framework, the question of whether a service-disabled veteran “owned” or “controlled” his or her business depended on two different, competing definitions. The VA defined unconditional ownership as follows:

[O]wnership must not be subject to conditions precedent, conditions subsequent, executory agreements, voting trusts, restrictions on assignments of voting rights, or other arrangements causing or potentially causing ownership benefits to go to another (other than after death or incapacity). The pledge or encumbrance of stock or other ownership interest as collateral, including seller-financed transactions, does not affect the unconditional nature of ownership if the terms follow normal commercial practices and the owner retains control absent violations of the terms.—38 C.F.R. § 74.3(b) (emphasis added)

The SBA regulations, in contrast, included no definition of “unconditional” ownership. (This may have been an oversight when drafting the regulations; there is a definition of unconditional ownership for both women owned small business (WOSBs) and 8(a) companies—two other small business programs run by the SBA).

As if this wasn’t confusing enough, these different eligibility regulations—13 C.F.R. part 125 for the SBA program and 38 C.F.R. part 74 for VA program—were interpreted differently in different cases, leading to significant inconsistencies. For example, because the SBA had no regulatory definition concerning ownership, when presented with a legal dispute requiring the agency to determine the meaning of “unconditional,” it created the following demanding framework:

[U]nconditional necessarily means there are no conditions or limitations upon an individual’s present or immediate right to exercise full control and ownership of the concern. Nor can there be any impediment to the exercise of the full range of ownership rights. Thus, a service-disabled veteran: (1) Must immediately and fully own the company (or stock) without having to wait for future events; (2) Must be able to convey or transfer interest in his ownership interest or stock whenever and to whomever they choose; and (3) Upon departure, resignation, retirement, or death, still own their stock and do with it as they choose. In sum, service-disabled veterans must immediately have an absolute right to do anything they want with their ownership interest or stock, whenever they want.—The Wexford Group Int’l, Inc., SBA No. SDV-105 (June 29, 2006)

Many years later, in Miles Construction LLC v. United States (a case that our firm [Cohen Sigleas] successfully litigated), the Court of Federal Claims handed down a much more liberal interpretation of unconditional, albeit in the context of the VA regulations relating to SDVOSB ownership. There, the Court found that certain “right of first refusal” language in the contractor’s corporate governance documents did not render the veteran’s ownership of the company to be “conditional.” The court
commercial practice” and did “not affect the veteran’s unconditional ownership.” Thereafter, the VA actually changed its policy on how its regulations were interpreted; the VA took the position that transfer restrictions on ownership that are part of normal commercial dealings, such as the right of first refusal, do not materially affect the ability of a veteran to unconditionally own or control his or her business. In other words, according to the cases interpreting the VA’s regulations, transfer restrictions no longer rendered an owner’s control “conditional” or nullified the owner’s VOSB/SDVOSB eligibility. This all seemed like good news for veteran contractors. Some contractors assumed that this new line of reasoning would apply to all VOSB/SDVOSB eligibility determinations. But then came the decision in Veterans Contracting Group.

This case involved a status protest filed against Veterans Contracting Group, Inc. (VCGI), challenging the company’s eligibility for a SDVOSB set-aside issued and administered by USACE. As noted above, eligibility for SDVOSBs administered by agencies other than the VA falls within the purview of the SBA, ruled by SBA’s regulations. When interpreting those regulations in the Veterans Contracting Group case, the SBA found that Ronald Montano, the veteran owner of VCGI, did not have unconditional ownership of the company because the company’s Shareholders Agreement provided that upon Mr. Montano’s death, incapacity, or insolvency, all of his shares would be purchased by VCGI at a predetermined price. In other words, Mr. Montano’s heirs could not freely convey or transfer the stock. The SBA believed that these provisions constituted “significant restrictions” on Mr. Montano’s ability to transfer his shares and, further, that these restrictions therefore rendered his ownership of the company conditional. VCGI disagreed. It argued that these provisions were “normal commercial practice,” which were part of regular commercial dealings, and, as such, did not materially affect the ability of Mr. Montano to unconditionally own or control the company. Accordingly, VCGI argued that the SBA’s decision appeared to be inconsistent with the ruling in Miles, as well as the ruling in AmBuild Co., LLC v. United States, a similar case.

Not surprisingly, the case ended up before the Court of Federal Claims—two times, in fact, each in a different context. The Court ultimately found that the SBA had not erred in concluding that Mr. Montano did not unconditionally own the company because—while it was (arguably) inconsistent with the decisions interpreting the VA’s SDVOSB regulations—the conclusion was consistent with the SBA’s SDVOSB regulations. The Court noted that the dual-SDVOSB system was comprised of “complex and divergent regulatory frameworks,” and, further, that such a dual system sometimes gave rise to “harsh” results. The Court made it clear that while Miles and AmBuild were instructive in the context of the VA’s SDVOSB regulations, they were “irrelevant” for purposes of analyzing eligibility under the SBA’s regulations. The Court called this outcome “perverse and draconian” but stipulated that it had no choice but to rule in favor of the SBA, denying VCGI eligibility.

Veterans Contracting Group made it glaringly obvious that the dual-eligibility system was causing a number of serious problems: a contractor could be found eligible for one program, while being excluded from the other; regulations were interpreted in wildly different ways depending on what agency was involved and who was
interpreting the regulations; interpretations could, at times, seem somewhat arbitrary and capricious; and, perhaps most importantly, contractors had no way to know what they could or could not do without risking the loss of their VOSB/SDVOSB status. In short, the whole system created confusion, frustration, and uncertainty. The situation was not good for anyone, let alone the veteran contractors who the Vets First Program was designed to help in the first place.

Congress Aims to Fix the Problem
Recognizing the problems inherent with the existing regulatory framework, Congress decided it had to act. As part of the National Defense Authorization Act of 2017 (NDAA 2017), Congress attempted to remedy the problem by providing a statutory definition of ownership and control to be used for all SDVOSBs. NDAA 2017 § 1832 amends the SBA’s charter, the Small Business Act, to include the following definitions (see below).

The NDAA also included businesses owned and controlled by the surviving spouse of a deceased service disabled veteran as a third category of SDVOSBs under certain circumstances. The NDAA further mandated that the SBA be responsible for the enforcement of these new definitions and making ultimate determinations about whether an SDVOSB met the new definition of unconditional ownership and control for both agencies, although the VA would retain its power to verify SDVOSB status.

NDAA 2017 made it clear that the VA should no longer issue regulations related to the status of a concern as a small business concern or the ownership and control of such small business concern. Instead, the terms “small business concern owned and controlled by veterans” and “small business owned and controlled by service-disabled veterans” would be governed by the definitions provided in the Small Business Act (including the new definition outlined above at § 1832).

Further, NDAA directed that the companies included in the VIP database must be verified using the procedures and regulations issued by the SBA. In short, all definitions concerning size, ownership, and control—as well as all decisions relating to eligibility of companies in connection with same—were to fall under the authority of the SBA.

That brings us up to the present.

NDAA 2017 § 1832

The term ‘small business concern owned and controlled by service-disabled veterans’ means any of the following:

(A) A small business concern—
   (i) not less than 51 percent of which is owned by one or more service-disabled veterans or, in the case of any publicly owned business, not less than 51 percent of the stock (not including any stock owned by an ESOP) of which is owned by one or more service-disabled veterans; and
   (ii) the management and daily business operations of which are controlled by one or more service-disabled veterans or, in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran.

(B) A small business concern—
   (i) not less than 51 percent of which is owned by one or more service-disabled veterans with a disability that is rated by the Secretary of Veterans Affairs as a permanent and total disability who are unable to manage the daily business operations of such concern; or
   (ii) in the case of a publicly owned business, not less than 51 percent of the stock (not including any stock owned by an ESOP) of which is owned by one or more such veterans.
VA and SBA Issue Proposed Regulations

In January 2018, both the VA and the SBA issued proposed rules relating to the NDAA’s statutory requirements, aimed at adopting the uniform definition for VOSBs/SDVOSBs. Unfortunately, it appears that the VA’s and SBA’s proposed rules could actually make it harder for a SDVOSB to achieve and maintain status as a verified SDVOSB in certain circumstances.

The VA’s proposed rule came first. Consistent with the NDAA 2017, the VA specified that the regulations relating to and clarifying ownership and control are no longer their responsibility. The proposed rule would eliminate the sections of the VA regulations dealing with VOSB/SDVOSB ownership and control (i.e. 38 C.F.R. 74.1, 38 C.F.R. 74.3 and 38 C.F.R. 74.4); in the future, these issues would be governed by SBA regulations and definitions.

The VA appears to be removing all references to its competing definition of ownership and control, as required by the statute, and ceding authority to the SBA to review its decisions on whether businesses qualify as an SDVOSB. However, the VA seeks to amend a number of provisions in a manner that may actually make it more difficult to become verified. First, it proposes expanding its requirement that a veteran show “good character” in 38 C.F.R. 74.2(b). Already an amorphous requirement that could be interpreted broadly to exclude business owners arbitrarily, it has now been expanded to specifically exclude parolees, probationers, felons or anyone who has committed a crime “involving business integrity.” In addition, the VA proposes to amend the requirements of 38 C.F.R. 74.2 (c) to state that any misrepresentation in the materials submitted - even a misrepresentation that is not material to the verification decision - is grounds to deny verification, while amending 38 C.F.R. 74.2(d) to prevent verification of any business owner that fails to pay financial obligations to federal or state authorities. The language is so broad in this latter provision that arguably someone who is in arrears on a federally guaranteed student loan would not qualify for verification as an SDVOSB. Any of these changes could make it much harder for an SDVOSB to be verified going forward.

The SBA’s proposed rule was issued shortly after the VA’s. It makes clear that it is, pursuant to the directives in NDAA 2017, proposing to issue regulations that provide “one definition of ownership and control for [VOSB/SDVOSB] concerns, which will apply to the Department of Veterans Affairs in its verification and Vets First Contracting Program procurements and all other government acquisitions which require self-certification.” Consistent with this goal, the SBA proposes to revise 13 C.F.R. § 125.12 relating to ownership and 13 C.F.R. § 125.13 relating to control.
We cannot go into detail about every single change to the regulations here, as this article would grow to be the length of a book. The critical take-away is that once the regulations are finalized, all VOSB/SDVOSB entities should carefully review them and analyze whether they are still in compliance and can fairly be classified as a VOSB/SDVOSB. If not, these companies will need to consult a legal expert to make the necessary changes.

As a whole, we view the new, consolidated/uniform definitions as being closer to the VA’s more liberal definitions of ownership and control. Indeed, the proposed regulations are more consistent with the ideas outlined in Miles and AmBuild, rather than the SBA’s former draconian definition articulated in Wexford and reluctantly accepted and applied by the Court in Veterans Contracting Group. However, there are still aspects of the new definitions which could arguably make it harder for legitimate VOSBs/SDVOSBs to establish the ownership and control necessary for eligibility.

For example, the SBA has added to 38 C.F.R. § 125.13(k) a rebuttable presumption that if the service-disabled veteran is not able to work for the firm during normal business hours then he or she does not control the business. Obviously, this calls into question owners who might work a late shift or work multiple jobs to keep their business on its feet. While this concept is consistent with prior case law, its actual inclusion in the regulations is new and could limit which SDVOSBs are eligible. The SBA has also added another rebuttable presumption to 38 C.F.R. § 125.13(l) that a service-disabled veteran who does not live within commuting distance to the firm’s headquarters is not in control of the business. This is arguably inconsistent with certain case law dealing with telecommuters. Moreover, it discounts the nature of government contracting, which often calls for businesses to maintain personnel in far-flung locations that may not be near company headquarters. For example, a business owner who moves temporarily to another state to help with proposals on federal work in that state could theoretically be presumed to not be in control of his or her company.

Conclusion
The comment periods for both proposed rules are now over, but we won’t see a final regulation from either agency before the summer. When the final regulations are released, it will be important for all VOSB/SDVOSB companies - and the PTACs that assist them - to familiarize themselves with the new regulations. While it is likely that the problem of draconian disqualifications under the old SBA definition of ownership and control is a thing of the past, some of the proposed changes indicate that the SBA and the VA may continue to make it harder to achieve and maintain status as an SDVOSB. In any event, it will certainly be different and therefore critically important for veteran owned companies and the people who advise them to understand the differences and nuances created by the new regulations. If you have any questions about them – or their potential consequences - consult a legal professional.

Stay tuned:
APTAC will keep you updated when the final rules are published!

Maria Panichelli is a Partner in Cohen Seglias’s federal contracting and construction groups, representing a national client base of prime and subcontractors with a focus on federal construction contracting and small business procurement issues. She was a presenter at APTAC’s 2017 Fall Training Conference and is a regular instructor for Govology.

Michael Richard is an Associate in Cohen Seglias’s federal contracting group and focuses his practice on government contracts litigation, in particular on drafting, negotiating, and litigating claims under the Contract Disputes Act.