Dear Ms. Fernandez:

On behalf of the American Bar Association (“ABA”) Section of Public Contract Law (“Section”), I am submitting comments on the proposed rule cited above (the “Proposed Rule”). The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section’s governing Council and substantive committees include members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The views expressed herein are presented on behalf of the Section. They have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the position of the ABA.

Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, and Marian Blank Horn, Kristine Kassekert, and Heather K. Weiner, members of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

This letter is available in pdf format at http://www.americanbar.org/groups/public_contract_law/resources/prior_section_comments.html under the topic “Small Business and Socioeconomic Issues.”
I. BACKGROUND AND INTRODUCTION

The Section is pleased to offer comments on the U.S. Small Business Administration (“SBA”) Proposed Rule, Ownership and Control of Service-Disabled Veteran-Owned Small Business Concerns (“SDVO SBCs”). The Section appreciates the SBA’s efforts to standardize the SBA and Department of Veterans Affairs (“VA”) rules on SDVO SBC ownership and control, and to make the rules consistent with relevant sections of the 8(a) Business Development Program rules. Nevertheless, the Section is concerned that the Proposed Rule does not incorporate and adopt certain language from the relevant 8(a) Business Development Program rules that helps to make clear the scope and application of those rules, and that the Proposed Rule could otherwise benefit from additional clarification and alignment with existing regulations. The Section is also concerned that, if the SBA and VA final rules are not jointly published, the implementing regulations will precede the amendment of the enabling statute.

II. COMMENTS

The Section recognizes the key role SDVO SBCs play in supporting the federal procurement system and applauds the SBA for taking steps to ensure the regulations are consistent and understandable. The Section believes that the Proposed Rule will improve clarity and consistency between the SBA’s and VA’s rules on ownership and control. The Section nonetheless believes that the Proposed Rule would benefit from additional clarification as described below.

A. The SBA Should Revise the Definition of “Extraordinary Circumstances” in Proposed 13 C.F.R. § 125.11.

Proposed 13 C.F.R. § 125.11 includes a definition for “Extraordinary Circumstances” that enumerates five “limited circumstances in which a service-disabled veteran owner will not have full control over the decision making process” that “would be exclusive” such that “SBA would not recognize any other facts or circumstances that would allow negative control by individuals that are not service-disabled.” 83 Fed. Reg. 4005 (Jan. 29, 2018) at 4006; see also id. at 4008 (defining “Extraordinary Circumstances”). These are known as negative control covenants.

Although it is helpful to have specific guidance on allowable negative control covenants, the Section suggests that SBA either refrain from adopting an exclusive list or, alternatively, expand its list. The enumerated list is less extensive than those circumstances approved by the SBA Office of Hearing and Appeals (“OHA”) and does not, for example, allow for SDVO SBCs to include limitations on unilateral amendments to the operating documents of the business that would disadvantage minority owners. It is important for SDVO SBCs, particularly in the early stages of the business, to attract non-controlling minority investors to support business growth. An overly-restrictive list of allowable negative controls will make that more difficult. As a result, the Section recommends that SBA expand this list to include a category for commercially reasonable terms or, at a minimum, those terms that have been found to be acceptable by the SBA OHA.
B. The SBA Should Revise Proposed 13 C.F.R. § 125.12(g).

The Section also believes that the proposed limitations on distributions of profits in proposed 13 C.F.R. § 125.12(g) may also be problematic. This limitation calls for profit to be distributed based on ownership percentage. The limitation thus may be in tension with joint venture rules that provide for profit distribution in accordance with workshare, not ownership. See 13 C.F.R. § 125.18(b)(2)(iv). The Section recommends that SBA revisit proposed § 125.12(g) to ensure that no conflict exists.

C. The SBA Should Clarify, and Further Revise, Proposed 13 C.F.R. § 125.13(i).

In the explanatory section for proposed 13 C.F.R. § 125.13(i), the SBA states that § 125.13 incorporates certain provisions from SBA’s 8(a) Business Development Program ownership and control regulations. 83 Fed. Reg. at 4007. The SBA goes on, however, to explain that, even for 8(a) Business Development Program regulations it did not specifically adopt as part of this rulemaking, the SBA plans to continue relying on those regulations for guidance on the eligibility of SDVO SBCs. Id. This partial adoption injects ambiguity and uncertainty into § 125.13(i). The Section recommends that SBA clarify this comment. If the SBA intends for additional 8(a) Business Development Program regulatory provisions to apply to the SDVO SBC program, the Section recommends that those provisions be added to § 125.13(i).

In addition, the Section recommends the following specific changes.

1. Revise the Lead-In Paragraph of Proposed § 125.13(i).

The lead-in paragraph of proposed § 125.13(i) would benefit from additional clarification. This paragraph appears to be based on the 8(a) Business Development Program regulation, 13 C.F.R. § 124.106(e), but is missing important language.

<table>
<thead>
<tr>
<th>Proposed 13 C.F.R. § 125.13(i)</th>
<th>13 C.F.R. § 124.106(e)</th>
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<tr>
<td>(i) Control by non-service-disabled veterans. Non-service-disabled veteran individuals or entities may not control the firm. Non-service-disabled veteran individuals or entities may be found to control or have the power to control a firm in any of the following circumstances, which are illustrative only and not inclusive:</td>
<td>(e) Non-disadvantaged individuals may be involved in the management of an applicant or Participant, and may be stockholders, partners, limited liability members, officers, and/or directors of the applicant or Participant. However, no non-disadvantaged individual or immediate family member may:</td>
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Unlike the lead-in of § 124.106(e), the lead-in of proposed § 125.13(i) uses the term “may,” leaving it less clear than it could be whether the scenarios in the ensuing list will or will not result in a finding that the non-SDV will be found to have control or the power to control.

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3 This provision lists one of the provisions required in a “joint venture agreement to perform an SDVO contract” as: “Stating that the SDVO SBC(s) must receive profits from the joint venture commensurate with the work performed by the SDVO SBC.”
The Section recommends that SBA amend the lead-in of proposed § 125.13(i) as follows:

Non-service-disabled veteran individuals or entities may not control the firm. There is a rebuttable presumption that non-service-disabled veteran individuals or entities may be found to control or have the power to control a firm in any of the following circumstances, which are illustrative only and not inclusive:

2. **Revise Proposed § 125.13(i)(1).**

Proposed § 125.13(i)(1), which appears to be based on the 8(a) Business Development Program regulations at 13 C.F.R. § 124.106(e)(2), is also missing key terminology.

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<tr>
<th>Proposed 13 C.F.R. § 125.13(i)(1)</th>
<th>13 C.F.R. § 124.106(e)(2)</th>
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<td>(i) [Reflecting revisions proposed above] There is a rebuttable presumption that non-service-disabled veteran individuals or entities may be found to control or have the power to control a firm in any of the following circumstances, which are illustrative only and not inclusive: (1) Be a former employer or a principal of a former employer, unless it is determined that the relationship between the former employer or principal and the eligible individual or concern does not give the former employer actual control over the concern and such relationship is in the best interests of the concern</td>
<td>(e) …. However, no non-disadvantaged individual or immediate family member may: *** (2) Be a former employer or a principal of a former employer of any disadvantaged owner of the applicant or Participant, unless it is determined by the AA/BD that the relationship between the former employer or principal and the disadvantaged individual or applicant concern does not give the former employer actual control or the potential to control the applicant or Participant and such relationship is in the best interests of the 8(a) BD firm; or</td>
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First, the lead-in language paragraph of proposed § 125.13(i) does not match the start of § 125.13(i)(1). Connecting the phrases results in a sentence stating that “individuals or entities . . . control a firm . . . in any of the following circumstances . . . [b]e a former employer . . . .” Words appear to be missing or needing revision. Second, the proposed § 125.15(i)(1) is missing some of operative terms present in § 124.106(e)(2), leaving the proposed section ambiguous.
The Section therefore recommends that proposed § 125.13(i)(1) be revised as follows:

In circumstances where a non-service-disabled veteran individual or entity, who is involved in the management or ownership of the firm, is the former employer or a principal of a former employer of any service-disabled veteran individual upon whom the firm’s eligibility is based, unless it is determined by the CVE [the VA Center for Verification and Evaluation] that the relationship between the former employer or principal and the eligible individual or concern does not give the former employer actual control over the concern and such relationship is in the best interests of the concern.

3. **Revise Proposed § 125.13(i)(2).**

Proposed § 125.13(i)(2) may be missing key terminology. It appears proposed § 125.13(i)(1) is based on 8(a) Business Development Program regulation, 13 C.F.R. § 124.106(e)(3), but specific language has been omitted.

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<tr>
<th>13 C.F.R. § 125.13(i)(2)</th>
<th>13 C.F.R. § 124.106(e)(3)</th>
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<tr>
<td>(i) .... Non-service-disabled veteran individuals or entities may be found to control or have the power to control a firm in any of the following circumstances, which are illustrative only and not inclusive:</td>
<td>(e) …. However, no non-disadvantaged individual or immediate family member may:</td>
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<td>(2) In circumstances where non-service-disabled veterans receive compensation from the firm in any form as directors, officers or employees, including dividends, that exceeds the compensation to be received by the highest officer (usually CEO or President). The highest ranking officer may elect to take a lower amount than the total compensation and distribution of profits that are received by a nonveteran only upon demonstrating that it helps the concern.</td>
<td>(3) Receive compensation from the applicant or Participant in any form as directors, officers or employees, including dividends, that exceeds the compensation to be received by the highest officer (usually CEO or President). The highest ranking officer may elect to take a lower salary than a non-disadvantaged individual only upon demonstrating that it helps the applicant or Participant. In the case of a Participant, the Participant must also obtain the prior written consent of the AA/BD or designee before changing the compensation paid to the highest ranking officer to be below that paid to a non-disadvantaged individual.</td>
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As seen from the above comparison, proposed § 125.13(i)(2) does not state to whom the firm must demonstrate that a lower compensation helps the concern. In addition, references to non-SDVs in proposed § 125.13(i)(2) should be changed from plural to singular, so that it is clear that compensation is not measured in the aggregate.
The Section therefore recommends that proposed § 125.13(i)(2) be revised as follows:

In circumstances where a non-service-disabled veterans receives compensation from the firm in any form as directors, officers or employees, including dividends, that exceeds the compensation to be received by the highest officer (usually CEO or President). The highest ranking officer may elect to take a lower amount than the total compensation and distribution of profits that are received by a nonveteran only upon demonstrating to CVE that it helps the concern.

4. **Revise Proposed §§ 125.13(i)(3) and (i)(4).**

   Proposed § 125.13(i)(3) states the standard for control relevant to another firm as “co-located.” 83 Fed. Reg. 4010. Nonetheless, it is not clear what constitutes co-location. Two firms could be considered “co-located” if they have neighboring job trailers on a construction site. Accordingly, the Section recommends that this term be narrowed so that it encompasses only the firm’s headquarters.

   In addition, the term “any type of services” in the standard for control relevant to shared services in proposed § 125.13(i)(4) is overbroad, and should be deleted from the proposed regulation. *Id.* at 4010-11. The term “same or similar line of business” in the same section is not defined in the regulation. *See id.* Accordingly, to avoid ambiguity, the Section recommends that the SBA incorporate the definition contained in 13 C.F.R. § 124.3.

   The Section therefore recommends that proposed § 125.13(i)(3) and proposed § 125.13(i)(4) be revised as follows:

   (3) In circumstances where the concern is co-located shares its headquarters with another firm in the same or similar line of business (as defined in 13 C.F.R. § 124.3), and that firm or an owner, director, officer, or manager, or a direct relative of an owner, director, officer, or manager of that firm owns an equity interest in the firm.

   (4) In circumstances where the concern shares employees, resources, equipment, or any type of services, whether by oral or written agreement, with another firm in the same or similar line of business (as defined in 13 C.F.R. § 124.3), and that firm or an owner, director, officer, or manager, or a direct relative of an owner, director, officer, or manager of that firm owns an equity interest in the concern.
5. **Revise Proposed § 125.13(i)(5).**

Proposed § 125.13(i)(5) should be clarified in relation to another paragraph. Under this subparagraph (i)(5), a “non-service-disabled veteran individual or entity, having an equity interest in the concern,” may be deemed to have control of the concern if it “provides critical financial or bonding support” to the concern. *Id.* at 4011. But subparagraph (i)(5) does not define the term “critical financial or bonding support.” *See id.* Creating additional potential ambiguity, proposed § 125.13(j) defines a similar term—“critical financing”—to effectively encompass any loan arrangement. But the definition in paragraph (j) is too broad for what the SBA appears to have meant to be a narrow restriction in § 125.13(i)(5). The Section recommends that the SBA revise proposed § 125.13(i)(5) to define “critical financial or bonding support” so that distinctions between that term and “critical financing” are apparent.

6. **Revise Proposed § 125.13(i)(6).**

Proposed § 125.13(i)(6) appears to be derived from the VA’s regulation at 38 C.F.R. § 74.4(b). But proposed § 125.13(i)(6) lacks important limiting language from the VA’s regulation, without which subparagraph (i)(6) and the associated existing regulation at 13 C.F.R. § 125.13(b) may be inconsistent with the VA’s approach.

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<tr>
<th>Proposed 13 C.F.R. § 125.13(i)(6)</th>
<th>38 C.F.R. § 74.4(b)</th>
<th>13 C.F.R. § 125.13(b)</th>
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<td>(6) In circumstances where a critical license is held by a non-service-disabled individual, or other entity, the nonservice-disabled individual or entity may be found to control the firm. A critical license is considered any license that would normally be required of firms operating in the same field or industry, regardless of whether a specific license is required on a specific contract.</td>
<td>(b) Control is not the same as ownership, although both may reside in the same person. . . . <strong>A veteran need not have the technical expertise or possess a required license to be found to control an applicant or participant if he or she can demonstrate that he or she has ultimate managerial and supervisory control over those who possess the required licenses or technical expertise.</strong> However, where a critical license is held by a non-veteran <strong>having an equity interest</strong> in the applicant or participant firm, the non-veteran may be found to control the firm.</td>
<td>(b) <strong>Managerial position and experience.</strong> . . . The service-disabled veteran manager (or in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran) <strong>need not have the technical expertise or possess the required license to be found to control the concern if the service-disabled veteran can demonstrate that he or she has ultimate managerial and supervisory control over those who possess the required licenses or technical expertise.</strong></td>
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Unlike 38 C.F.R. § 74.4(b), proposed § 125.13(i)(6) is not limited to non-SDVs who hold a critical license and an equity interest. Adding “equity interest” language to § 125.13(i)(6) will make proposed § 125.13, as a whole, consistent with its predecessor 38 C.F.R. § 74.4(b).

The Section therefore recommends that proposed § 125.13(i)(6) be revised as follows:

In circumstances where a critical license is held by a non-service-disabled individual, or other entity having an equity interest in the firm, the nonservice-disabled individual or entity may be found to control the firm. A critical license is considered any license that would normally be required of firms operating in the same field or industry, regardless of whether a specific license is required on a specific contract.


Proposed § 125.13(l) creates a rebuttable presumption that a service-disabled veteran does not control a firm if the individual is “not located within a reasonable commute to [the] firm’s headquarters and/or job-sites locations, regardless of the firm’s industry.” 83 Fed. Reg. 4011. The Section recommends that the SBA reconsider whether this type of provision is consistent with the modern work environment. In certain industries, persons must be within a reasonable proximity of the job site to manage the work. But in many industries, there is no physical job site, projects are manageable from off-site, leaving no need for the managing person to be within a reasonable proximity of a job site (if there is one). In addition, many companies now emphasize telecommuting and no longer operate with a true headquarters or no longer require their employees to work from the headquarters. In fact, some local and state governments have created incentives to encourage telecommunicating to ease traffic burdens. The Section’s members are aware of firms that are actively managed by individuals who work remotely or from non-headquarters offices for family, health, or other reasons.

As a result, this presumption should be struck or, at minimum, treated as if it “may be a basis to find lack of control” rather than a rebuttable presumption. If the presumption is retained, exceptions should be made for SDVs that regularly visit the headquarters location.

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4 See Mark Armstrong, Opinion: Mayor Durkan should encourage CEOs to support telecommuting, SEATTLE TIMES (Jan. 5, 2018), https://www.seattletimes.com/opinion/my-commute-is-zero-minutes-and-yours-should-be-too/; Laura Shin, At These 125 Companies, All Or Most Employees Work Remotely, FORBES (Mar. 31, 2016), https://www.forbes.com/sites/laurashin/2016/03/31/at-these-125-companies-all-or-most-employees-work-remotely/#4144bd106530.

If the SBA keeps this provision, then the term “and/or” in the proposed regulation should be changed to “or” to avoid ambiguity. In addition, the term “job-sites locations” appears to be a typographical error. And finally, the term “reasonable commute” is unclear. People in one region might think a reasonable commute is 30 minutes, whereas elsewhere a reasonable commute is an hour. Others may travel to headquarters or a job site for the work week and then travel to a more distant home for the weekend. The Section recommends that the SBA better define the term “reasonable commute” if this provision is retained.

E. The SBA Should Clarify Whether Certain Other Minority Investor Rights Result in Lack of Control by the SDV.

Case law conflicts as to whether certain commercially-common minority-investor rights, such as a right of first refusal or tag-along rights, infringe on an SDV’s control. Compare Miles Constr., LLC v. United States, 108 Fed. Cl. 792 (2013) (finding right of first refusal to be a standard commercial practice that does not affect unconditional ownership under the VA SDVO SBC program) with Veterans Contracting Grp., Inc. v. United States, 135 Fed. Cl. 316 (2017) (upholding SBA’s strict enforcement of the unconditional ownership rule to declare a company ineligible for award). The Section recommends that SBA consider specifically addressing these rights, which apply only when the SDV has decided to exit the program and sell his/her interest or upon the SDV’s death, incapacity, or insolvency, but which have nonetheless been interpreted as constant, sometimes disqualifying, limitations on the SDV’s control. The lack of clarity in this area is challenging for SDVs who are seeking outside investment or start-up support.

F. The SBA Should Jointly Issue Any Final Proposal with the VA.

Section 1832 of the National Defense Authorization Act for Fiscal Year 2017 (“NDAA”) provides that its amendments to the Small Business Act and Title 38 of the United States Code “shall take effect on the date on which the Administrator of the Small Business Administration and the Secretary of Veterans Affairs jointly issue regulations implementing such sections.” As a result, if the SBA issues final rules before the VA issues its final rules, then the regulations would be effective before the enabling statute (Small Business Act) is amended. The Section recommends that the SBA work with the VA to jointly issue final rules to align with the NDAA.
III. CONCLUSION

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Aaron Silberman
Chair, Section of Public Contract Law

cc:
Kara M. Sacilotto
Linda Maramba
Susan Warshaw Ebner
Annejanette Heckman Pickens
Council Members, Section of Public Contract Law
Chairs and Vice Chairs, Small Business & Other Socioeconomic Programs Committee
Craig Smith
Samantha S. Lee