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Part IV

Small Business Administration

13 CFR Parts 121 and 124

Small Business Size Regulations; 8(a) Business Development/Small Disadvantaged Business Status Determinations; Proposed Rule

SMALL BUSINESS ADMINISTRATION

13 CFR Parts 121 and 124

RIN 3245–AF53

Small Business Size Regulations; 8(a) Business Development/Small Disadvantaged Business Status Determinations

AGENCY: U.S. Small Business Administration.

ACTION: Proposed rule.

SUMMARY: This rule proposes to make changes to the regulations governing the 8(a) Business Development (8(a) BD) and Small Disadvantaged Business (SDB) programs, and to the U.S. Small Business Administration's (SBA or Agency) size regulations. Some of the changes involve technical issues such as changing the term ''SIC code'' to ''NAICS code'' to reflect the national conversion to the North American Industry Classification System. Other changes are more substantive and result from SBA's experience in implementing the current regulations. For example, SBA has learned through experience that certain of its rules governing the 8(a) BD program are too restrictive and serve to unfairly preclude firms from being admitted to the program. In other cases, SBA has determined that a rule is too expansive or indefinite and has sought to restrict or clarify that rule. In one case wording changes are being proposed to correct past public or agency misinterpretation. Also, new situations have arisen that were not anticipated when the current rules were drafted and the proposed rule seeks to cover those situations. Finally, one of the changes, involving Native Hawaiian Organizations (NHO's), implements a statutory change.

DATES: Comments must be received on or before December 28, 2009.

ADDRESSES: You may submit comments, identified by RIN: 3245–AF53, by any of the following methods:

• *Federal eRulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.

• *Mail, for paper, disk, or CD/ROM submissions:* Joseph Loddo, Associate Administrator, Office of Business Development, 409 Third Street, SW., Mail Code, Washington, DC 20416.

• *Hand Delivery/Courier:* Joseph Loddo, Associate Administrator, Office of Business Development, 409 Third Street, SW., Washington, DC 20416.

SBA will post all comments on *www.regulations.gov.* If you wish to submit confidential business information (CBI) as defined in the User Notice at *www.Regulations.gov,* please submit the information to LeAnn Delaney, Deputy Associate Administrator, Office of Business Development, 409 Third Street, SW., Washington, DC 20416, or send an e-mail to *leann.delaney@sba.gov*. Highlight the information that you consider to be CBI and explain why you believe SBA should hold this information as confidential. SBA will review the information and make the final determination of whether it will publish the information or not.

FOR FURTHER INFORMATION CONTACT: LeAnn Delaney, Deputy Associate Administrator, Office of Business Development, at (202) 205–5852, or *leann.delaney@sba.gov*.

SUPPLEMENTARY INFORMATION:

This rule proposes to make a number of changes to the regulations governing the 8(a) BD and SDB programs, and several changes to SBA's size regulations. Some of the changes involve technical issues. Other changes are more substantive and result from SBA's experience in implementing the current regulations.

The following specific changes are being proposed to SBA's regulations. There are six proposed changes to SBA's size regulations, two dealing with mentor/protégé situations, one amending requirements for joint ventures, one clarifying how a procurement should be classified, one further explaining the nonmanufacturer rule, and one relating to who may request a formal size determination. The remaining proposed changes are to the regulations governing SBA's 8(a) BD and SDB programs. It is noted that all regulations governing the 8(a) program apply to the SDB program, unless otherwise specified. While the SDB program no longer has an application and certification component, the provisions specifying what constitutes an SDB are still needed for self-certification and protest purposes.

Exception to Affiliation for Mentor/Protégé Programs

The first proposed change would clarify when SBA would consider a protégé firm not to be affiliated with its mentor based on assistance received from the mentor through a mentor/protégé agreement. The current regulation may be misconstrued to allow other Federal agencies to establish mentor/protégé programs and exempt protégés from SBA's size affiliation rules. That was never SBA's intent. The exception to affiliation contained in § 121.103(b)(6) was meant to apply to SBA's 8(a) BD mentor/protégé program and other Federal mentor/protégé programs that specifically authorize an exception to affiliation in their authorizing statute. Because of the business development purposes of the 8(a) BD program, SBA administratively established an exception to affiliation for protégé firms. Specifically, protégé firms are not affiliated with their mentors based on assistance received from their mentors through an SBA-approved 8(a) BD mentor/protégé agreement. That exception exists in the current rule and remains in this proposed rule. The proposed rule merely spells out more explicitly the affiliation exception for clarity purposes.

In addition, the proposed rule makes clear that an exception to affiliation for protégés in other Federal mentor/protégé programs will be recognized by SBA only where specifically authorized by statute (*e.g.,* the Department of Defense mentor/protégé program) or where SBA has authorized an exception to affiliation for a mentor/protégé program of another Federal agency under the procedures set forth in § 121.903. By statute, SBA is the sole agency responsible for determining size for purposes of any Federal assistance. SBA does not believe that another agency should be able to exempt firms from SBA's affiliation rules (and in effect make program-specific size rules) by itself. There is a formal process spelled out in § 121.903 that an agency must use if it would like to deviate from SBA's size rules, including those relating to affiliation. This process must be followed and SBA must specifically authorize an exception to affiliation for another Federal mentor/protégé program in order for SBA to recognize the exception. SBA does not anticipate approving exceptions to affiliation to agencies seeking to have such an exception for their mentor/protégé programs except in limited circumstances. SBA believes that the 8(a) BD program is a unique business development program that is unlike other Federal programs. If a program of another agency is also intended to assist business development and an exclusion from affiliation for joint ventures conducted under that agency's mentor/protégé program would promote such business development, SBA would be inclined to grant an exclusion from affiliation because it would serve the same purpose as the exclusion from affiliation for 8(a) mentor/protégé relationships.

Joint Ventures

The second proposed change to the size rules pertains to joint ventures.

Under current § 121.103(h), a joint venture is an entity with limited duration. Specifically, the current regulation limits a specific joint venture to submitting no more than three offers over a two year period. Two firms (including an 8(a) protégé firm and its mentor) are limited to pursuing three contract opportunities under one joint venture, but there is nothing in the regulations prohibiting the same two firms from forming a second joint venture and pursuing three additional contract opportunities. The rule limiting the number of contract opportunities any single joint venture can pursue was actually intended to loosen the requirements of the prior regulations. SBA's previous regulations defined a joint venture to be an entity that was ''formed * * * to engage in and carry out a single, specific business venture for joint profit * * *'' The genesis for the change initially came from 8(a) firms, which complained that it was hard and costly for them to go out and form a new joint venture entity (usually in the form of a limited liability company (LLC)) for every contract opportunity that they sought. SBA agreed, and decided to provide more flexibility. SBA did so by changing the size regulations, the place in SBA's regulations where the term joint venture was defined. Because the provision appears in part 121 of SBA's regulations, it applies to all of SBA's programs, including the 8(a) BD program (as intended).

This provision, however, has caused confusion. Some firms misunderstood that the limitation contained in the regulation was on the number of offers submitted by the joint venture instead of the number of contracts awarded to the joint venture. As such, some joint ventures continued to submit offers beyond the three permitted by the regulation and were determined not to be eligible for award where the joint venture was otherwise the apparent successful offeror, but the offer was a fourth (or more) offer. Firms have recommended to SBA that if there is such a limit, it should be on contracts, not offers. Upon further reflection, SBA agrees and proposes to change the limit of three offers to a limit of three contract awards under one joint venture agreement.

The proposed rule would clarify that three contract awards is not an absolute limit for a specific joint venture agreement. A joint venture could choose to pursue and be awarded a fourth (or more) contract award, but in doing so would cause the partners to the joint venture to be deemed affiliated for all purposes. Again, the two (or more) firms could form a second joint venture and be awarded three additional contracts, and a third joint venture to be awarded three more. At some point, however, such a longstanding relationship or contractual dependence would lead to a finding of general affiliation, even in the 8(a) mentor/protégé joint venture context. As an alternative, SBA also considered revising this provision to limit the number of contract awards that the same partners to one or more joint ventures could receive without the partners being deemed affiliates for all purposes. SBA thought that three awards might be too restrictive and considered limiting the number of contracts that the same joint venture partners could be awarded to five. Under this approach, the identical partners could form one joint venture and receive five contracts or form several joint ventures and receive five contracts in total before SBA would find the partners to be affiliated for all purposes. SBA specifically requests comments on this approach, specifically addressing whether this approach is preferable to the one proposed.

In drafting the current three offers over two years requirement, SBA did not intend to limit the number of contracting opportunities that two (or more) firms could seek or contracts that they could be awarded through a joint venture relationship. As noted above, SBA believes that a ''joint venture'' is an entity of limited duration. If SBA did not limit the number of contracting opportunities, or under this proposed rule the number of contract awards, that a specific joint venture could receive, then the joint venture could be an ongoing entity with unlimited duration. In determining the size of a joint venture, the receipts or employees of the joint venture partners are generally aggregated (unless an exclusion from affiliation applies). If the aggregated receipts or employees are less than the size standard assigned to the relevant procurement, the joint venture qualifies as a small business. If one of the joint venture partners seeks a different contract opportunity apart from the joint venture, its size is generally considered individually (unless there are other bases for finding affiliation). If a specific ''joint venture'' could seek unlimited contracting opportunities and be awarded unlimited contracts, then the parties to the joint venture would necessarily be deemed affiliates for all purposes because of their interdependent contractual relations. This is the case because in effect the ''joint venture'' would be a new ongoing business entity that is owned by two individual firms. Because of this affiliation, the revenues or employees would be aggregated even where one of the firms sought a contract opportunity individually.

The proposed rule also clarifies the time at which SBA will determine whether this three in two years requirement has been met. SBA understands that any offeror, including a joint venture offeror, may seek more than one contract opportunity at the same time. Under SBA's regulations, size is determined as of the date a concern submits a written self-certification that it is small as part of its initial offer including price. *See* 13 CFR 121.404(a). As long as a concern is small as of that date, it may be awarded a contract as a small business even if it has grown to be other than small as of the date of award. In other words, even if a concern has received additional revenues which would render it other than small after it certifies itself to be small as part of its initial offer including price, it may be awarded a contract as a small business. Having one specific point in time to determine size gives certainty to the procurement process for both the concern and the procuring agency. SBA believes that compliance with the three awards in two years rule should be treated similarly. As such, SBA proposes to determine compliance with the three in two years rule as of the date of initial offer including price. An individual joint venture may have submitted offers to perform two, three or more procurements before it finds out that it has won any specific competition. If at the time of offer the joint venture had not yet received three contract awards, then the joint venture would be able to submit offers for several procurement opportunities and ultimately be awarded any contract for which it submitted an offer before receiving a third contract. For example, Joint Venture AB has received two contracts. On April 2, Joint Venture AB submits an offer for Solicitation 1. On June 6, Joint Venture AB submits an offer for Solicitation 2. On July 13, Joint Venture AB submits an offer for Solicitation 3. In September, Joint Venture AB is found to be the apparent successful offeror for all three solicitations. Even though the award of the three contracts would give Joint Venture AB a total of five contract awards, it could receive those awards without causing general affiliation between its joint venture partners because Joint Venture AB had not yet received three contract awards as of the dates of the offers for each of three solicitations at issue.

The proposed rule also clarifies that while a joint venture may or may not be a separate legal entity (*e.g.,* an LLC), it must exist through a written document. Thus, even an ''informal'' joint venture must have a written agreement between the partners. In addition, the rule clarifies SBA's current policy that a joint venture may or may not be populated (*i.e.,* have its own separate employees). Whether a joint venture needs to be populated or have separate employees depends upon the legal structure of the joint venture. If a joint venture is a separate legal entity, then it must have its own employees. If a joint venture merely exists through a written agreement between two or more individual business entities, then it need not have its own separate employees and employees of each of the individual business entities may perform work for the joint venture.

There has also been confusion as to whether this three in two year rule applies to the 8(a) BD program. Some individuals mistakenly believed that it did not apply to joint ventures between mentors and protégé firms in the 8(a) BD program. This is not the case. Because the rule appears in SBA's size regulations, it applies to all of SBA's programs. That is, it applies to all situations in which a joint venture seeks to qualify as a ''small business concern.'' Because this confusion is limited and SBA believes that the size regulations clearly apply the three in two year rule to all joint venture situations, SBA does not believe that a regulatory change is necessary to specifically apply the rule to the 8(a) BD program.

This proposed rule would also amend § 124.513(e) to clarify the requirement that SBA approve 8(a) joint ventures prior to award for a second or third 8(a) contract award to a specific joint venture. The current regulation states that SBA must approve a joint venture for an 8(a) contract prior to contract award. There has been some confusion about how this requirement relates to the size provision which would now allow three contract awards over a two year period to a specific joint venture. Prior to the first contract award, SBA would have to approve the joint venture. SBA's review would examine the structure of the joint venture and the work each joint venture partner would perform on the proposed 8(a) contract. For the second (and third) 8(a) contract, SBA would not need to examine the structure of the joint venture again, but would need to determine that the work to be done by the joint venture partners on the proposed second (or third) 8(a) contract meets SBA's requirements. To this end, the 8(a) Participant to the joint venture must submit to SBA an addendum to the joint venture agreement explaining how the work will be performed on the contract, specifying what resources will be provided by each joint venture partner, and providing any other information necessary to fulfill the requirements set forth in 13 CFR 124.512(c). If the second (and/or third) contract to be awarded to a specific joint venture is not an 8(a) contract, the joint venture entity would not be required to submit an addendum to SBA prior to award, but would, as explained in the following paragraph, be required to meet the general 8(a) joint venture requirements.

Exclusion from Affiliation for Mentor/Protégé Joint Ventures

The third proposed change to the size regulations also pertains to exceptions to affiliation. Currently, SBA's regulations authorize an exception to affiliation where two firms approved by SBA to be a mentor and protégé under the 8(a) BD program seek to joint venture and perform a contract as a small business concern for any Federal Government procurement. For a procurement to be awarded through the 8(a) BD program, SBA's regulations at § 124.513 require SBA to approve the joint venture agreement prior to award and specify what must be included in the joint venture agreement. There has been some confusion as to whether the requirements for 8(a) joint venture agreements apply to non-8(a) procurements. SBA believes that any joint venture seeking to use the 8(a) mentor/protégé status as a basis for an exception to affiliation requirements must follow the 8(a) requirements (*i.e.,* it must meet the content requirements set forth in § 124.513(c) and the performance of work requirements set forth in § 124.513(d)). Although SBA does not approve joint venture agreements for procurements outside the 8(a) program, if the size of a joint venture claiming an exception to affiliation is protested, the requirements of § 124.513(c) and (d) must be met in order for the exception to affiliation to apply. The reason SBA's 8(a) regulations permit exceptions to affiliation on small business contracts outside the 8(a) program (*e.g.,* small business set asides, HUBZone set asides, service disabled veteran owned small business set asides) is to further assist protégé 8(a) BD Participants in their business development. If the requirements ensuring control and performance of work by the 8(a) protégé firm are not enforced, a large business would be able to have unchecked and inappropriate access to Federal procurements intended for small business. While this is not a change to how SBA has interpreted this regulation, SBA believes that it should be spelled out in the regulation to avoid any further confusion and, thus, clarifying language has been added to § 121.103(h)(3)(iii). SBA is also considering whether to limit the exclusion to affiliation for a joint venture that is comprised of a protégé firm and its SBA-approved mentor only to 8(a) contracts. If this proposal were adopted, mentor/protégé joint ventures for small business set aside contracts (or other small business contracts) would not receive an exclusion from affiliation. As such, if the mentor were a large business, the joint venture would be large and, thus, ineligible for a small business set aside contract. Proponents of this view believe that benefits for 8(a) firms should be limited to contracts obtained through the 8(a) program, and not extended to other small business programs. They believe that it is unfair for non-8(a) small business concerns to have to compete against a joint venture involving a protégé firm and a large mentor for small business contracts outside the 8(a) program. SBA specifically requests comments on whether this policy should be changed in a subsequent final rule.

Classification of a Procurement for Supplies

SBA's current regulations provide that acquisitions for supplies must be classified under the appropriate manufacturing NAICS code, not under a wholesale trade NAICS code. The fourth proposed change to the size regulations would clarify that a procurement for supplies also cannot be classified under a retail trade NAICS code.

Application of the Nonmanufacturer Rule

The fifth proposed change to the size regulations would provide further guidance to the current nonmanufacturer rule (*i.e.,* the rule that requires, in pertinent part, a firm that is not itself the manufacturer of the end item being procured to provide the product of a small business manufacturer). Several procuring agencies have misconstrued when to apply the nonmanufacturer rule. The proposed rule would explicitly state that the nonmanufacturer rule applies only where the procuring agency has classified a procurement as a manufacturing procurement by assigning the procurement a NAICS code under Sectors 31–33. It would also clarify that the nonmanufacturer rule does not apply to supply contracts that

do not involve manufacturing. For example, the nonmanufacturer rule would not apply to situations where a procuring agency is acquiring agricultural commodities that are not processed or changed and the procuring agency classifies the contract as crop production under NAICS Subsector 111.

In addition, the rule applies only to the manufacturing or supply component of a manufacturing procurement. The rule provides two examples to clarify SBA's position regarding the rule. Where a procuring agency has classified a procurement as a manufacturing procurement and is also acquiring services, the nonmanufacturer rule would apply to the supply component of that procurement only. In other words, a firm seeking to qualify as a small business nonmanufacturer must supply the product of a small business manufacturer (unless a nonmanufacturer waiver applies), but need not perform any specific portion of the accompanying services. Since the procurement is classified under a manufacturing NAICS code, it cannot also be considered a services procurement and, thus, the 50% performance of work requirement set forth in § 125.6 for services does not apply to that procurement. In classifying the procurement as a manufacturing/supply procurement, the procuring agency must have determined that the ''principal nature'' of the procurement was supplies. As a result, any work done by a subcontractor on the services portion of the contract cannot rise to the level of being ''primary and vital'' requirements of the procurement, and therefore cannot be the basis or affiliation as an ostensible subcontractor. Conversely, if a procuring agency determines that the ''principal nature'' of the procurement is services, only the requirements relating to services contracts apply. The nonmanufacturer rule, which applies only to manufacturing/supply contracts, would not apply. Thus, although a firm seeking to qualify as a small business with respect to such a contract must certify that it will perform at least 50% of the cost of the contract incurred for personnel with its own employees, it need not supply the product of a small business manufacturer on the supply component of the contract. In order to qualify as a nonmanufacturer, a firm must be primarily engaged in the retail or wholesale trade and normally sell the type of item being supplied. We are proposing to further define this statutory requirement to mean that the firm takes ownership or possession of the item(s) with its personnel, equipment or facilities in a manner consistent with industry practice. This change is primarily in response to situations where SBA has waived the nonmanufacturer rule and the prime contractor essentially subcontracts all services, such as warehousing or delivery, to a large business. Such an arrangement, where the prime contractor can legally provide the product of a large business and then subcontract all tangential services to a large business, is contrary to the intent and purpose of the Small Business Act, *i.e.,* providing small businesses with an opportunity to perform prime contracts. Such an arrangement inflates the cost to the Government of contract performance and inflates the statistics for prime contracting dollars awarded to small business, which is detrimental to other small businesses that are willing and able to perform Government contracts.

Request for Formal Size Determination

The sixth proposed change to the size regulations would amend § 121.1001(b) to give the SBA's Office of Inspector General (OIG) the authority to ask for a formal size determination. Because the OIG is not currently listed in the regulations as an individual who can request a formal size determination, the OIG must currently seek a formal size determination through the relevant SBA program office. SBA believes that the Inspector General should be able to seek a formal size determination when questions about a concern's size arise in the context of an investigation or other review of SBA programs by the Office of Inspector General.

Completion of Program Term

The first proposed change to SBA's 8(a) BD regulations is an amendment to the current rule to specify that a firm that merely completes its program term is not deemed to ''graduate'' from the 8(a) program. Pursuant to the Small Business Act, a Participant is considered to graduate only if it successfully completes the program by substantially achieving the targets, objectives, and goals contained in the concern's business plan, thereby demonstrating its ability to compete in the marketplace without 8(a) assistance. 15 U.S.C. 636(j)(10)(H). Sections 124.2, 124.301 and 124.302 would be amended to effect this change. In addition, the proposed rule would add a new § 124.112(f) to require SBA to determine if a firm should be deemed to graduate from the 8(a) BD program at the end of its nine-year program term. As part of the final annual review performed by SBA prior to the expiration of a Participant's nine-year program term, SBA would determine whether the firm has met the targets and objectives set forth in its business plan.

Definitional Changes

This rule would amend Section 124.3, to add a definition of NAICS code. Additionally, the term ''SIC code'' would be changed to ''NAICS code'' everywhere it appears in part 124 to take into account the replacement of the Standard Industry Classification (SIC) code system with the North American Industry Classification System. The NAICS code system is used to classify businesses for size purposes. Specifically, the term ''NAICS code'' would replace the term ''SIC code'' in §§ 124.110(c), 124.111(d), 124.502(c)(3), 124.503(b), 124.503(b)(1), 124.503(b)(2), 124.503(c)(1)(iii), 124.503(g)(3), 124.505(a)(3), 124.507(b)(2)(i), 124.513(b)(1), 124.513(b)(1)(i), 124.513(b)(1)(ii)(A), 124.513(b)(2), 124.513(b)(3), 124.514(a)(1), 124.515(d), 124.517(d)(1), 124.517(d)(2), 124.519(a)(1), 124.519(a)(2), 124.1002(b)(1), 124.1002(b)(1)(i), 124.1002(b)(1)(ii), and 124.1002(f)(3).

The rule also proposes to amend the definition of primary industry classification to specifically recognize that a Participant may change its primary industry classification over time. The rule would allow a Participant to change its primary industry classification from one NAICS code to another where it can demonstrate that the majority of its revenues during a two-year period have evolved from its former primary NAICS code to another NAICS code. The proposed rule would also add a new § 124.112(e) to permit a Participant to request a change in its primary industry classification with its servicing SBA district office where it can demonstrate that its revenues have in fact evolved from one NAICS code to another.

The rule would also add a definition of the term ''regularly maintains an office.'' This definition is important in determining whether a participant has a bona fide place of business in a particular geographic location. While the definition proposed is not a change in current SBA policy, SBA believes that the definition should be added to the regulations for clarity purposes. Under the proposed rule, a Participant would be deemed to regularly maintain an office in a particular location if it conducts business activities as an on-going business concern from a fixed location on a daily basis. The rule would also provide that the best evidence of the regular maintenance of an office is documentation that shows that third parties routinely transact

business with a participant at that location. Such evidence includes advertisements, bills, correspondence, lease agreements, land records, and evidence that the participant has complied with all local requirements concerning registering, licensing, or filing with the State or County where the place of business is located. This means that a firm would generally be required to have a license to do business in a particular location in order to ''regularly maintain an office'' there. The firm would not, however, be required to have a construction license or other specific type of license in order to regularly maintain an office and thus have a bona fide place of business in a specific location. SBA's bona fide place of business requirement is met with a license to do business generally. Whether a firm is or is not able to get a specific type of contract because it does not possess an additional license is not a bona fide place of business issue.

Size for Primary NAICS Code

This rule proposes to amend § 124.102(a) to require that a firm remain small for its primary NAICS code during its term of participation in the 8(a) BD program, and correspondingly to revise § 124.302 to permit SBA to graduate a Participant prior to the expiration of its program term where the firm exceeds the size standard corresponding to its primary NAICS code for two successive program years. SBA has historically permitted a firm to remain in the 8(a) program and receive 8(a) contracts in secondary NAICS codes as long as it remains small for such secondary codes. SBA has reexamined this policy and concluded that if a firm has grown to be other than small in its primary NAICS code, it can reasonably be said that the firm has achieved its goals and objectives. Understanding that the size of a firm can vary from year to year based on the receipts/number of employees in any given year, SBA is proposing that a firm be graduated early only where it exceeds the size standard for its primary NAICS code in two successive program years. SBA believes that it would be unfair to early graduate a firm from the 8(a) program where it has one very successful program year that may not again be repeated. This does not mean that a firm cannot change its primary NAICS code during its participation in the program. As noted in the Supplementary Information corresponding to the definition of primary industry classification in § 124.3, the proposed rule would authorize a firm to change its primary NAICS code by demonstrating that the majority of its revenues during a two-year period have evolved from its former primary NAICS code to another NAICS code. As such, SBA may early graduate a firm from the 8(a) BD program if the firm exceeds the size standard corresponding to its primary NAICS code (whether its initial primary NAICS code or a revised primary NAICS code) for two successive program years.

Economic Disadvantage

SBA proposes to amend § 124.104 *Who is Economically Disadvantaged?* to incorporate into the regulations certain interpretations and policies that have been followed informally by SBA. Some of these policies and regulatory interpretations are currently set forth in SBA's Standard Operating Procedures (SOPs) or in decisions rendered by the SBA Office of Hearings and Appeals (OHA). A sentence would be added to paragraph (b)(2) to clarify that SBA does not take community property laws into account when determining economic disadvantage. This means that property that is legally in the name of one spouse would be considered wholly that spouse's property, whether or not the couple lived in a community property state. Since community property laws are usually applied when a couple separates and since spouses in community states generally have the freedom to keep their property separate while they are married, SBA has decided to treat property owned solely by one spouse as that spouse's property for economic disadvantage determinations. This policy also results in equal treatment for applicants in community and non-community property states. Community property laws will continue to be applied in § 124.105(k) for purposes of determining ownership of an applicant or Participant firm, but they will not be applied for any other purpose. Paragraph (b)(2) would also be amended to provide that SBA may consider a spouse's financial situation in determining an individual's access to capital and credit. This addition reflects current practice.

Paragraph (c)(2) would be amended to exempt funds in Individual Retirement Accounts (IRAs) and other official retirement accounts from the calculation of net worth provided that the funds cannot currently be withdrawn from the account prior to retirement age without a significant penalty. Retirement accounts are not assets to be currently enjoyed, rather they are held for purposes of ensuring future income when an individual is no longer working. SBA believes it is unfair to count those assets as current assets. Through experience SBA has found that the inclusion of IRA's and other retirement accounts in the calculation of an individual's net worth does not serve to disqualify wealthy individuals from participation in the program; rather, it has worked to make middle and lower income individuals ineligible to the extent they have invested prudently in accounts to ensure income at a time in their lives that they are no longer working. SBA is cognizant of the potential for abuse of this proposed provision, with individuals attempting to hide current assets in funds labeled ''retirement accounts.'' Obviously, SBA does not believe such attempts to remove certain assets from an individual's economic disadvantage determination would be appropriate. Therefore, it has added the condition that in order for funds not to be counted in an economic disadvantage determination, the funds cannot be currently withdrawn from the account without a significant penalty. A significant penalty would be one equal or similar to the penalty assessed by the Internal Revenue Service for early withdrawal. In order for SBA to determine whether funds invested in a specific account labeled a ''retirement account'' may be excluded from an individual's net worth calculation, the individual must provide to SBA information about the terms and conditions of the account. SBA is interested in hearing from the public concerning this proposed revision, and specifically requests comments on how best to exclude legitimate retirement accounts without affording others a mechanism to circumvent the economic disadvantage criterion.

SBA is also proposing to amend paragraph (c)(2) to exempt income from an S Corporation from the calculation of both income and net worth to the extent such income is reinvested in the firm or used to pay taxes arising from the normal course of operations of an S corporation. Therefore, while the income of an S corporation flows through and is taxed to individual shareholders in accordance with their interest in the S corporation for Federal tax purposes, SBA will take such income into account for economic disadvantage purposes only if it is actually distributed to the particular shareholder. This change would result in equal treatment of corporate income for C and S corporations. In cases where that income is reinvested in the firm or used to pay taxes arising from the normal course of operations of the S corporation and not retained by the individual, SBA believes it should be treated the same as C corporation

income for purposes of determining economic disadvantage. In order to be excluded, the owner of the S corporation would be required to clearly demonstrate that he or she paid taxes of the S corporation or reinvested certain funds into the S corporation within 12 months of the distribution of income. Conversely, the owner of an S corporation could not subtract S corporation losses from the income paid by the S corporation to him/her or from the individual's total income from whatever source. S corporation losses, like C corporation losses, are losses to the company only, not losses to the individual, and based upon the legal structure of the corporation and the protections affording the principals through this structure, the individual is not personally liable for the debts representing any of those liabilities. Thus, it is inappropriate to consider these personal losses and individuals should not be able to use them to reduce their personal incomes.

A new paragraph (c)(3) would be added to provide that SBA would presume that an individual is not economically disadvantaged if his or her adjusted gross income averaged over the past two years exceeds $200,000. SBA considered incorporating into the regulation the present policy that an individual is not economically disadvantaged if his or her adjusted gross income exceeds that for the top two percent of all wage earners according to Internal Revenue Service (IRS) statistics. Under the current approach, SBA compares the income of the individual claiming disadvantage to the most currently available final IRS income tax return data. In some cases, SBA may be comparing IRS information relating to one tax year to an individual's income from a succeeding tax year because final IRS information is not available for that succeeding tax year. Although that policy has been upheld by SBA's OHA and the Federal courts (*see SRS Technologies* v. *United States,* 894 F. Supp. 8 (D.D.C. 1995); *Matter of Pride Technologies, Inc.,* SBA No. 557 (1996) SBA No. MSB–557), SBA believes that a straight line numerical figure is more understandable, easier to implement, and avoids any appearance of unfair treatment when statistics for one tax year are compared to an income level for another tax year. SBA is proposing an income level of $200,000 because that figure closely approximates the income level corresponding to the top two percent of all wage earners, which has been upheld as a reasonable indicator of a lack of economic disadvantage. Although a $200,000 income may seem unduly high as a benchmark, we note that this amount is being used only to presume, without more information, that the individual is not economically disadvantaged. We also note that average income for a small business owner is higher than average income for the population at large. SBA may consider incomes lower than $200,000 as indicative of lack of economic disadvantage. However, it would not presume lack of economic disadvantage in that case. It may also consider income in connection with other factors when determining an individual's access to capital. SBA specifically requests comments on both the straight line approach proposed and the current comparison of income levels to the IRS statistics. The rule also proposes to establish a two year average income level of $250,000 for continued 8(a) BD program eligibility. SBA believes that a higher income level may be more appropriate as a firm becomes more developed, but does not want to sanction too high a level. SBA requests comments on the $250,000 level, including whether the same $200,000 level should be used for both initial and continued 8(a) BD eligibility and whether some other level (*e.g.,* $225,000) should be used for continued eligibility.

The proposed regulation would permit applicants to rebut the presumption of lack of economic disadvantage upon a showing that the income is not indicative of lack of economic disadvantage. For example, the presumption could be rebutted by a showing that the income was unusual (inheritance) and is unlikely to occur again or that the earnings were offset by losses as in the case of winnings and losses from gambling resulting in a net gain far less than the actual income received. SBA may still consider any unusual earnings or windfalls as part of its review of total assets. Thus, although an inheritance of $5 million, for example, may be unusual income and excluded from SBA's determination of economic disadvantage based on income, it would not be excluded from SBA's determination of economic disadvantage based on total assets. In such a case, a $5 million inheritance would render the individual not economically disadvantaged based on total assets. This paragraph would also provide that S corporation income will not be considered in determining an individual's average income if the S corporation owner submits evidence that such income was reinvested in the firm or used to pay corporate taxes within 12 months of the distribution of income. Again, while the income of an S corporation flows through and is taxed to individual shareholders in accordance with their interest in the S corporation, SBA will take such income into account only if it is actually distributed to the particular shareholder.

This rule also proposes to amend § 124.104(c) to establish an objective standard by which an individual can qualify as economically disadvantaged based on his or her total assets. The regulations have historically authorized SBA to use total assets as a basis for determining economic disadvantage, but did not identify a specific level below which an individual would be considered disadvantaged. The regulations also did not spell out a specific level of total assets above which an individual would not qualify as economically disadvantaged. Although SBA has used total assets as a basis for denying an individual participation in the 8(a) BD program based on a lack of economic disadvantage, the precise level at which an individual no longer qualifies as economically disadvantaged is not certain. SBA's findings that an individual was not economically disadvantaged with total asset levels of $4.1 million and $4.6 million have been upheld as reasonable. *See Matter of Pride Technologies,* SBA No. 557 (1996), and *SRS Technologies* v. *U.S.,* 843 F. Supp. 740 (D.D.C. 1994). Alternatively, SBA's finding that an individual was not economically disadvantaged with total assets of $1.26 million was overturned. *See Matter of Tower Communications,* SBA No. 587 (1997). This rule proposes to eliminate any confusion as to what level of total assets qualifies as economic disadvantage for 8(a) BD purposes. Under the proposed rule, an individual would not be considered economically disadvantaged if the fair market value of all his or her assets exceeds $3 million at the time of 8(a) application and $4 million for purposes of continued 8(a) BD program participation. While the proposed rule would exclude retirement accounts from an individual's net worth in determining economic disadvantage, it would not exclude such amounts from the individual's total assets in determining economic disadvantage on that basis.

Changes to Ownership Requirements

SBA is proposing to amend § 124.105(g) governing ownership to provide more flexibility in determining whether to admit to the 8(a) program companies owned by individuals where such individuals have immediate family members who are owners of current or

former 8(a) concerns. The current rule provides that ‘‘the individuals determined to be disadvantaged for purposes of one Participant, their immediate family members, and the Participant itself, may not hold, in the aggregate, more than a 20 percent equity ownership interest in any other single Participant.’’ Because of the wording of that provision, SBA has been forced to deny 8(a) program admission to companies solely because the owners of those firms have family members who are disadvantaged owners of other 8(a) concerns. In some cases, the two firms are in different industries and are located in different parts of the country.

SBA believes that it serves no purpose to automatically disqualify a firm simply because the individual seeking to qualify the firm has an immediate family member already participating in the program. Although there may be situations in which SBA would choose to deny admission to a firm based on a family member's program participation, such a decision must necessarily be made on a case-by-case basis. For example, SBA may wish to deny admission to the program to a construction firm owned by a woman whose father owns an 8(a) firm in the construction industry where the program term of the father's firm is about to end, if it appears that the daughter does not have sufficient management experience to manage the firm and there are indications that the applicant is simply a front for the current firm.

In order to prevent disadvantaged individuals from using family members to extend their program terms and to prevent fronts, SBA proposes to amend § 124.105(g) to provide that an individual may not use his or her disadvantaged status to qualify a firm if such individual has an immediate family member who has used his or her disadvantaged status to qualify another firm for participation in the 8(a) BD program. However, the proposed rule will permit the SBA's Associate Administrator for Business Development (AA/BD) to waive this prohibition under certain circumstances. Those circumstances are similar to the clear line of fracture exception to the identity of interest rule in the size regulations.

SBA would waive the prohibition where there are no or negligible connections between the two firms, either in the form of ownership, control or contractual relations, and where the individual seeking to use his or her disadvantaged status to qualify the firm can demonstrate he or she has sufficient management and technical experience to operate the firm. If a firm seeking a waiver is in the same or similar line of business as a current or former 8(a) Participant of a family member, there would be a presumption against granting a waiver. The applicant must provide clear and compelling evidence that no connection exists between the two firms.

SBA believes that this narrow exception to the general prohibition against family members owning 8(a) concerns in the same or similar line of business will permit the Agency sufficient flexibility to admit firms where they are clearly operating separately and independently from the relative's firm. SBA also proposes to add a provision specifying that it may terminate an 8(a) concern for which it had granted a waiver if connections between the two firms become apparent (*e.g.,* sharing of employees, contractual relationships between the two firms) or if that firm begins to operate in the same or a similar line of business as the current or former 8(a) concern owned by the disadvantaged immediate family member.

SBA also proposes to amend § 124.105 to add a phrase that was inadvertently omitted from the current rule. The words ‘‘or a principal of such firm’’ were inadvertently omitted from § 124.105(h)(2) after the words ‘‘A non-Participant concern.’’ That provision prohibits concerns in the same or a similar line of business as an 8(a) concern from owning more than a 10 percent interest in an 8(a) concern in the developmental stage of program participation or more than a 20 percent interest in a Participant in the transitional stage of the program. The intent was to also prohibit principals of such concerns from owning these same percentages. However, the necessary language to effect this was inadvertently omitted. This omission is made particularly evident by the rule permitting former Participants and principals of former Participants to own up to 20 percent of a program Participant in the developmental stage of program participation and up to 30 percent of a Participant in the transitional stage. The anomalous result of the omission was to permit principals of non-8(a) concerns to own greater percentages of 8(a) firms in the same or similar line of business than principals of former 8(a) concerns even though the clear intent of the rule was to afford former 8(a) firms and their principals greater ownership rights. SBA has corrected that error in this proposed rule.

Changes to Control Requirements

SBA also proposes to amend § 124.106, which addresses control of an 8(a) applicant or Participant. SBA proposes to add an additional requirement to this section that the disadvantaged manager of an 8(a) applicant or Participant must reside in the United States and spend part of every month physically present at the primary offices of the applicant or Participant. This change is being proposed in response to a recent Small Disadvantaged Business (SDB) eligibility appeal before SBA's Office of Hearings and Appeals. In OHA's decision on that case, which was vacated on other grounds, the Administrative Judge held that a disadvantaged owner of a firm seeking SDB status controlled the firm from her residence in Paris, France. SBA believes that an individual seeking to qualify as eligible for the SBA's 8(a) BD program must reside in the United States. There is a presumption in the regulations for such residency, but it is not explicit. The regulations require an individual seeking 8(a) eligibility to be a citizen of the United States and individuals who are non-designated group members are required to establish their individual social disadvantage based on instances of bias or discrimination ‘‘in American society, not in other countries.’’ In addition, SBA believes that in order for an individual to exercise the requisite degree of control of an 8(a) firm, such individual must be physically present at the offices of the firm at least part of every month. In SBA's view, the potential for negative control is great when an individual on-site manager is relied on by an absent chief executive. The proposed rule would also add a conforming change to the general requirements for 8(a) BD eligibility contained in § 124.104(a) to recognize the residency requirement.

The Agency recognizes that the 21st century has created new opportunities for off-site management through the increased use of e-mail and overnight express and decreasing interstate and international telephone costs, and that these new and improved technologies enable managers to maintain control over the operations of their businesses without the need for a constant or consistent physical presence. Nevertheless, SBA believes that in order to prevent negative control and to ensure that the disadvantaged majority owner(s) are the true managers of the 8(a) concern or applicant, the disadvantaged manager must generally be present in the firm's primary offices at least part of every month and must be

able to physically reach the firm in a matter of a few hours from his or her residence should the need arise. SBA considered requiring physical presence by the individual(s) claiming disadvantaged status in the headquarters of the applicant or participant firm for a minimum amount of time each month (*e.g.,* 10 hours, 20 hours, or some other higher number of hours) and specifically asks for comments on whether such a requirement makes sense in today's world (and, if so, what should the minimum number of hours be) or whether control should be determined on a case-by-case basis. SBA also understands that any provision requiring presence in every month may be unworkable. With such a strict requirement, a disadvantaged owner who took a month-long vacation one year would be ineligible for continued 8(a) BD participation. As such, the proposed rule has the requirement that a disadvantaged owner must ''generally'' spend part of every month at the firm's principal office, imposing a monthly presence requirement while at the same time allowing for unusual circumstances in any given month.

Section 124.106 would also be amended by deleting the word ''such'' from the second sentence in the preamble of paragraph (e) so as to make clear that paragraphs (e)(1) and (e)(2) apply to all non-disadvantaged individuals and not just to those non-disadvantaged individuals involved in the management of an applicant or Participant or who are stockholders, partners, limited liability members, officers, or directors of the applicant or Participant. This change is needed to correct a misinterpretation of this regulation by SBA's Office of Hearings and Appeals (OHA). That decision, *In the Matter of Avasar Corporation,* No. 209 (August 24, 2004), incorrectly held that paragraphs (a)(1), (a)(2), and (a)(3) as well as paragraph (g) of § 124.106 concerning non-disadvantaged control, applied only to non-disadvantaged individuals involved in the management of an applicant or Participant, or stockholders, partners, limited liability members, officers, and/or directors of the applicant or Participant. The result of that decision was that under certain circumstances, non-disadvantaged individuals would be permitted to control an 8(a) concern. This is an absurd result and contrary to statute. The proposed change makes it clear that the above paragraphs apply to all non-disadvantaged individuals, regardless of their current or former relationship to the applicant or Participant.

The proposed rule would also add a new § 124.106(h) regarding control of an 8(a) BD Participant where a disadvantaged individual upon whom eligibility is based is a reserve component member in the United States military who has been called to active duty. Currently, there is no statutory or regulatory authority to permit such a firm to stay in the 8(a) BD program, whether on an active or inactive basis, while the individual upon whom eligibility is based is away from the firm for an extended period of time. Some have even questioned whether SBA should in fact terminate such a firm from the 8(a) BD program for failure to maintain control by one or more disadvantaged individuals. SBA believes that termination in these circumstances would be inappropriate. Specifically, the proposed rule would permit a Participant to designate one or more individuals to control its daily business operations during the time that a disadvantaged individual upon whom eligibility has been called to active duty in the United States military. The proposed rule would also amend § 124.305 to authorize the Participant to suspend its 8(a) BD participation during the active duty call-up period. If the Participant elects to designate one or more individuals to control the concern on behalf of the disadvantaged individual during the active duty call-up period, the concern will continue to be treated as an eligible 8(a) Participant and no additional time will be added to its program term. If the Participant elects to suspend its status as an eligible 8(a) Participant, the Participant's program term would be extended by the length of the suspension when the individual returns from active duty.

Benchmarks

The proposed rule would remove § 124.108(f), as well as other references to the achievement of benchmarks contained in §§ 124.302(d), 124.403(d), and 124.504(d). When these regulations were first implemented, the Department of Commerce was supposed to update industry codes every few years to determine those industries which minority contractors were underrepresented in the Federal market. It is SBA's view that because these industry categories have never been revised since the initial publication, references to them are outdated and should be removed.

Changes Applying Specifically to Tribally-Owned Firms

The Small Business Act permits 8(a) Participants to be owned by ''an economically disadvantaged Indian tribe (or a wholly owned business entity of such tribe).'' 15 U.S.C. 637(a)(4)(A)(i)(II). The term Indian tribe includes any Alaska Native village or regional corporation. 15 U.S.C. 637(a)(13). Pursuant to the Alaska Native Claims Settlement Act, a concern which is majority owned by an Alaska Native Corporation (ANC) is deemed to be both owned and controlled by Alaska Natives and an economically disadvantaged business. As such, ANCs do not have to establish that they are ''economically disadvantaged.'' Conversely, Indian tribes are not afforded the same automatic statutory economic disadvantage designation. Current § 124.109(b) requires tribes to demonstrate their economic disadvantage through the submission of data, including information relating to tribal unemployment rate, per capita income of tribal members, and the percentage of the tribal population below the poverty level. SBA requests comments on how best to determine whether a tribe should be considered ''economically disadvantaged.'' Some have advocated a bright line assets or net worth test for tribes. SBA is not convinced that such a test truly captures the economic disadvantage status of a tribe. SBA continues to believe that the factors set forth in current § 124.109(b)(2) paint a truer picture, but specifically requests comments from tribes on this issue. The current regulation also requires a tribe to demonstrate its economic disadvantage only once. SBA also requests comments regarding whether this one time demonstration of economic disadvantage makes sense.

The proposed rule would also amend § 124.109(c)(3)(ii) to more clearly define the type of work that a tribally-owned firm may perform in the 8(a) program. One of the goals of the 8(a) BD program is to develop businesses to the point where they can be independent, viable businesses when they graduate or otherwise leave the 8(a) BD program. In order to encourage a tribally-owned firm to continue to operate as an independent business after it leaves the 8(a) BD program, SBA has prohibited for many years a tribally-owned applicant from having the same primary NAICS code as another firm in the 8(a) BD program owned by the same tribe or one that has left the program within the last two years. It could perform secondary work in such a NAICS code, but it could not duplicate the primary NAICS code of another or recently former tribally-owned 8(a) Participant. SBA believed that this requirement would encourage tribes to expand their business activities

by having two or more viable businesses doing separate and distinct work. In some cases, however, SBA admitted a second tribally-owned firm into the 8(a) BD program under one primary NAICS code and it immediately began to perform all or most of its work in a NAICS code that was the primary NAICS code of a firm owned by the tribe that recently graduated from the 8(a) BD program. This is not what SBA envisioned. Again, the purpose of the 8(a) BD program is to promote business development. Having one business take over work previously performed by another does not advance the business development of two distinct firms. In order to further encourage the continued, long-term viability of two separate businesses, this rule proposes that a newly certified tribally-owned Participant cannot receive an 8(a) contract in a secondary NAICS code that is the primary NAICS code of another Participant (or former participant that has left the program within two years of the date of application) owned by the tribe for a period of two years from the date of admission to the program. SBA also considered allowing such secondary work on a limited basis (*e.g.,* no more than 20% or 30% of its 8(a) work could be in a NAICS code that was/is the primary NAICS code of a former/other tribally-owned Participant). SBA seeks comments on both approaches.

SBA also proposes to delete the word ''disadvantaged'' in § 124.109(c)(4) to make clear that any tribal member may participate in the management of a tribally-owned firm and need not individually qualify as economically disadvantaged. Under current rules, a tribal member would generally have to qualify as economically disadvantaged to run the daily business operations of a tribally-owned concern. Tribal representatives emphasized the need for this change to enable them to attract the most qualified tribal members to assist in running tribal businesses and further allow them to assist economic and community development through their tribally-owned concerns. SBA agrees that the current rule is overly restrictive and proposes this change. This change would also eliminate the requirement that directors and officers must submit copies of their individual tax returns to establish their economic disadvantage. If, however, there is a question as to whether an individual filed taxes, SBA could request proof of payment of taxes to satisfy the good character requirement. SBA also requests specific comments on whether the individuals involved in the management of a tribally-owned concern should be members of the tribe that owns the concern or, in the alternative, whether membership in any tribe should suffice. Currently, the regulations generally require management by individuals who are members of the tribe that owns the concern. SBA requests comments on whether that is too restrictive for the tribal community.

This rule also proposes to clarify the potential for success requirement for tribally-owned applicants contained in § 124.109(c)(6). SBA believes that the current regulation does not adequately capture the realities of tribally-owned firms. In substantial part, the current regulation for potential for success applicable to tribally-owned firms is the same as that applicable to firms owned by socially and economically disadvantaged individuals. Under the current rule, the firm must generally be in business for two years and have revenues in its primary industry classification. A firm that is in business for less than two years may be deemed to possess the necessary potential for success if the individuals who manage and control its daily operations have substantial technical and managerial experience, the applicant has a record of successful performance on contracts in its primary industry category, and the applicant has adequate capital to sustain its business operations. SBA believes that those two approaches continue to be valid ways to find that a tribally-owned firm meets the potential for success requirement. In addition, SBA believes that a third basis to find potential for success should be made available to tribally-owned firms. It is undisputed that a firm owned by a tribe may have financial and physical resources available to it that a firm owned by one or more disadvantaged individuals may not have. While a firm owned by disadvantaged individuals is designed to make a profit and its survivability depends on its ability to do so, that is not necessarily the case for a tribally-owned concern. The purpose of a tribally-owned concern may be to increase tribal employment, assist in tribal community development, or serve other tribal needs. If a tribe pledges to use the resources of the tribe to support an applicant concern and to not allow that concern to cease its operations, SBA believes that the concern should be deemed to meet the potential for success requirement. As such, this rule proposes to find potential for success where a tribe has made a firm written commitment to support the operations of the applicant concern and the tribe has the financial ability to do so.

The Government Accountability Office (GAO) and SBA's Office of Inspector General have recently reviewed participation in the 8(a) BD program by firms owned by ANCs. These reviews questioned certain aspects of SBA's oversight of ANC-owned firms. In particular, there was a concern that SBA did not adequately track the extent to which the benefits of the 8(a) BD program reached individual Alaska natives or the native community. As such, SBA proposes to amend the requirements for annual reviews contained in § 124.112(b) to require the submission of such information. SBA also believes that the same reporting requirements should apply to 8(a) Participants owned by tribes, Native Hawaiian Organizations (NHOs), and Community Development Corporations (CDCs). Specifically, the proposed rule would require each Participant owned by a tribe, ANC, NHO or CDC to submit information showing how its 8(a) participation has benefited the tribal or native members and/or the tribal, native or other community as part of its annual review submission. The firm should submit information relating to funding cultural programs, employment assistance, jobs, scholarships, internships, subsistence activities, and other services to the affected community.

Excessive Withdrawals

The proposed rule would also amend § 124.112(d) requiring what amounts should be considered excessive withdrawals, and thus a basis for possible termination or early graduation. SBA believes that the current definition of withdrawal unreasonably restricts Participants. For example, by including the income of all officers and all bonuses, a Participant is hampered in its ability to recruit and retain key employees or to pay fair wages to its officers. Under the current regulation, if the income of all officers in the aggregate exceeds $300,000 for a multimillion dollar firm, the income alone would be deemed ''excessive'' and could be a basis for termination or early graduation. SBA believes that this does not make sense, particularly in light of the income level permitted in determining economic disadvantage. In determining whether an individual is economically disadvantaged, SBA has determined that individuals claiming disadvantage may earn income of up to $200,000 without jeopardizing their economic disadvantage status for initial eligibility, and as noted above, up to $250,000 for continued 8(a) BD program eligibility. As such, a firm could pay two officers $175,000 each and those

officers would be deemed economically disadvantaged under the regulations, but in doing so, the firm would also be deemed to have made excessive withdrawals to those two individuals and be a possible basis for termination or early graduation. SBA also believes that the definition of withdrawal restricts a Participant from exercising business judgment in the operation of the concern. SBA's intent when the definition was initially promulgated was to prevent a ''cashing out'' of earnings from the Participant by its owners or managers. Thus, this rule proposes to modify the definition of withdrawal to generally eliminate the inclusion of officers' salaries within the definition of the term withdrawal. The rule also proposes to generally exclude other items currently included within the definition of withdrawal. SBA acknowledges, however, that some firms may try to circumvent the excessive withdrawal limitations through the distribution of salary or by other means. To take that possibility into account, the proposed rule would authorize SBA to look at the totality of the circumstances in determining whether to include a specific amount as a ''withdrawal.'' If SBA believes that a firm is attempting to get around the excessive withdrawal limitations though the payment of officers' salaries, SBA would count those salaries as withdrawals in such a situation.

The rule also would amend § 124.112(d)(3) pertaining to withdrawal thresholds for purposes of determining whether the withdrawal is in fact excessive. The proposed rule would amend § 124.112(d)(3) to increase the current ''excessive'' amounts by $50,000 at the two lower levels, and by $100,000 for the highest level. Thus, for firms with sales of less than $1,000,000 the excessive withdrawal amount would be $200,000 instead of $150,000, for firms with sales between $1,000,000 and $2,000,000 the excessive withdrawal amount would be $250,000 instead of $200,000, and for firms with sales exceeding $2,000,000 the excessive withdrawal amount would be $400,000 instead of $300,000. SBA also asks for comments as to whether the excessive withdrawal level for higher revenue firms should be tied to each owner or officer of the firm instead of to the firm as a whole, and, if so, what level should be deemed excessive for an individual.

Applications to the 8(a) BD Program

The proposed rule would make minor changes to §§ 124.202, 124.203, 124.204 and 124.205 to emphasize SBA's preference that applications for participation in the 8(a) BD program be submitted in an electronic format. The use of the electronic application not only reduces the administrative burden on SBA, but is reflective of a government-wide shift to use electronic applications and forms whenever possible. Entering the application online is the most efficient method to apply for 8(a) BD program participation since it allows SBA to promptly process the application once the supporting documentation is received. Most importantly, prior to entering the information into the online 8(a) BD application, the system reminds the applicant to enter/update the firm's Central Contractors Registration (CCR) and Dynamic Small Business Search (DSBS) profiles. The information in these databases ensures that the firm's capabilities are advertised to any Federal, State or local government, prime contractor, or other business organization looking for the capabilities the firm offers. The proposed rule permits a concern that does not have access to the electronic format or does not wish to file an electronic application to request a hard copy application from the AA/BD. The rule also clarifies that in all cases (whether an electronic or hard copy application is filed) those individuals claiming disadvantage status must submit wet signatures as part of the application.

The proposed rule would also change the location for SBA's initial review of applications from ANC-owned firms. The current regulation specifies that SBA's Anchorage, Alaska District Office would initially review all applications from ANC-owned applicants. SBA believes that the San Francisco DPCE unit is better suited to receive and review applications from ANC-owned applicants because it has more knowledge of SBA's eligibility requirements, in addition to having knowledge of issues specific to ANC-owned firms. As such, the proposed rule would provide that applications for 8(a) BD certification from ANC-owned firms will be reviewed and processed by the San Francisco DPCE unit. SBA would have the discretion to require an ANC-owned applicant to submit its application to the Philadelphia DPCE unit in appropriate circumstances, such as where there is an uneven distribution of applications and the San Francisco DPCE unit as a backlog of cases while the Philadelphia DPCE unit does not.

SBA is also proposing to add a new paragraph to § 124.204, which governs application processing, to clarify that the burden of proof to demonstrate eligibility for participation in the 8(a) BD program is on the applicant and to permit SBA to presume that information requested but not submitted would be adverse. Under the proposed regulation, if SBA makes a specific request for relevant information and that information is not provided, SBA may presume that the information would be adverse to the firm and conclude that the firm has not demonstrated eligibility in the area to which the information relates. A similar provision has existed as part of SBA's size regulations for many years and is cited regularly in SBA size determinations.

Graduation

Section 124.301 and 124.302 would be amended to utilize the terms ''early graduation'' and ''graduation'' in a way that matches the statutory meaning of those terms. *See* amendment to § 124.2, explained above.

Termination From the 8(a) BD Program

The proposed rule would amend three paragraphs in § 124.303 regarding termination from the 8(a) BD program. Section 124.303(a)(2) would be amended to specifically clarify that a Participant could be terminated from the program where an individual owner or manager exceeds any of the thresholds for economic disadvantage (*i.e.,* net worth, personal income or total assets), or is otherwise determined not to be economically disadvantaged, where such status is needed for the Participant to remain eligible, and where the Participant has not met the targets and objectives set forth in its business plan. This regulatory change is needed to rectify a decision made by SBA's OHA in the case of *Digital Management, Inc.,* SBA No. BDP–288 (2008). The Small Business Act provides, in pertinent part, that ''[i]f the [SBA] determines * * * that a Program Participant and its disadvantaged owners are no longer economically disadvantaged for the purpose of receiving assistance * * * the Program Participant shall be graduated'' from the 8(a) BD program. 15 U.S.C. 637(a)(6)(C)(ii). In addition, as noted above, the Small Business Act provides that ''the term 'graduated' or 'graduation' means that the Program Participant is recognized as successfully completing the program by substantially achieving the targets, objectives, and goals contained in the concern's business plan thereby demonstrating its ability to compete in the marketplace without assistance * * *'' 15 U.S.C. 636(j)(10)(H). In *Digital Management,* the individual upon whom 8(a) BD eligibility was based no longer qualified as economically disadvantaged. Because the Participant firm had not yet met the targets, objectives, and goals contained

in its business plan, SBA did not believe that early ''graduation'' was required, and instead commenced proceedings to terminate the Participant from the 8(a) BD program. The basis for the termination action was the Participant's failure to maintain its eligibility for program participation, as set forth in current § 124.303(a)(2). OHA ruled that termination was inappropriate and that the SBA should have utilized the early graduation procedures. SBA believes that early graduation was not mandated under 15 U.S.C. 637(a)(6)(C)(ii) because SBA had not determined that both the Program Participant and its disadvantaged owners were no longer economically disadvantaged, but rather that only the disadvantaged owner was no longer economically disadvantaged. The SBA's early graduation regulations at § 124.302(a)(2) authorize early graduation where one or more disadvantaged owners upon whom eligibility is based are no longer economically disadvantaged, but do not require it. While SBA must early graduate a firm from the 8(a) BD program where one or more disadvantaged individuals upon whom eligibility is no longer economically disadvantaged and where the firm has met the targets, objectives and goals set forth in its business plan, SBA believes that it has the discretion to either terminate or early graduate a firm where one or more owners claiming disadvantaged status are no longer economically disadvantaged, but the firm has not met the targets, objectives and goals set forth in its business plan. This proposed change would more clearly provide for that discretion.

Section 124.303(a)(13) would be amended to be consistent with the proposed changes to § 124.112(d)(13) regarding excessive withdrawals being a basis for termination.

Section 124.303(a)(16) would be amended to remove the reference to part 145, a regulatory provision that addresses nonprocurement debarment and suspension that was moved to 2 CFR parts 180 and 2700.

Effect of Early Graduation or Termination

SBA also proposes to amend § 124.304(f) regarding the effect an early graduation or termination would have. When SBA early graduates or terminates a firm from the 8(a) BD program, proposed § 124.304(f)(2) would generally not permit the firm to self certify that it qualifies as an SDB for future procurement actions. If the firm believes that it does qualify as an SDB and seeks to certify itself as an SDB, the firm must notify the contracting officer that SBA early graduated or terminated the firm from the 8(a) BD program. The firm must also demonstrate either that the grounds upon which the early graduation or termination was based do not affect its status as an SDB, or that the circumstances upon which the early graduation or termination was based have changed and the firm would now qualify as an SDB. For example, if SBA terminates a firm from the 8(a) BD program for a persistent pattern of failing to provide required financial information, the reason for termination would not be connected to ownership, control, social disadvantage or economic disadvantage. As such, the firm could continue to qualify as an SDB, without making any changes to its business structure or management. Whenever a firm notifies a contracting officer that it has been terminated or early graduated by SBA along with its SDB certification, the contracting officer must protest the SDB status of the firm so that SBA can make a formal eligibility determination.

Suspensions for Call-Ups to Active Duty

As noted above, the proposed rule would amend § 124.305 to permit SBA to suspend an 8(a) Participant where the individual upon whom eligibility is based can no longer control the day-to-day operations of the firm because the individual is a reserve component member in the United States military who has been called to active duty. Suspension in these circumstances is intended to preserve the firm's full term in the program by adding the time of the suspension to the end of the Participant's program term when the individual returns to control its daily business operations. Suspension would not be needed where one or more additional disadvantaged individuals remain to control the Participant after the reservist's call-up to active duty, or where the Participant elects to designate a non-disadvantaged individual to control the concern during the call-up period pursuant to proposed § 124.106(h). In such a case, the firm would remain an active Participant in the 8(a) BD program and could continue to receive new 8(a) contracts and other program assistance.

Task and Delivery Order Contracts

SBA is proposing to amend § 124.503(h), which addresses task and delivery order contracts. Agencies are increasingly reserving prime contract awards for small business concerns under multiple award solicitations that are competed on a full and open basis. Agencies are also awarding multiple award contracts that provide that competition for certain orders will be limited based on socio-economic status, including status as an 8(a) concern. Historically, agencies could count an order towards their 8(a) prime contracting goals only if the contract under which the order was placed was awarded either sole source or based on competition limited exclusively to 8(a) concerns. Over the years, the 8(a) BD program office has received numerous requests from procuring agencies to receive 8(a) credit for orders awarded to 8(a) concerns under contracts that were not set aside for exclusive competition among 8(a) concerns. On June 7, 2000, SBA entered into a Memorandum of Understanding (MOU) with the General Services Administration which allowed ordering agencies to receive 8(a) credit for orders awarded to 8(a) concerns under full and open Multiple Award Schedule contracts. That MOU expired on September 30, 2003. SBA had concerns with renewing the MOU as written because it did not provide for competition solely among eligible 8(a) firms as required by the Small Business Act for 8(a) competitive awards. SBA has also authorized other agencies to take 8(a) credit for orders placed with 8(a) concerns under full and open multiple award contracts, based on the procedures applicable to the particular multiple award procurement. In order to help 8(a) concerns compete in the current multiple-award contracting environment, SBA is proposing to amend § 124.503(h) to allow agencies to receive 8(a) credit for orders placed with 8(a) concerns under contracts that were not set aside for 8(a) concerns as long as the order is offered to and accepted for the 8(a) BD program and competed exclusively among eligible 8(a) concerns, and as long as the limitations on subcontracting provisions apply to the individual order. To be an ''eligible'' 8(a) concern, the firm must be a current Participant in the 8(a) BD program as of the date specified for receipt of offers contained in the solicitation for the order and otherwise meet the requirements set forth in § 124.507(b)(2). This proposed change would merely allow contracting officers the discretion to reserve orders for 8(a) concerns if they so choose. This rule would not require any contracting officer to make such a reservation. If a contracting officer chose not to reserve a specific order for 8(a) concerns (*e.g.,* if a contracting officer went to an 8(a) firm, a small business, and a large business off a schedule or otherwise competed an order among 8(a) and one or more non-8(a) concerns), the contracting officer

could continue to take SDB credit for the award of an order to an 8(a) firm.

Barriers to Acceptance and Release From the 8(a) BD Program

Current § 124.504(a) provides that SBA will not accept a procurement for award through the 8(a) BD program where a procuring activity has issued a solicitation for or otherwise expressed publicly a clear intent to reserve the procurement as a small business or SDB set-aside prior to offering the requirement to SBA for award as an 8(a) contract. This regulation was written prior to legislation authorizing HUBZone and service disabled veteran-owned (SDVO) small business contracts, either through set-asides or where appropriate on a sole source basis. As such, this rule proposes to add a provision limiting SBA's ability to accept a requirement for the 8(a) BD program where a procuring agency expresses a clear intent to make a HUBZone or SDVO small business award. In addition, the reference to SDB set-asides would be eliminated as that provision is no longer applicable.

This rule also proposes to amend § 124.504(e), regarding the release of follow-on procurements from the 8(a) BD program. It has always been SBA's policy, and implicit in the regulations, that once a requirement is awarded as an 8(a) contract, any follow-on procurement should generally also be awarded as an 8(a) contract. SBA's regulations for both the HUBZone and service disabled veteran-owned small business programs address the release of requirements from the 8(a) BD program to those programs where no 8(a) firm can currently perform the contract. The 8(a) BD regulations did not specifically address release of requirements other than those where a firm is graduating from the program and needs the follow-on contract to further its business development. As such, the proposed rule would require that follow-on or repetitive 8(a) procurements would generally remain in the 8(a) BD program unless SBA agrees to release them for non-8(a) competition. If a procuring agency would like to fulfill a follow-on or repetitive acquisition outside of the 8(a) BD program, it must make a written request to and receive the concurrence of the AA/BD to do so. Release may be based on an agency's achievement of its SDB goal, but failure to achieve its HUBZone or SDVO goal, where the requirement is not critical to the business development of the 8(a) Participant that is currently performing the requirement or another 8(a) BD Participant. The requirement that a follow-on procurement must be released from the 8(a) BD program in order for it to be fulfilled outside the 8(a) BD program would not apply to orders offered to and accepted for the 8(a) BD program pursuant to § 124.503(h).

Competitive Threshold Amounts

SBA is also proposing to amend § 124.506. That regulation addresses the dollar threshold for competing 8(a) procurements among eligible Participants and provides generally that a procurement offered and accepted for award through the 8(a) BD program must be competed among eligible Program Participants if the anticipated award price of the contract, including options, will exceed $5,000,000 for manufacturing contracts and $3,000,000 for all other contracts. In 2004, Congress passed new legislation requiring an inflationary adjustment of statutory acquisition-related dollar thresholds every five years. *See* 41 U.S.C. § 431a. On September 28, 2006, the Federal Acquisition Regulation (FAR) Council published in the **Federal Register** a final rule implementing 41 U.S.C. § 431a 71 Fed. Reg. 57363. With respect to the 8(a) BD competitive threshold, the final rule amended FAR § 19.805–1 by ''removing from paragraph (a)(2) '$5,000,000' and '$3,000,000' and adding '$5.5 million' and '$3.5 million', respectively, in their place.'' This rule would incorporate the FAR changes into SBA's regulations, so that the revised SBA regulation would also set the competitive threshold amounts at $5,500,000 and $3,500,000, respectively.

Based on statute, the regulation further provides an exemption from the competition requirement for 8(a) Participants owned and controlled by Indian tribes and Alaska Native Corporations (ANCs). Contracts may be awarded through the 8(a) BD program on a sole source basis to tribally or ANC-owned concerns above the competitive threshold amounts if the procuring agency believes the firm is responsible to perform the contract and SBA has not already accepted the requirement into the 8(a) program as a competitive procurement, and adverse impact analyses, as appropriate, have been conducted. *See* 13 CFR 124.506(b).

Historically, SBA has permitted sole source 8(a) contracts above the competitive threshold amounts both directly to 8(a) Participants owned and controlled by tribes or ANCs and to joint ventures with one or more tribally or ANC-owned 8(a) Participants. There have been complaints that non-8(a) firms have received substantial benefits through the performance of large sole source 8(a) contracts as joint venture partners with tribally-owned and ANC-owned 8(a) firms. The perception of impropriety has been even greater where the joint venture partner is a large business that performs a significant portion of the 8(a) contract. Under SBA's regulations, a joint venture between an 8(a) firm and any business that SBA has approved as the 8(a) firm's ''mentor'' is considered to be small for a particular contract opportunity if the 8(a) firm (*i.e.,* the protégé) qualifies as small for the size standard corresponding to the requirement. Thus, a joint venture between a large business mentor and an 8(a) protégé is considered to be a small business for any contract for which the protégé qualifies as small. This provision currently applies to all Government contracts, including sole source 8(a) contracts above the competitive threshold amounts where the protégé firm is a tribally-owned or ANC-owned concern.

In addition, pursuant to SBA's current regulations, where SBA approves a joint venture for a particular 8(a) contract, the joint venture, and not the individual 8(a) Participant(s), must meet the applicable performance of work requirement (*e.g.,* the joint venture as a whole must perform at least 50% of the contract), and the 8(a) Participant(s) must perform ''a significant portion'' of the contract. In the context of a joint venture between a tribally-owned or ANC-owned protégé and its large business mentor for a sole source contract above the competitive threshold amounts, there is a perception that large businesses may be unduly benefiting from the 8(a) program where the large business is performing a significant amount of work under the contract. This is particularly true where a large business mentor also acts as a subcontractor to the prime joint venture contractor in addition to its role as joint venture partner. In such a case, a joint venture between a protégé firm and its large business mentor could agree to perform 50% of the work through the joint venture entity (with the 8(a) protégé firm performing close to half of that work) and then subcontract the remaining 50% to the large business mentor in its individual capacity. In this scenario, a large business would be performing 70–80% of a large 8(a) contract, while the protégé firm would be performing somewhere in the 20–30% range of the contract. Even though that 20–30% could be a significant amount of work for a developing protégé firm, SBA does not believe that it is appropriate for a large business to benefit to such an extent through an 8(a) contract, particularly where that

contract is awarded on a sole source basis.

SBA recognizes that the mentor/protégé aspect of the 8(a) BD program can be an important component to the overall business development of 8(a) small businesses. However, SBA does not believe that non-8(a) businesses, particularly non-8(a) large businesses, should benefit more from an 8(a) contract than 8(a) protégé firms themselves. As such, this rule proposes that non-8(a) joint venture partners to 8(a) sole source contracts cannot also be subcontractors under the joint venture prime contract. If a non-8(a) joint venture partner seeks to perform more work under the contract, then the amount of work done by the 8(a) partner to the joint venture must also increase. Because of the proposed change to § 124.513(d) contained in this rule (which would require the 8(a) partner(s) to a joint venture to perform at least 40% of the work performed by the joint venture), the additional amount of work required to be performed by the 8(a) partner(s) to a joint venture would be spelled out.

The proposed change to disallow subcontracts to non-8(a) joint venture partners is not meant to penalize tribal and ANC 8(a) firms, but, rather, to ensure that the benefits of the program flow to its intended beneficiaries. SBA consulted with ANC and tribal groups, both informally and formally, in drafting this proposal. These groups felt that both the 8(a) program generally and tribal and ANC-owned Participants in particular had received unfair criticism, but understood the negative perception surrounding the performance of 8(a) contracts where the majority of the contract is ultimately performed by a non-8(a), large business. While they supported some change to eliminate abuse in the program, they felt strongly that the mentor/protégé joint venture program served an important function. They believed that protégé firms gained invaluable developmental assistance through this program and did not want to see it unduly restricted or eliminated. SBA considered several other alternatives to this proposal, including eliminating joint ventures on sole source awards above the competitive threshold amounts, requiring a majority of subcontract dollars under a sole source 8(a) joint venture contract between a protégé firm and its mentor to be performed by small businesses, and allowing sole source joint venture contracts above the competitive threshold amounts only where the 8(a) partner(s) to the joint venture performed a specified percent (*e.g.,* 40%) of the entire contract itself. SBA has attempted to address the perceived abuse without unduly limiting this important business development tool. SBA specifically requests comments on how best to limit sole source awards to ensure that program benefits flow to the intended beneficiaries, including comments on each of the three identified alternatives. SBA also requests comments on whether it should extend the prohibition against non-8(a) joint venture partners from also being subcontractors under the joint venture prime contract beyond sole source contracts and whether it should be applied to all 8(a) contracts awarded to any joint venture.

SBA proposes to further amend § 124.506(b) to implement a provision contained in § 8021 of the Department of Defense (DoD) appropriations act for fiscal year (FY) 2004. That provision gave DoD agencies the authority to make sole source awards for 8(a) contracts above the competitive threshold amounts to 8(a) concerns owned and controlled by Native Hawaiian Organizations (NHOs). *See* Public Law 108–87, 117 Stat. 1054. However, the statute limited the exemption to contracts issued by DoD. This authority was initially tied to specific appropriations, and hence limited in duration. The words ''and hereafter'' were included in Section 8020 of the DoD Emergency Supplemental Appropriation to Address Hurricanes in the Gulf of Mexico, and Pandemic Influenza Act, 2006, Pub. L. 109–148, 119 Stat. 2680, 2702, making this authority permanent. The proposed addition to § 124.506(b) implements the statutory authority.

Bona Fide Place of Business

The proposed rule would also amend the bona fide place of business requirements set forth in § 124.507. Certain 8(a) contracts are restricted to 8(a) Participants having a ''bona fide place of business'' within a particular geographic location. There has been some confusion regarding the procedures a Participant must follow to establish a bona fide place of business in a new location. This rule clarifies that a Participant must first submit its request to be recognized as having a bona fide place of business in a different location to the SBA district office that normally services it. This will ensure that there is proper coordination between the two SBA district offices. The servicing district office will forward the request to the SBA district office serving the geographic area of the particular location for processing. The SBA district office in the geographic location of the purported bona fide place of business will then contact the Participant and may ask for further information in support of the Participant's claim. In order for a Participant to establish a bona fide place of business in a particular geographic location, the SBA district office serving the geographic area of that location must determine if that location in fact qualifies as a bona fide place of business under SBA's requirements. A Participant cannot submit an offer for an 8(a) procurement limited to a specific geographic area unless it has received from SBA a determination that it has a bona fide place of business within that area. In other words, eligibility in terms of having a bona fide place of business in a particular geographic location will be determined at the time a Participant submits its offer. This coincides with the time at which size status is determined.

Competitive Business Mix

Section 124.509(a)(1) would also be amended to clarify that work performed by an 8(a) Participant for any Federal department or agency other than through an 8(a) contract, including work performed on orders under the General Services Administration (GSA) Multiple Award Schedule program, and work performed as a subcontractor, including work performed as a subcontractor to another 8(a) Participant on an 8(a) contract, qualifies as work performed outside the 8(a) BD program. Several 8(a) Participants specifically questioned whether orders off the GSA Schedule and subcontracts on 8(a) contracts counted against their competitive business mix requirement. SBA believes that the current regulation clearly provides that only 8(a) contract awards count against a Participant's competitive business mix. Nevertheless, to avoid any confusion, SBA has clarified that all Federal contracts other than 8(a) contracts, and any subcontract to a Federal contract, including a subcontract to an 8(a) contract, do not count against the firm's competitive business mix. Such revenue is not an 8(a) award to the Participant and, thus, cannot act to limit further sole source 8(a) awards.

Administration of 8(a) Contracts

The proposed rule would also add clarifying language to § 124.512. Administration of 8(a) contracts has been delegated to procuring agencies. The current regulation specifies that the procuring activity is accountable for ''all responsibilities for administering an 8(a) contract.'' Despite this broad language, the Government Accountability Office (GAO) and others have asked what role

SBA plays in tracking whether an 8(a) firm has met the performance of work requirements set forth in § 124.510 throughout the life of an 8(a) contract. As part of contract administration, compliance with the performance of work requirements is a responsibility of the procuring activity. While SBA believed that was clear from the current broad regulatory language, the proposed rule would specifically recognize that tracking compliance with the performance of work requirements is a contract administration function which is performed by the procuring activity. Also included within the delegation of contract administration is the authority to exercise priced options and issue appropriate modifications. The regulation has required contracting officers who issued modifications or exercised options on 8(a) contracts to notify SBA of these actions. Because there was no clear guidance as to when SBA must be notified, there was often a delay between the issuance of a modification (or exercise of an option) and notification being supplied to SBA. This proposal would require contracting officers to submit copies of modifications and options to SBA within 10 days of their issuance or exercise. If SBA has a question regarding whether a particular 8(a) contractor has complied with applicable regulatory requirements, the proposed rule would specifically authorize SBA to review the procuring activity's 8(a) contracting files.

Changes to Joint Venture Requirements

This rule would also amend § 124.513(c)(3) to provide that the 8(a) Participant(s) to an 8(a) joint venture must receive profits from the joint venture commensurate with the work performed by the 8(a) Participant(s). Currently, SBA's regulations provide that the 8(a) Participant(s) must receive at least 51% of the net profits of the joint venture. SBA believes that such a requirement may be untenable where more work is done by a non-8(a) joint venture partner than the 8(a) Participant partner(s). Under current regulations, the joint venture must perform at least 50% of an 8(a) contract and the 8(a) Participants must perform a significant portion of the amount performed by the joint venture. If, for example, a joint venture will perform 60% of an 8(a) contract, with the 8(a) partner performing 25% of the contract and the non-8(a) partner performing 35% of the contract, it does not make sense that the 8(a) partner should receive at least 51% of the net profits of the joint venture where it is performing less than the non-8(a) firm on the contract. SBA understands the concern that 8(a) firms should receive their fair share of the profits from such a joint venture, and believes that profits commensurate with the work performed should ensure this result.

SBA also proposes to amend the requirement setting forth the amount of work that an 8(a) Participant must perform as part of a joint venture. Sections 124.510 and 125.6 of SBA's regulations require that the 8(a) Participant being awarded an 8(a) contract must perform a specific amount of work on the contract (generally at least 50%). For a joint venture on an 8(a) contract, § 124.513(d) requires that the joint venture perform the applicable percentage of work set forth in § 124.510 and that the 8(a) Participant(s) to the joint venture must perform a ''significant portion'' of the contract. The term ''significant portion'' was not defined in SBA's regulations. As such, various procuring agencies and SBA field offices interpreted this requirement differently. This rule proposes to impose a more objective requirement. Specifically, the rule proposes that the 8(a) Participant(s) to a joint venture for an 8(a) contract must perform at least 40% of the work done by the joint venture. So, for example, if the joint venture proposes to perform 50% of the contract, the 8(a) Participant(s) must perform at least 40% of the 50% or at least 20% of the entire contract.

The proposed rule would also add a new paragraph 124.513(i) to require 8(a) firms that joint venture to perform an 8(a) contract to report on contract performance at the conclusion of the contract. Specifically, each 8(a) firm that performs an 8(a) contract through a joint venture would be required to report to SBA how the performance of work requirements (*i.e.,* that the joint venture performed at least 50% of the work of the contract and that the 8(a) participant to the joint venture performed at least 40% of the work done by the joint venture) were met on the contract. This requirement is needed to reinforce the performance of work requirements. Several audits performed by SBA's Office of Inspector General have revealed that the performance of work requirements are not always met. SBA needs to know when and why the requirements are not met. This could affect the firm's future responsibility to perform additional contracts and, depending upon the circumstance, could be cause for termination from the 8(a) BD program.

Sole Source Limits for NHO-Owned Concerns

SBA proposes to amend § 124.519, which imposes limits to the amount of 8(a) contract dollars a Participant may receive on a sole source basis. The current rule exempts ANC and tribally owned concerns from the limitations set forth in the rule. The amendment would add NHO-owned concerns to the list of 8(a) concerns exempted from the limitations. SBA believes that all three of these types of firms should be treated consistently, and the failure to include NHO-owned concerns in the exemption in the current regulation was an inadvertent omission. The proposed rule would also change the SBA official authorized to waive the requirement prohibiting a Participant from receiving sole source 8(a) contracts in excess of the dollar amount set forth in § 124.519. Under the current regulations, only the SBA Administrator, on a non-delegable basis, may grant such a waiver. SBA believes that such waivers have been requested and acted on sparingly because of the high level approval required. While SBA continues to believe that such waivers should not be commonplace, SBA does believe that a change from the Administrator to the AA/BD is warranted in order to facilitate waivers where appropriate.

Changes to Mentor/Protégé Program

The proposed rule would make several changes to § 124.520, governing SBA's mentor/protégé program. The rule would specifically require that assistance to be provided through a mentor/protégé relationship be tied to the protégé firm's SBA-approved business plan. Although SBA believed that this was implicit in the current regulations, SBA feels that it is important to reinforce that the mentor/protégé program is but one tool that can be used to help the business development of 8(a) Participants in accordance with their business plans.

Section 125.520(b)(2) would be amended to provide for an absolute limit of three protégés per mentor. SBA is proposing this rule to prevent mentor firms from being able to take advantage of the program by collecting protégés in order to benefit from 8(a) contracts. SBA is interested in hearing from the public on this proposed limitation. In addition, § 124.520(b)(3) would be amended to allow a firm seeking to be a mentor to submit Federal income tax returns or audited financial statements, including any notes, or other evidence from the mentor in order to demonstrate the firm's favorable financial health. The current regulation requires the

submission of Federal tax returns only. SBA believes that it may be unnecessary in all cases to require the Federal tax returns of the proposed mentor, provided the firm submits audited financial statements, including any notes, or in the case of publicly traded concerns the filings required by the Securities and Exchange Commission (SEC) for the past three years, or other relevant documentation to SBA for review. SBA's concern is to ensure that the firm seeking to be a mentor evidences its financial wherewithal.

SBA is also considering amending who may be a mentor under the 8(a) BD mentor/protégé program. SBA's current regulation states that a mentor can be ''[a]ny concern that demonstrates a commitment and the ability to assist developing 8(a) Participants * * *'' Section 121.105 of SBA's size regulations defines the word ''concern'' to be a for profit entity. As such, non-profit businesses have not been eligible to be mentors under the mentor/protégé program. SBA is considering making a change to § 124.520(b) to specifically allow non-profit business entities to be mentors, and seeks public comment on this issue.

Section 124.520(c)(1) would be amended for clarity purposes. There appears to be some confusion regarding the use of the conjunction ''or'' at the end of paragraph (ii) in SBA's current regulation. Some have questioned whether the current regulation requires a firm to be in the developmental stage of program participation in all instances and either have never received an 8(a) contract or have half the applicable size standard. That was not SBA's intent. The intent of the 8(a) mentor/protégé program is to assist Participants that are in the early stages of the 8(a) BD program (*i.e.,* thus, paragraph (i) allows any firm in the developmental stage of program participation to be a protégé) or need additional assistance in their business development (*i.e.,* paragraphs (ii) and (iii) allow a firm that has never received an 8(a) contract or one that has a size standard that is less than half the size standard corresponding to its primary NAICS code to be a protégé, respectively). A firm that has never received an 8(a) contract or has a size standard less than half the size standard corresponding to its primary NAICS code may need developmental assistance regardless of the number of years it has spent in the 8(a) BD program. In fact, a firm that is in the transitional stage of program participation that has never received an 8(a) contract may very well need greater assistance than a similar firm in the developmental stage of program participation. Thus, the regulation would be amended to make clear that a firm may qualify as a protégé if it is in the developmental stage of program participation, or has never received an 8(a) contract, or has a size standard that is less than half the size standard corresponding to its primary NAICS code.

This rule would also add clarifying language to § 124.520(c)(2) to make it clear that the benefits derived from the mentor/protégé relationship end once the protégé firm graduates from or otherwise leaves the 8(a) BD program. While this is implicit in the current regulations which provide that ''[o]nly firms that are in good standing in the 8(a) BD program * * * may qualify as a protégé,'' SBA wanted to specifically make clear that the exclusion from affiliation enjoyed by joint ventures between protégés and their mentors generally ends when the protégé leaves the 8(a) BD program. Of course, a joint venture between a mentor and protégé would be expected to complete any contract awarded to the joint venture while the protégé was a Participant in the 8(a) BD program and a contracting officer could continue to count such contract as an award to an 8(a) or small business concern, as the case may be.

Section 124.520(c)(3) currently provides that a protégé firm can have only one mentor. As part of SBA's tribal consultation under Executive Order 13175, Consultation and Coordination with Tribal Governments, SBA received comments that this provision was too restrictive, not just for tribally owned 8(a) firms, but for all 8(a) firms. While SBA continues to believe that the norm should continue to be one mentor for any given protégé firm, SBA concedes that there may be unusual circumstances where a second mentor/protégé relationship is warranted. This proposed rule would allow the AA/BD to approve a second mentor for a protégé firm in limited circumstances. Specifically, a second mentor may be approved where the protégé firm demonstrates that the second relationship pertains to an unrelated, secondary NAICS code, the first mentor does not possess the specific expertise that is the subject of the mentor/protégé agreement with the second mentor, and the two relationships will not compete or otherwise conflict with each other.

Section 124.520 would also be amended to preclude 8(a) firms from being mentors and protégés at the same time. The amendment would provide that an 8(a) concern must give up its status as a protégé if it becomes a mentor. SBA believes that if an 8(a) concern has the expertise and experience to be a mentor, it no longer has the need for a mentor itself. This amendment is intended to reduce the risks of questionable mentor/protégé relationships entered into solely to enable mentors to take advantage of 8(a) contracts.

The proposed rule would also add a new § 124.520(c)(5), which would prohibit SBA from approving a mentor/protégé agreement if the proposed protégé firm has less than one year remaining in its program term. Recently, SBA received a request to approve a mentor/protégé agreement for a firm whose program term was ending within weeks. It appeared that the real reason that the mentor/protégé relationship was proposed was to pursue a particular 8(a) contract for which the protégé sought to joint venture with the proposed mentor. With the firm's program term and SBA's oversight of the firm ending, there was no assurance that the protégé firm would ever receive the business development assistance identified in the mentor/protégé agreement. In such a case, the mentor/protégé relationship becomes more of a convenient contracting tool (by which the mentor can largely benefit) than a business development tool. To ensure that protégé firms actually receive identified business development assistance, SBA is proposing not to approve any mentor/protégé agreement where the proposed protégé has less than one year remaining on its program term. SBA asks for comments as to what the appropriate length of time before the end of a firm's program term should be for SBA not to permit new mentor/protégé agreements (*e.g.,* 6 months, 9 months, 1 year, 18 months).

The proposed rule would amend § 124.520(d)(1) to allow a joint venture between a mentor and protégé to be small for Federal subcontracts. A similar change would also be made to § 121.103(h)(3)(iii) of SBA's size regulations to ensure consistent implementation throughout SBA's regulations. Currently, SBA's regulations permit such a joint venture to be small for any ''government procurement.'' This provision has been interpreted as applying solely to Federal prime contracts. SBA believes that if this benefit applies to all Federal contracts it should also be available with respect to subcontracts. SBA believes that the current interpretation is particularly onerous for the Department of Energy (DOE), which has a significant amount of contracting activity go through government owned contractor operated (GOCO) facilities, and the contracts between the GOCO and a contractor technically are

government subcontracts for which the exclusion from affiliation for a mentor/protégé joint venture do not apply. SBA initially considered allowing mentor/protégé joint ventures to qualify as small businesses only for DOE subcontracts, but felt that the business development afforded to protégés would be beneficial government-wide. SBA specifically requests comments on both the proposed language and a provision which would limit its applicability solely to DOE subcontracts. SBA also understands concerns raised with applying the exclusion from affiliation for mentor/protégé joint ventures to contracts that are not Federal contracts and seeks input as to whether an extension of the affiliation exclusion is appropriate. In addition, as mentioned in the supplementary information regarding changes to § 121.103(h)(3), SBA is also considering allowing an exclusion to affiliation only for mentor/protégé joint ventures for 8(a) contracts. SBA specifically requests comments on such a proposal.

SBA also proposes to clarify that if a mentor and a protégé joint venture on a procurement, in order to take advantage of the special exception to the size requirements for that procurement, the mentor/protégé agreement must be approved by SBA prior to the submission of the bid or offer on the procurement. One of the benefits of the mentor/protégé relationship is that mentors and protégés are permitted to joint venture on 8(a) procurements and procurements set aside for small business as long as the protégé qualifies as small for the procurement. This change clarifies that the mentors and protégés may take advantage of this size advantage only if the mentor/protégé agreement is approved by SBA prior to the submission of the bid or offer on the procurement. Although this is the current practice, SBA felt it was useful to make this practice clear in its regulations, as some companies have mistakenly assumed that, like joint ventures between mentors and protégés on 8(a) procurements, a mentor/protégé agreement could be approved after submission of an offer as long as it was approved prior to the date of award. This is not the case. Joint ventures are tied to procurements and often there is insufficient time to obtain SBA's approval between the issuance of a solicitation and the submission of an offer. Therefore, SBA has permitted joint ventures to be approved on 8(a) procurements after the submission of offers, as long as the approval takes place prior to the actual award. Unlike joint ventures, mentor/protégé agreements should not be specifically connected with procurements. Size benefits for purposes of joint ventures are a benefit of engaging in a mentor/protégé agreement, not the reason for the relationship. Therefore, there are no strict time limitations at issue. Because it is possible that SBA might not approve a mentor/protégé agreement in a given situation, it believes that it is important that approval occur prior to a joint venture's submission of its bid or offer.

Under SBA's size regulations, size is determined at a fixed point in time (*i.e.,* as of the date of the initial offer, including price). *See* 13 CFR 121.504. If the entity submitting an offer is small as of that date, it will qualify as small for the procurement even if it grows to be other than small at the date of award. If the entity submitting an offer does not qualify as small as of the date it submits its initial offer, it cannot later come into compliance and qualify as small for that procurement. Thus, in order for a joint venture to be eligible as a small business, it must be small at the time it submits its offer including price. Generally, the revenues or employees of joint venture partners are aggregated when determining whether a joint venture qualifies as small. However, where there is an SBA-approved 8(a) mentor/protégé relationship, the receipts or revenues of the two joint venture partners are not aggregated. In such a case, size for the joint venture depends on the size of the protégé firm by itself. It seems obvious to SBA that if SBA has not yet approved a mentor/protégé agreement, a joint venture between proposed protégé and mentor firms is not entitled to receive the benefits of the 8(a) mentor/protégé program, including the exclusion from affiliation.

In addition, the proposed rule would add a provision making it clear that in order to receive the exclusion from affiliation for both 8(a) and non-8(a) procurements, the joint venture must comply with the requirements set forth in § 124.513(a). This has been SBA policy, but may not have been as clearly identified as SBA had hoped. There never has been any doubt or confusion as to the application of § 124.513(a) to 8(a) contracts. Unfortunately, not all contracting officers and 8(a) Participants understood that the § 124.513(a) joint venture requirements applied to non-8(a) contracts as well. It is SBA's view that in order to obtain a benefit derived from the 8(a) program (*i.e.,* the exclusion from affiliation for joint ventures between approved protégés and mentors), the same restrictions that are applicable to 8(a) contracts apply to non-8(a) contracts. For example, the performance of work requirement (*i.e.,* 50% rule) applies equally to small business set-aside and 8(a) contracts. SBA believes that it would not make sense for the requirement that the protégé firm perform a "significant portion" of the procurement not apply to small business set-aside contracts. The whole purpose of the mentor/protégé program is to help protégé firms develop so that they can better compete for future contracts on their own. If they are not required to perform a significant portion of or be the project manager on a contract, the development purposes of the mentor/protégé program would not be served.

The proposed rule would also clarify procedures for requesting reconsideration of SBA's decision to deny a proposed mentor/protégé agreement. Where SBA declines to approve a specific mentor/protégé agreement, the protégé may request the AA/BD to reconsider the Agency's initial decline decision by filing a request for reconsideration with its servicing SBA district office within 45 calendar days of receiving notice that its mentor/protégé agreement was declined. The protégé should revise its mentor/protégé agreement to more fully detail the business development assistance that the mentor will provide and provide any additional information and documentation pertinent to overcoming the reason(s) for the initial decline. If the AA/BD declines to approve the mentor/protégé agreement on reconsideration, the 8(a) firm seeking to become a protégé could not submit a new mentor/protégé agreement with that same mentor for one year. It may, however, submit a proposed mentor/protégé agreement with a different proposed mentor at any time after the SBA's final decline decision.

The rule also proposes to add a new § 124.520(h) which would set forth consequences for a mentor that fails to provide the assistance it agreed to provide in its mentor/protégé agreement. This recommendation was also received in response to SBA's tribal consultations to ensure that protégé firms do obtain beneficial business development assistance through their mentor/protégé relationships. Under the proposal, where SBA determines that a mentor has not provided to the protégé firm the business development assistance set forth in its mentor/protégé agreement, SBA will afford the mentor an opportunity to respond. The response must explain why the assistance set forth in the mentor/protégé agreement has not been provided to date and must set forth a

definitive plan as to when it will provide such assistance. If the mentor fails to respond, does not supply adequate reasons for its failure to provide the agreed upon assistance, or does not set forth a definite plan to provide the assistance SBA will recommend to the relevant procuring agency to issue a stop work order for each Federal contract for which the mentor and protégé are performing as a small business joint venture and received the exclusion from affiliation authorized by § 124.520(d)(1). The stop work order could be withdrawn when SBA is satisfied that the assistance has been or will be provided to the protégé. If the work is critical to and any delay in contract performance would harm the procuring activity, SBA may request that another Participant be substituted for the joint venture to continue performance. Where SBA terminates a mentor/protégé agreement because the mentor has failed to provide the agreed upon developmental assistance, the firm would be ineligible to again act as a mentor for a period of two years from the date SBA terminates the mentor/protégé agreement. If SBA believes that the mentor entered into the mentor/protégé relationship solely to obtain one or more Federal contracts as a joint venture partner with the protégé and had no intent to provide developmental assistance to the protégé, SBA could initiate proceedings to debar the mentor from Federal contracting. Similarly, if SBA believes that a protégé firm entered a mentor/protégé agreement in order to be awarded joint venture contracts with its mentor knowing that it would bring little or no value to the joint venture, SBA could initiate proceedings to terminate the firm from 8(a) participation or debar the firm from Federal contracting.

Reporting Requirement and Submission of Financial Statements

The proposed rule would also amend § 124.601, which addresses a statutorily required reporting requirement for 8(a) Participants. Small business concerns participating in the 8(a) BD program are required by statute to semiannually submit a written report to their assigned BDS that includes a listing of any agents, representatives, attorneys, accountants, consultants and other parties (other than employees) receiving fees, commissions, or compensation of any kind to assist such participant in obtaining a Federal contract. The listing must indicate the amount of compensation paid and a description of the activities performed for such compensation. The current regulation incorrectly required this report to be submitted annually. This change is needed in order to bring the regulation into compliance with the statutory requirement.

The proposed rule would also amend § 124.602 regarding the submission of audited and reviewed financial statements. As the cost for audited and reviewed financial statements increases, those costs are becoming more of a burden on developing disadvantaged small businesses. As such, SBA believes that audited financial statements should be required only for larger firms. SBA proposes to raise the level above which audited financial statements are required from Participants with gross annual receipts of more than $5,000,000 to Participants with gross annual receipts of more than $10,000,000. Reviewed financial statements would be required of all Participants with gross annual receipts between $2,000,000 and $10,000,000, instead of between $1,000,000 and $5,000,000. SBA requests comments as to whether these levels are appropriate. Specifically, SBA considered changing the level above which audited financial statements are required to Participants with gross annual receipts in excess of $6,000,000 or $7,500,000, and requests comments on those alternatives vis a vis the $10,000,000 level contained in the proposed rule.

Requirements Relating to SDBs

Finally, SBA is proposing to amend § 124.1002, which defines what is an SDB. SBA first proposes to add a provision to § 124.1002(d) to make it clear that the ''other eligibility requirements'' set forth in § 124.108 for 8(a) BD program participation do not apply to SDBs. As part of an SDB protest, SBA would merely be determining whether a concern is owned and controlled by one or more individuals who qualify as socially and economically disadvantaged. SBA would not consider whether the concern is a responsible business for the particular contract. As such, issues such as good character and failure to pay Federal financial obligations should not be part of SBA's determination as to whether a firm qualifies as an SDB. If a firm does not have good character, for example, a procuring agency should take that into account as an issue of responsibility prior to contract award.

SBA is also proposing to add a new paragraph to § 124.1002 to define full time management as it applies to the SDB program. Since the SDB program is a contracts program and not a business development program, and since there is no good policy reason to exclude part-time companies from the SDB program, SBA proposes to permit SDB owners to devote fewer than 40 hours per week to their SDB firms provided that the disadvantaged manager works for the firm during all the hours that the firm operates. For example, if a firm is only in operation 20 hours per week, the disadvantaged manager of the firm would be considered to devote full time to the firm if the individual was available and working for the firm during the 20 hours the firm was operating. This definition is not being extended to 8(a) firms as those firms are expected to operate 40 or more hours per week. SBA is interested in the public's comments on this proposed change.

Compliance with Executive Orders 12866, 12988, 13175, and 13132, the Regulatory Flexibility Act (5 U.S.C. 601–612), and the Paperwork Reduction Act (44 U.S.C., Ch. 35).

Executive Order 12866

The Office of Management and Budget (OMB) has determined that based on the revision to § 124.506(b)(4), this rule constitutes a significant regulatory action for purposes of Executive Order 12866, and as a result a regulatory impact analysis is required.

Regulatory Impact Analysis

Is there a need for the regulation action?

As stated above, the revision to § 124.506 would limit the amount of work that a non-8(a) business, particularly a non-8(a) large business in the context of a mentor/protégé relationship, could perform on an 8(a) sole source contract above the competitive threshold amounts. Specifically, a joint venture between a tribally or ANC-owned concern and a non-8(a) business concern could be awarded a sole source contract above the applicable competitive threshold amount only where the non-8(a) joint venture partner does not receive any work on the contract as a subcontract to the joint venture prime contractor.

SBA believes this rule is needed to prevent large businesses as well as other non-8(a) firms from being able to reap the benefits of sole source contracts intended for tribally-owned or ANC-owned 8(a) Participants. When these large contracts are awarded on a sole source basis to joint ventures, the contracts are not available for competition among other 8(a) firms. Thus, large firms and other non-8(a) firms joint venturing with tribally owned or ANC owned firms are realizing the benefits of sole source 8(a) contracts to the detriment of 8(a) firms who might otherwise compete for these

contracts. This is particularly true when the non-8(a) joint venture partner is also a subcontractor on the same 8(a) contract. In such a case, a non-8(a) concern could conceivably be performing 70–80% of the entire contract. SBA believes that such an outcome should not be possible under the 8(a) program.

Other proposed changes in this rule are needed to clarify SBA's requirements and remove confusion. For example, the proposed change to § 121.103(h) to permit a specific joint venture to be formed for three contract awards over a two-year period, instead of an entity that can seek three contract opportunities over a two-year period, is proposed because the current requirement has caused confusion and resulted in some firms being ineligible for certain small business awards due to that confusion. Similarly, the proposed change to § 124.104(c)(2) to exempt income from an S corporation from the calculation of both the individual owner's income and net worth to the extent such income is reinvested in the firm or used to pay corporate taxes is designed to treat an individual owner of an S corporation the same as an individual owner of a C corporation. The current rule has caused confusion as to whether such income should be included in an individual's income or net worth for purposes of determining economic disadvantage.

Finally, several changes in this rule are being proposed to eliminate or ease restrictions that SBA believes are unnecessary. For example, the proposed change to § 124.105(g) would provide more flexibility in determining whether to admit to the 8(a) program companies owned by individuals where such individuals have immediate family members who are owners of current or former 8(a) concerns. SBA believes that the current rule, which broadly prohibits such ownership, is too strict and needs to be revised to recognize separate business ownership in more than one immediate family member. In addition, SBA believes that the proposed change to § 124.104(c)(2) to exempt funds in Individual Retirement Accounts (IRAs) and other official retirement accounts from the calculation of an individual's net worth in determining his or her economic disadvantage is needed so that those individuals who have wisely invested in retirement accounts should not be penalized.

What are the potential benefits and costs of this regulatory action?

During the past five years, an estimated 62 joint ventures between tribally owned or ANC-owned firms and firms which are not tribally owned or ANC owned were awarded contracts above the competitive threshold amounts based on the current application of the statutory exception. The dollar amounts of these contracts ranged from $3 million to $600 million and the total contract dollars awarded was approximately $2.5 billion. It is estimated based on past experience that each joint venture partner performs approximately one half of the contract awarded the joint venture, with the 8(a) concern performing slightly more based on regulatory requirements that more than half the profits from the contract be distributed to the 8(a) firm. *See* 13 CFR 124.513(c)(3). Thus, under this assumption, in the past five years an estimated $1.25 billion has been awarded to firms that are not tribally-owned or ANC-owned as a result of the current regulatory scheme and approximately $1.25 billion was awarded to tribally or ANC-owned firms. (Contracts awarded to joint ventures between tribally owned concerns and other tribally owned concerns were not counted as these contracts would still be allowed under the proposed rule.) Under the above assumptions and based on the data compiled approximately $500 million (approximately half of 25 contracts) went to large businesses and $750 million (approximately half of 37 contracts) went to small businesses not tribally or ANC-owned. We also believe that a significant percentage of non-8(a) joint venture partners also acted as subcontractors on the same 8(a) contracts for which they were joint venturers. If non-8(a) joint venture partners can no longer act as subcontractors, the only way for them to perform additional work on an 8(a) contract is to increase the percentage of work performed by the joint venture. This will necessarily have the beneficial effect of increasing the amount of work performed by tribally and ANC-owned 8(a) firms. This change, in concert with the change to require the 8(a) partner(s) to a joint venture on an 8(a) contract to perform at least 40% of the work performed by the joint venture, should enable 8(a) joint venture partners to perform not only more work, but more meaningful work on 8(a) joint venture contracts.

If this change dissuades large mentors from participating as joint venture partners with tribally or ANC-owned firms on sole source 8(a) contracts, many of these contracts may not be offered to the 8(a) program at all. These contracts would then be either competed among all small businesses, or competed among all firms on an unrestricted basis.

It is difficult to estimate the costs and benefits to the various classes of firms as it is impossible to foresee which future contracts above the competitive thresholds would be awarded based on the various options (sole source to tribally-owned or ANC-owned firms, competition among 8(a) firms, competition among small businesses, unrestricted competition). It is likely that large firms and firms not in the 8(a) program will get smaller proportionate shares of these contracts; however, we note that Congress clearly intended the exception from the competition requirements to be for the benefit of ANC-owned and tribally-owned firms and not to large and non-8(a) firms. Therefore, any impact on large or non-8(a) firms is of little consequence for purposes of this rule. The benefits to large and non-8(a) firms are incidental to the purpose of the rule and are arguably at the expense of other 8(a) firms.

Although ANC-owned and tribally-owned 8(a) firms may receive fewer contract dollars if mentors are dissuaded from participating as joint venture partners under the proposed rule, we note that those firms will nevertheless be permitted to bid on all the contracts that are no longer available to them on a sole source basis as joint venture partners. We also note that these firms may still be awarded these contracts as prime contractors bidding alone or as joint venture partners with other tribally or ANC-owned firms, and that such firms will still be able to subcontract substantial portions of the contracts to other non-8(a) firms. We also reference the recent report issued by the GAO entitled ''CONTRACT MANAGEMENT Increased Use of Alaska Native Corporations' Special 8(a) Provisions Calls for Tailored Oversight'', GAO–06–399, April 2006 (''GAO Report''). That report noted that 8(a) obligations to firms owned by ANCs increased from $265 million in FY 2000 to $1.1 billion in 2004 and that in FY 2004, obligations to ANC firms represented 13 percent of total 8(a) dollars (GAO Report, p. 6). This sharp increase in 8(a) dollars awarded to ANC firms from 2000 to 2004 draws into question the need for such firms to utilize joint venture vehicles to take advantage of 8(a) sole source opportunities above the competitive threshold amounts.

Finally, SBA notes that the rule requiring the 8(a) member of a joint venture to receive the majority of the joint venture's profits is easily

manipulated and difficult to monitor. Thus, it would not be difficult for a joint venture to manipulate its numbers so that less than 51 percent of the actual profits from a contract in fact go to the tribally-owned or ANC-owned 8(a) concern. On the other hand, performance of work is more easily measured and thus easier to monitor. If a contract is awarded to an ANC-owned or tribally-owned firm and more than the allowed percentage is subcontracted, this fact is more difficult to hide and easier to track. Therefore, it is expected that instances of abuse and the use of fronts will decrease as a result of the proposed change.

For all of the reasons listed above, SBA believes that the benefits of the proposed rule far exceed its costs and far exceed the benefits of continuing the status quo.

Regarding other proposed changes set forth in this rule, SBA believes that increased clarity and easing of restrictions is overall beneficial to 8(a) applicants and Participants.

Alternatives to the Regulatory Action

SBA has considered a number of alternatives to the proposed rule and is interested in hearing from the public concerning these alternatives. One alternative SBA has considered is to continue to allow joint ventures on contracts above the competitive thresholds between ANC or tribally-owned concerns and other concerns with the condition that the ANC or tribally owned concern be required to meet the performance of work requirements set forth in 13 CFR 124.510 with its own workforce. *Also see* 13 125.6. Section 13 CFR 124.510 requires a prime contractor on an 8(a) contract to perform certain percentages of work with its own workforce (50 percent for service and manufacturing contracts, 15 percent for general construction and 25 percent for special trades). Another alternative being considered is to permit joint ventures above the threshold amounts with other 8(a) concerns or with other small businesses, but not with large businesses. Finally, SBA also considered disallowing any joint ventures on 8(a) sole source contracts above the competitive threshold amounts. Under this approach, ANC and tribally-owned Participants could still receive 8(a) sole source contracts above the competitive threshold amounts, they just could not perform those contracts through a joint venture. This would force ANC and tribally-owned Participants to be the prime contractor and meet the performance of work (*i.e.,* 50%) requirement with their own workforce. The first alternative is not being proposed because of the difficulty of enforcing the performance of work requirements. It is not clear whether a firm is meeting the required percentages of work requirements until the firm (or joint venture) is well along in the performance of the contract. It is difficult to enforce these provisions at this point and often the only recourse if the requirements are not met is to terminate the contract, a solution that creates numerous problems for the procuring activity. The second alternative is not being proposed at this time because it would still result in granting a significant portion of an 8(a) contract to a non-8(a) concern. Finally, the elimination of all joint ventures above the competitive thresholds approach is not being proposed because SBA was persuaded by tribal and ANC representatives that joint ventures serve an important function in the overall business development of ANC and tribally-owned Participants.

SBA is very interested in comments from the public on these issues.

Executive Order 12988

This action meets applicable standards set forth in Sec. 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have retroactive or preemptive effect.

Executive Order 13132

This rule does not have federalism implications as defined in Executive Order 13132, Federalism. It will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government, as specified in the Executive Order. As such it does not warrant the preparation of a Federalism Assessment.

Executive Order 13175, Tribal Summary Impact Statement

For the purposes of Executive Order 13175, Consultation and Coordination with Indian Tribal Governments, the SBA's General Counsel has determined that the requirements of this order have been met in a meaningful and timely manner. This rule complies with the standards set forth in the Executive Order and SBA has provided the tribal officials with an opportunity to provide meaningful and timely input on regulatory policies that have tribal implications.

In drafting this proposed rule, SBA consulted with representatives of Alaska Native Corporations (ANCs) and Indian tribes, both informally and formally, pursuant to Executive Order 13175, primarily to discuss potential changes to the mentor/protégé requirements. SBA met informally with tribal and ANC representatives in Washington, DC on July 19, 2007, and more formally in Fairbanks, Alaska on October 24, 2007, 72 FR 57889, and in Denver, Colorado on November 11, 2007, 72 FR 60702. A vast majority of the comments received from these discussions were concerned that SBA would overreact to negative publicity regarding one or two 8(a) Participants and would change the mentor/protégé program in a way that would take away an important business development tool to tribal and ANC-owned firms. Tribal representative after tribal representative talked about the importance of the 8(a) BD program to the tribal and ANC communities. They stressed that the 8(a) BD program works, providing the government with a contracting option that is efficient and cost effective while permitting the government to achieve its policy of supporting disadvantaged small businesses and providing benefits to some of the most underemployed people in America. They explained that they have been trying to dispel program misperceptions caused by unsubstantiated allegations of misconduct and abuse, when they would rather be devoting their efforts to business and community development. Several tribal representatives felt that relatively few tribes have realized the benefits of the mentor/protégé component of the 8(a) program, and were concerned that SBA would be closing this business development option just as they are getting to the point where they would use it. Representatives also were concerned that SBA would propose changes that would restrict the participation of mentors in the program. That is not SBA's intent. SBA too believes that the 8(a) BD program is a much-needed and beneficial program, and that the tribal and ANC component of the program serves a valuable economic and community development purpose in addition to its business development purpose. It is not SBA's intent to shut down any component of the 8(a) program that truly assists the development of any small disadvantaged businesses. Specifically, SBA is not proposing to close this business development option to tribes and ANCs as some tribal representatives were concerned. SBA does not seek to make it more difficult for tribally-owned and ANC-owned firms to participate in

the 8(a) BD program, and merely looks for ways to help ensure that the benefits of the program flow to those who are truly eligible to participate. SBA has carefully reviewed both the testimony given at the tribal consultation meetings and the formal comments submitted in response thereto. SBA welcomes the opportunity to discuss its proposals with the tribal and ANC communities in more detail during the public comment period.

Initial Regulatory Flexibility Analysis

This rule, if finalized, may have a significant impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601–612. As such, SBA sets forth an initial regulatory flexibility analysis (IRFA) of this proposed rule addressing the following questions: (1) What is the need for and objective of the rule, (2) what is SBA's description and estimate of the number of small entities to which the rule will apply, (3) what is the projected reporting, record keeping, and other compliance requirements of the rule, (4) what are the relevant Federal rules which may duplicate, overlap or conflict with the rule, and (5) what alternatives will allow the Agency to accomplish its regulatory objectives while minimizing the impact on small entities? SBA will specifically address six provisions of the proposed rule which may have a significant impact on a substantial number of small businesses. They are: (1) The provisions relating to joint ventures between protégé firms and their SBA-approved mentors; (2) the requirement that the disadvantaged manager of an 8(a) applicant or Participant must reside in the United States and spend part of every month physically present at the primary offices of the applicant or Participant; (3) the provision excluding qualified individual retirement accounts from an individual's net worth in determining economic disadvantage; (4) the provisions establishing objective criteria for determining economic disadvantage in terms of income and total assets; (5) the provision requiring SBA to early graduate a firm from the 8(a) program if the firm becomes large for the size standard corresponding to its primary NAICS code; and (6) the provisions relating to what size 8(a) Participants must annually submit either audited or reviewed financial statements to SBA.

1. *What is the need for and objective of the rule?* The need for and objective of the provisions relating to joint ventures between protégé firms and their SBA-approved mentors is set forth in detail in the Regulatory Impact Analysis above.

SBA believes that the proposed requirement that the disadvantaged manager of an 8(a) applicant or Participant must reside in the United States and spend part of every month physically present at the primary offices of the applicant or Participant is needed to reduce the potential abuse of ''front'' companies in which a non-disadvantaged individual actually runs the day-to-day operations of the business.

SBA believes that a change is needed to exclude qualified individual retirement accounts from the calculation of an individual's net worth when considering economic disadvantage. As noted in the supplementary information above, SBA has found that the inclusion of individual retirement accounts in the calculation of an individual's net worth does not serve to disqualify wealthy individuals from participation in the program, but has worked to make middle and lower income individuals ineligible to the extent they have invested prudently in accounts to ensure income at a time in their lives that they are no longer working. SBA believes that it should not penalize an individual who has invested in a qualified retirement account.

SBA believes that it is necessary to put into the regulations provisions establishing objective criteria for income and total assets in determining economic disadvantage to publicize SBA's current policies in this area. While the proposed rule establishing $200,000 in income and $3,000,000 in total assets as the levels above which an individual is deemed not to be economically disadvantaged for purposes of initial 8(a) eligibility is not a change in SBA policy, these standards are currently contained only in decisions rendered by SBA's OHA. Including these standards in the regulatory text will aid all applications in more fully understanding SBA's eligibility requirements.

SBA believes that it makes sense to early graduate a firm from the 8(a) BD program where it no longer qualifies as small for its primary NAICS code for two consecutive years because it is reasonable to conclude that at that point the firm has substantially achieved the targets, objectives and goals contained in its business plan, and thus, has met the standard set forth in § 7(j)(10)(H) of the Small Business Act, 15 U.S.C. 636(j)(10(H), for graduation.

SBA also believes it makes sense to raise the revenue levels above which audited financial statements and reviewed financial statements should be required for continued 8(a) BD participation. As the cost for audited and reviewed financial statements increases, those costs are becoming more of a burden on developing disadvantaged small businesses. In addition, SBA notes that while size standards have increased due to inflation over time, the levels of revenue above which audited and reviewed financial statements are required for the 8(a) program have not. As such, SBA believes that it makes sense to increase these levels and alleviate the burden on smaller firms.

2. *What is SBA's description and estimate of the number of small entities to which the rule will apply?* In FY 2007, SBA approved 60 mentor/protégé agreements. In FY 2006, SBA approved 173 mentor/protégé agreements. There are currently more than 300 approved mentor/protégé agreements. The proposed changes to the mentor/protégé program would not affect all small firms that are currently SBA-approved protégés. The significant proposed restriction on the program would prohibit a joint venture between a protégé firm and its SBA-approved mentor to subcontract additional work on the contract to the mentor. Thus, it would affect only those mentor/protégé relationships in which the mentor and protégé firms joint venture for one or more government contracts and the mentor wants to also act as a subcontractor on the contract. While the number of these situations is not great, the potential for abuse without the proposed change is.

The average number of applications for the 8(a) BD program for the past five fiscal years (FYs 2003 to 2007) is 3,682. There are approximately 6–10 declines based solely on control issues per 100 declines. For this time period, there were 1,583 total declines for the 8(a) program. Based on the estimated number of declines due to control issues, this would translate as between 95 and 158 declines for control for the past five fiscal years, or an average of 19 to 30 per year. The number of firms declined for control reasons because the individual claiming disadvantaged status lived outside the United States is miniscule. We know of only two cases during the five year period where SBA declined a firm on that basis.

For the last five fiscal years, there are approximately 3–5 declines per 100 declines based solely on issues relating to economic disadvantage. This would translate into between 48 and 80 declines based on economic disadvantage during the last five fiscal years, or an average of 9 to 16 per year. SBA believes that the number of firms

declined due solely to significant assets in an IRA or other qualifying retirement account is very small. SBA anticipates that 1 or 2 firms per year which would have been found not to be economically disadvantaged, and thus ineligible for the 8(a) BD program, will be eligible because of the proposed change. Of the 9 to 16 declines per year due to economic disadvantage, less than half were due to excessive income or total assets. As such, the provisions establishing objective criteria for income and total assets would affect no more than 8 8(a) applicants each year.

During the last three fiscal years (FYs 2005 to 2007), a total of 591 firms were terminated from the 8(a) BD program (143 in FY 2007, 318 in FY 2006, and 130 in FY 2005), 342 firms voluntarily withdrew from the program (149 in FY 2007, 95 in FY 2006, and 98 in FY 2005), and 42 firms left the program due to early graduation (12 in FY 2007, 12 in FY 2006, and 18 in FY 2005).

As reported in the Dynamic Small Business Search, there are currently 9,609 Participants in the 8(a) BD program. Of those firms, 5,876 firms have less than $10 million in annual revenue, and 5,365 firms have less than $5 million in annual revenue. Thus, the proposed change to raise the revenue level under which Participants must submit audited or reviewed financial statements to SBA would ease the regulatory burden on these firms.

3. *What are the projected reporting, recordkeeping, and other compliance requirements of the rule and an estimate of the classes of small entities which will be subject to the requirements?* There would be no additional reporting or recordkeeping requirements imposed by the rule. The rule would ease the regulatory burden on smaller 8(a) firms. Specifically, SBA proposes to raise the level above which audited financial statements are required from Participants with gross annual receipts of more than $5,000,000 to Participants with gross annual receipts of more than $10,000,000. Reviewed financial statements would be required of all Participants with gross annual receipts between $2,000,000 and $10,000,000, instead of between $1,000,000 and $5,000,000.

4. *What are the relevant Federal rules which may duplicate, overlap or conflict with the rule?* The Federal Acquisition Regulation (FAR) defers to and incorporates the substance of the provisions set forth in SBA's regulations for issues pertaining to the 8(a) program. To the extent the FAR is inconsistent with 8(a) rules implemented by SBA, the FAR would need to be changed to be consistent.

Paperwork Reduction Act

For purposes of the Paperwork Reduction Act, 44 U.S.C. Ch. 35, SBA has determined that this proposed rule, if adopted in final form, would contain no new reporting or recordkeeping requirements.

List of Subjects

13 CFR Part 121

Administrative practice and procedure, Government procurement, Government property, Grant programs—business, Individuals with disabilities, Loan programs—business, Reporting and recordkeeping requirements, Small businesses.

13 CFR Part 124

Administrative practice and procedures, Government procurement, Hawaiian natives, Indians—business and finance, Minority businesses, Reporting and recordkeeping requirements, Tribally-owned concerns, Technical assistance.

For the reasons set forth above, the Small Business Administration proposes to amend parts 121 and 124 of title 13 of the Code of Federal Regulations as follows:

PART 121—SMALL BUSINESS SIZE REGULATIONS

Subpart A—Size Eligibility Provisions and Standards

1. The authority citation for part 121 continues to read as follows:

Authority: 15 U.S.C. 632, 634(b)(6), 636(b), 637(a), 644 and 662(5); and, Pub. L. 105–135, sec. 401 *et seq.,* 111 Stat. 2592.

2. Amend § 121.103 by revising paragraph (b)(6), by revising the second and third sentences of paragraph (h) introductory text, and by revising paragraph (h)(3)(iii) to read as follows:

§ 121.103 How does SBA determine affiliation?

* * * * *

(b) * * *

(6) An 8(a) BD Participant that has an SBA-approved mentor/protégé agreement is not affiliated with a mentor firm solely because the protégé firm receives assistance from the mentor under the agreement. Similarly, a protégé firm is not affiliated with its mentor solely because the protégé firm receives assistance from the mentor under a Federal Mentor-Protégé program where an exception to affiliation is specifically authorized by statute or by SBA under the procedures set forth in § 121.903. Affiliation may be found in either case for other reasons.

* * * * *

(h) * * * This means that a specific joint venture entity generally may not be awarded more than three contracts over a two year period, starting from the date of the award of the first contract, without the partners to the joint venture being deemed affiliated for all purposes. Because SBA determines size and affiliation as of the date an offeror submits its initial offer including price to a procuring agency, SBA will also determine compliance with this three awards in two years rule as of the date of initial offer including price. As such, an individual joint venture may be awarded more than three contracts without SBA finding general affiliation between the joint venture partners where the joint venture had received two or fewer contracts as of the date it submitted one or more additional offers which thereafter result in one or more additional contract awards. The same two (or more) entities may create additional joint ventures, and each new joint venture entity may be awarded up to three contracts in accordance with this section. At some point, however, such a longstanding inter-relationship or contractual dependence between the same joint venture partners will lead to a finding of general affiliation between and among them. For purposes of this provision and in order to facilitate tracking of the number of contract awards made to a joint venture, a joint venture must be in writing and must do business under its own name, and it may (but need not) be in the form of a separate legal entity, and it may (but need not) be populated. * * *

* * * * *

(3) * * *

(iii) Two firms approved by SBA to be a mentor and protégé under 13 CFR 124.520 may joint venture as a small business for any Federal government prime contract or subcontract, provided the protégé qualifies as small for the size standard corresponding to the NAICS code assigned to the procurement and, for purposes of 8(a) sole source requirements, has not reached the dollar limit set forth in 13 CFR 124.519. If the procurement is to be awarded through the 8(a) BD program, SBA must approve the joint venture pursuant to § 124.513. If the procurement is to be awarded other than through the 8(a) BD program (*e.g.,* small business set aside, HUBZone set aside), SBA need not approve the joint venture prior to award, but if the size status of the joint venture is protested, the provisions of §§ 124.513(c) and (d) will apply. This

means that the joint venture must meet the requirements of §§ 124.513(c) and (d) in order to receive the exception to affiliation authorized by this paragraph.

* * * * *

3. Amend § 121.402(b) by revising the last sentence and adding a new sentence at the end thereof to read as follows:

§ 121.402 What size standards are applicable to Federal Government contracting programs?

* * * * *

(b) * * * Acquisitions for supplies must be classified under the appropriate manufacturing NAICS code, not under a wholesale trade or retail trade NAICS code. A concern that submits an offer or quote for a contract or subcontract where the NAICS code assigned to the contract or subcontract is one for supplies, and furnishes a product it did not itself manufacture or produce, is categorized as a nonmanufacturer and deemed small if it meets the requirements set forth in § 121.406(b).

* * * * *

4. Amend § 121.406 by revising paragraph (a) introductory text, (a)(1) (b)(1) introductory text, revising paragraphs (b)(1)(ii) and (b)(1)(iii), by redesignating paragraphs (b)(3), (b)(4) and (b)(5) as paragraphs (b)(5), (b)(6), and (b)(7), respectively, by adding new paragraphs (b)(3) and (b)(4), and by revising newly redesignated paragraph (b)(6) to read as follows:

§ 121.406 How does a small business concern qualify to provide manufactured products or other supply items under small business set-aside or 8(a) contracts?

(a) *General.* In order to qualify as a small business concern for a small business set-aside or 8(a) contract to provide manufactured products or other supply items, an offeror must either:

(1) Be the manufacturer or producer of the end item being procured (and the end item must be manufactured or produced in the United States); or

* * * * *

(b) *Nonmanufacturers.* (1) A concern may qualify as a small business concern for a requirement to provide manufactured products or other supply items as a nonmanufacturer if it:

* * * * *

(ii) Takes ownership or possession of the item(s) with its personnel, equipment or facilities in a manner consistent with industry practice; and

(iii) Will supply the end item of a small business manufacturer, processor or producer made in the United States, or obtains a waiver of such requirement pursuant to paragraph (b)(5) of this section.

* * * * *

(3) The nonmanufacturer rule applies only to procurements that have been assigned a manufacturing NAICS code, Sectors 31–33. It does not apply to supply contracts that do not primarily consist of manufacturing.

(4) The nonmanufacturer rule applies only to the supply component of a requirement classified as a manufacturing contract. If a requirement is classified as a service contract, but also has a supply component, the nonmanufacturer rule does not apply to the supply component of the requirement.

Example 1 to paragraph (b)(4). A procuring agency seeks to acquire computer integration and maintenance services. Included within that requirement, the agency also seeks to acquire some computer hardware. If the procuring agency determines that the principal nature of the procurement is services and classifies the procurement as a services procurement, the nonmanufacturer rule does not apply to the computer hardware portion of the requirement. This means that while a contractor must meet the applicable performance of work requirement set forth in § 125.6 for the services portion of the contract, the contractor does not have to supply the computer hardware of a small business manufacturer.

Example 2 to paragraph (b)(4). A procuring agency seeks to acquire computer hardware, as well as computer integration and maintenance services. If the procuring agency determines that the principal nature of the procurement is for supplies and classifies the procurement as a supply procurement, the nonmanufacturer rule applies to the computer hardware portion of the requirement. A firm seeking to qualify as a small business nonmanufacturer must supply the computer hardware manufactured by a small business. Because the requirement is classified as a supply contract, the contractor does not have to meet the performance of work requirement set forth in § 125.6 for the services portion of the contract.

* * * * *

(6) The two waiver possibilities identified in paragraph (b)(5) of this section are called ''individual'' and ''class'' waivers respectively, and the procedures for requesting and granting them are contained in § 121.1204.

* * * * *

5. In § 121.1001, add a new paragraph (b)(10) to read as follows:

§ 121.1001 Who may initiate a size protest or request a formal size determination?

* * * * *

(b) * * *

(10) The SBA Inspector General may request a formal size determination with respect to any of the programs identified in paragraph (b) of this section.

PART 124—8(a) BUSINESS DEVELOPMENT/SMALL DISADVANTAGED BUSINESS STATUS DETERMINATIONS

6. The authority citation for part 124 is revised to read as follows:

Authority: 15 U.S.C. 634(b)(6), 636(j), 637(a), 637(d) and Pub. L. 99–661, Pub. L. 100–656, sec. 1207, Pub. L. 101–37, Pub. L. 101–574, section 8021, Pub. L. 108–87, and 42 U.S.C. 9815.

7. Remove the term ''SIC'' and add, in its place, the term ''NAICS,'' in the following places:

a. § 124.110(c);
b. § 124.111(d);
c. § 124.502(c)(3);
d. § 124.503(b);
e. § 124.503(b)(1);
f. § 124.503(b)(2);
g. § 124.503(c)(1)(iii);
h. § 124.503(g)(3);
i. § 124.505(a)(3);
j. § 124.507(b)(2)(i);
k. § 124.513(b)(1), (b)(1)(i), and (b)(1)(ii)(A);
l. § 124.513(b)(2);
m. § 124.513(b)(3);
n. § 124.514(a)(1);
o. § 124.515(d);
p. § 124.517(d)(1);
q. § 124.517(d)(2);
r. § 124.519(a)(1);
s. § 124.519(a)(2);
t. § 124.1002(b)(1), (b)(1)(i), and (b)(1)(ii); and
u. § 124.1002(f)(3).

8. Revise § 124.2 to read as follows:

§ 124.2 For what length of time may a business participate in the 8(a) BD program?

A Participant receives a program term of nine years from the date of SBA's approval letter certifying the concern's admission to the program. The Participant must maintain its program eligibility during its tenure in the program and must inform SBA of any changes that would adversely affect its program eligibility. The nine year program term may be shortened only by termination, early graduation or voluntary withdrawal as provided for in this subpart.

9. In § 124.3, add new definitions for ''NAICS code,'' and ''Regularly maintains an office'' in alphabetical order, and revise the definitions of ''Primary industry classification'' and ''Same or similar line of business,'' to read as follows:

§ 124.3 What definitions are important in the 8(a) BD program?

* * * * *

NAICS code means North American Industry Classification System code.

* * * * *

Primary industry classification means the six digit North American Industry Classification System (NAICS) code designation which best describes the primary business activity of the 8(a) BD applicant or Participant. The NAICS code designations are described in the North American Industry Classification System book published by the U.S. Office of Management and Budget. SBA utilizes § 121.107 of this chapter in determining a firm's primary industry classification. SBA may permit a Participant to change its primary industry classification if the Participant can demonstrate that the majority of its revenues during a two-year period have evolved from one NAICS code to another.

* * * * *

Regularly maintains an office means conducting business activities as an on-going business concern from a fixed location on a daily basis. The best evidence of the regular maintenance of an office is documentation that shows that third parties routinely transact business with a Participant at a location within a particular geographical area. Such evidence includes advertisements, bills, correspondence, lease agreements, land records, and evidence that the Participant has complied with all local requirements concerning registering, licensing, or filing with the State or County where the place of business is located.

Same or similar line of business means business activities within the same four-digit ''Industry Group'' of the NAICS Manual as the primary industry classification of the applicant or Participant. The phrase ''same business area'' is synonymous with this definition.

* * * * *

10. Revise § 124.101 to read as follows:

§ 124.101 What are the basic requirements a concern must meet for the 8(a) BD program?

Generally, a concern meets the basic requirements for admission to the 8(a) BD program if it is a small business which is unconditionally owned and controlled by one or more socially and economically disadvantaged individuals who are of good character and citizens of and residing in the United States, and which demonstrates potential for success.

11. Amend § 124.102 by redesignating paragraph (a) as paragraph (a)(1), and by adding a new paragraph (a)(2) to read as follows:

§ 124.102 What size business is eligible to participate in the 8(a) BD program?

(a)(1) * * *

(2) In order to remain eligible to participate in the 8(a) BD program after certification, a firm must generally remain small for its primary industry classification, as adjusted during the program. SBA may graduate a participant prior to the expiration of its program term where the firm exceeds the size standard corresponding to its primary NAICS code for two successive program years.

* * * * *

12. Amend § 124.104 by revising paragraph (b)(2); redesignating paragraph (c)(2)(ii) as paragraph (c)(2)(iv), adding new paragraphs (c)(2)(ii) and (c)(2)(iii), and by adding new paragraphs (c)(3) and (c)(4) to read as follows:

§ 124.104 Who is economically disadvantaged?

* * * * *

(b) * * *

(2) When married, an individual claiming economic disadvantage must submit separate financial information for his or her spouse, unless the individual and the spouse are legally separated. SBA may consider a spouse's financial situation in determining an individual's access to credit and capital. SBA does not take into consideration community property laws when determining economic disadvantage.

* * * * *

(c) * * *

(2) * * *

(ii) Funds invested in an Individual Retirement Account (IRA) or other official retirement account that are unavailable to an individual until retirement age without a significant penalty will not be considered in determining an individual's net worth. In order to properly assess whether funds invested in a retirement account may be excluded from an individual's net worth, the individual must provide information about the terms and restrictions of the account to SBA.

(iii) Income received from an S corporation will be excluded from net worth where the applicant or Participant provides documentary evidence demonstrating that the income was reinvested in the firm or used to pay taxes arising in the normal course of operations of the firm.

* * * * *

(3) *Personal income for the past two years.* If an individual's adjusted gross income averaged over the two years preceding submission of the 8(a) application exceeds $200,000, SBA will presume that such individual is not economically disadvantaged. For continued 8(a) BD eligibility, SBA will presume that an individual is not economically disadvantaged if his or her adjusted gross income averaged over the two preceding years exceeds $250,000. The presumption may be rebutted by a showing that this income level was unusual and not likely to occur in the future, that losses commensurate with and directly related to the earnings were suffered, or by evidence that the income is not indicative of lack of economic disadvantage. Income earned by S corporations which is reinvested in or used to pay taxes arising in the normal course of operations of the firm is exempted from income for purposes of this section provided that documentary evidence is submitted demonstrating this use. Likewise, S corporation losses may not be subtracted from an individual's income to reduce that income.

(4) *Fair market value of all assets.* An individual will generally not be considered economically disadvantaged if the fair market value of all his or her assets (including his or her primary residence and the value of the applicant/Participant firm) exceeds $3 million for an applicant concern and $4 million for continued 8(a) BD eligibility. The only assets excluded from this determination are funds excluded under paragraph (c)(2)(ii) of this section as being invested in a qualified IRA account.

13. Amend § 124.105 by revising paragraphs (g) and (h)(2) to read as follows:

§ 124.105 What does it mean to be unconditionally owned by one or more disadvantaged individuals?

* * * * *

(g) *Ownership of another Participant in the same or similar line of business.*

(1) An individual may not use his or her disadvantaged status to qualify a concern if that individual has an immediate family member who is using or has used his or her disadvantaged status to qualify another concern for the 8(a) BD program. The AA/BD may waive this prohibition if the two concerns have no connections, either in the form of ownership, control or contractual relationships, and provided the individual seeking to qualify the second concern has management and technical experience in the industry. Where the concern seeking a waiver is in the same or similar line of business as the current or former 8(a) concern, there is a presumption against granting the waiver. The applicant must provide clear and compelling evidence that no

connection exists between the two firms.

(2) If the AA/BD grants a waiver under paragraph (g)(1) of this section, SBA will, as part of its annual review, assess whether the firm continues to operate independently of the other current or former 8(a) concern of an immediate family member. SBA may initiate proceedings to terminate a firm for which a waiver was granted from further participation in the 8(a) BD program if it is apparent that there are connections between the two firms that were not disclosed to the AA/BD when the waiver was granted or that came into existence after the waiver was granted. SBA may also initiate termination proceedings if the firm begins to operate in the same or similar line of business as the current or former 8(a) concern of the immediate family member and the firm did not operate in the same or similar line of business at the time the waiver was granted.

(h) * * *

(2) A non-Participant concern in the same or similar line of business or a principal of such concern may not own more than a 10 percent interest in a Participant that is in the developmental stage or more than a 20 percent interest in a Participant in a transitional stage of the program, except that a former Participant or a principal of a former Participant (except those that have been terminated from 8(a) BD program participation pursuant to §§ 124.303 and 124.304) may have an equity ownership interest of up to 20 percent in a current Participant in the developmental stage of the program or up to 30 percent in a transitional stage Participant, in the same or similar line of business.

* * * * *

14. Amend § 124.106 by revising paragraph (a)(2), and (e) introductory text, and by adding a new paragraph (h) to read as follows:

§ 124.106 When do disadvantaged individuals control an applicant or Participant?

* * * * *

(a)(1) * * *

(2) A disadvantaged full-time manager must hold the highest officer position (usually President or Chief Executive Officer) in the applicant or Participant. Such manager must reside in the United States, and must generally spend at least part of every month physically present in the primary offices of the applicant or Participant.

* * * * *

(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: * * *

* * * * *

(h) Notwithstanding the provisions of this section requiring a disadvantaged owner to control the daily business operations and long-term strategic planning of an 8(a) BD Participant, where a disadvantaged individual upon whom eligibility is based is a reserve component member in the United States military who has been called to active duty, the Participant may elect to designate one or more individuals to control the Participant on behalf of the disadvantaged individual during the active duty call-up period. If such an election is made, the Participant will continue to be treated as an eligible 8(a) Participant and no additional time will be added to its program term. Alternatively, the Participant may elect to suspend its 8(a) BD participation during the active duty call-up period pursuant to §§ 124.305(h)(1)(ii) and 124.305(h)(4).

§ 124.108 [Amended]

15. Amend § 124.108 by removing paragraph (f).

16. Amend § 124.109 by revising paragraphs (c)(3)(ii), (c)(4)(i) introductory text, and (c)(6) to read as follows:

§ 124.109 Do Indian tribes and Alaska Native Corporations have any special rules for applying to the 8(a) BD program?

* * * * *

(c) * * *

(3) * * *

(ii) A tribe may not own 51% or more of another firm which, either at the time of application or within the previous two years, has been operating in the 8(a) program under the same primary NAICS code as the applicant. A tribe may, however, own a Participant or other applicant that conducts or will conduct secondary business in the 8(a) BD program under the NAICS code which is the primary NAICS code of the applicant concern. In addition, once an applicant is admitted to the 8(a) BD program, it may not receive an 8(a) contract in a secondary NAICS code that is the primary NAICS code of another Participant (or former participant that has left the program within two years of the date of application) owned by the tribe for a period of two years from the date of admission to the program.

* * * * *

(4) * * *

(i) The management and daily business operations of a tribally-owned concern must be controlled by the tribe, through one or more individual members who possess sufficient management experience of an extent and complexity needed to run the concern, or through management as follows:

* * * * *

(6) *Potential for success.* A tribally-owned applicant concern must possess reasonable prospects for success in competing in the private sector if admitted to the 8(a) BD program. A tribally-owned applicant may establish potential for success by demonstrating that:

(i) It has been in business for at least two years, as evidenced by income tax returns for each of the two previous tax years showing operating revenues in the primary industry in with the applicant is seeking 8(a) BD certification; or

(ii) The individual(s) who will manage and control the daily business operations of the firm have substantial technical and management experience, the applicant has a record of successful performance on contracts from governmental or nongovernmental sources in its primary industry category, and the applicant has adequate capital to sustain its operations and carry out its business plan as a Participant; or

(iii) The tribe has made a firm written commitment to support the operations of the applicant concern and it has the financial ability to do so.

* * * * *

17. Amend § 124.112 by removing the word ''and'' at the end of paragraph (b)(7), by redesignating paragraph (b)(8) as paragraph (b)(9), by adding a new paragraph (b)(8), by revising paragraphs (d)(1) and (d)(3), and by adding new paragraphs (e) and (f) to read as follows:

§ 124.112 What criteria must a business meet to remain eligible to participate in the 8(a) BD program?

* * * * *

(b) * * *

(8) For each Participant owned by a tribe, ANC, NHO or CDC, information showing how its 8(a) participation has benefited the tribal or native members and/or the tribal, native or other community. This data includes information relating to funding cultural programs, employment assistance, jobs, scholarships, internships, subsistence activities, and other services to the affected community; and

* * * * *

(d) *Excessive withdrawals.* (1) The term withdrawal includes, but is not limited to, the following: cash dividends; distributions in excess of amounts needed to pay S Corporation taxes; cash and property withdrawals;

payments to immediate family members not employed by the Participant; bonuses to officers; and investments on behalf of an owner. SBA will look at the totality of the circumstances in determining whether to include a specific amount as a withdrawal under this paragraph.

* * * * *

(3) Withdrawals are excessive if during any fiscal year of the Participant they exceed:

(i) $200,000 for firms with sales up to $1,000,000;

(ii) $250,000 for firms with sales between $1,000,000 and $2,000,000; and

(iii) $400,000 for firms with sales exceeding $2,000,000.

* * * * *

(e) *Change in primary industry classification.* A Participant may request that the primary industry classification contained in its business plan be changed by filing such a request with its servicing SBA district office. SBA will grant such a request only where the Participant can demonstrate that the majority of its revenues during a two-year period have evolved from one NAICS code to another.

(f) *Graduation determination.* As part of the final annual review performed by SBA prior to the expiration of a Participant's nine-year program term, SBA will determine if the Participant has met the targets and objectives set forth in its business plan and, thus, whether the Participant will be considered to have graduated from the 8(a) BD program at the expiration of its program term.

18. Revise § 124.202 to read as follows:

§ 124.202 How must an application be filed?

An application for 8(a) BD program admission must generally be filed in an electronic format. An electronic application can be found by going to the 8(a) BD page of SBA's Web site (*www.sba.gov*). An applicant concern that does not have access to the electronic format or does not wish to file an electronic application may request in writing a hard copy application from the AA/BD. The SBA district office will provide an applicant concern with information regarding the 8(a) BD program.

19. Revise § 124.203 to read as follows:

§ 124.203 What must a concern submit to apply to the 8(a) BD program?

Each 8(a) BD applicant concern must submit those forms and attachments required by SBA when applying for admission to the 8(a) BD program. These forms and attachments may include, but not be limited to, financial statements, Federal personal and business tax returns, and personal history statements. An applicant must also submit IRS Form 4506T, Request for Copy or Transcript of Tax Form, to SBA. In all cases, the applicant must provide a wet signature from each individual claiming social and economic disadvantage status.

20. Amend § 124.204 by revising paragraph (a), redesignating paragraphs (c), (d) (e) and (f) as paragraphs (d), (e), (f) and (g), and adding new paragraph (c) to read as follows:

§ 124.204 How does SBA process applications for 8(a) BD program admission?

(a) The AA/BD is authorized to approve or decline applications for admission to the 8(a) BD program. The DPCE will receive, review and evaluate all 8(a) BD applications. Applications submitted by firms owned by ANCs will be initially reviewed by SBA's San Francisco DPCE unit. SBA will advise each program applicant within 15 days after the receipt of an application whether the application is complete and suitable for evaluation and, if not, what additional information or clarification is required to complete the application. SBA will process an application for 8(a) BD program participation within 90 days of receipt of a complete application package by the DPCE. Incomplete packages will not be processed.

* * * * *

(c) The burden of proof to demonstrate eligibility is on the applicant concern. If a concern does not provide requested information within the allotted time provided by SBA, or if it submits incomplete information, SBA may presume that disclosure of the missing information would adversely affect the firm or would demonstrate lack of eligibility in the area to which the information relates.

* * * * *

21. Revise § 124.205 (a) and (b) to read as follows:

§ 124.205 Can an applicant ask SBA to reconsider SBA's initial decision to decline its application?

(a) An applicant may request the AA/BD to reconsider his or her initial decline decision by filing a request for reconsideration with SBA. The applicant may submit a revised electronic application or submit its request for reconsideration to the SBA field office that originally processed its application by personal delivery, first class mail, express mail, facsimile transmission followed by first class mail, or commercial delivery service. The applicant must submit its request for reconsideration within 45 days of its receipt of written notice that its application was declined. If the date of actual receipt of such written notice cannot be determined, SBA will presume receipt to have occurred ten calendar days after the date the notice was sent to the applicant. The applicant must provide any additional information and documentation pertinent to overcoming the reason(s) for the initial decline, including information and documentation regarding changed circumstances.

(b) The AA/BD will issue a written decision within 45 days of SBA's receipt of the applicant's request. The AA/BD may either approve the application, deny it on the same grounds as the original decision, or deny it on other grounds. If denied, the AA/BD will explain why the applicant is not eligible for admission to the 8(a) BD program and give specific reasons for the decline.

* * * * *

22. Revise § 124.301 to read as follows:

§ 124.301 What are the ways a business may leave the 8(a) BD program?

A concern participating in the 8(a) BD program may leave the program by any of the following means:

(a) Expiration of the program term established pursuant to § 124.2;

(b) Voluntary withdrawal;

(c) Graduation pursuant to § 124.302;

(d) Early graduation pursuant to the provisions of §§ 124.302 and 124.304; or

(e) Termination pursuant to the provisions of §§ 124.303 and 124.304.

23. Amend § 124.302 by revising the heading, by revising paragraphs (a) introductory text and (a)(1), by removing paragraph (d), by redesignating paragraph (c) as paragraph (d), and by adding a new paragraph (c) to read as follows:

§ 124.302 What is graduation and what is early graduation?

(a) *General.* SBA may graduate a firm from the 8(a) BD program at the expiration of its program term (graduation) or prior to the expiration of its program term (early graduation) where SBA determines that:

(1) The concern has successfully completed the 8(a) BD program by substantially achieving the targets, objectives, and goals set forth in its business plan, and has demonstrated the ability to compete in the marketplace without assistance under the 8(a) BD program; or

* * * * *

(c) *Exceeding the size standard corresponding to the primary NAICS code.* SBA may graduate a participant prior to the expiration of its program term where the firm exceeds the size standard corresponding to its primary NAICS code for two successive program years.

* * * * *

24. Amend § 124.303 by revising paragraphs (a)(2), (a)(13) and (a)(16) to read as follows:

§ 124.303 What is termination?

(a) * * *

(2) Failure by the concern to maintain its eligibility for program participation, including failure by an individual owner or manager to continue to meet the requirements for economic disadvantage set forth in § 124.104 where such status is needed for eligibility and the Participant has not met the targets and objectives set forth in its business plan.

* * * * *

(13) Excessive withdrawals, including transfers of funds or other business assets, from the concern for the personal benefit of any of its owners or any person or entity affiliated with the owners that hinder the development of the concern (*see* § 124.112(d)).

* * * * *

(16) Debarment, suspension, voluntary exclusion, or ineligibility of the concern or its principals pursuant to 2 CFR parts 180 and 2700 or FAR subpart 9.4 (48 CFR part 9, subpart 9.4).

* * * * *

25. Revise § 124.304(f) to read as follows:

§ 124.304 What are the procedures for early graduation and termination?

* * * * *

(f) *Effect or early graduation or termination.* (1) After the effective date of early graduation or termination, a Participant is no longer eligible to receive any 8(a) BD program assistance. However, such concern is obligated to complete previously awarded 8(a) contracts, including any priced options which may be exercised.

(2) When SBA early graduates or terminates a firm from the 8(a) BD program, the firm will generally not qualify as an SDB for future procurement actions. If the firm believes that it does qualify as an SDB and seeks to certify itself as an SDB, as part of its SDB certification the firm must identify:

(i) That it has been early graduated or terminated; and

(ii) The circumstances that have changed since the early graduation or termination or that do not prevent it from qualifying as an SDB.

(3) Where a concern certifies that it qualifies as an SDB pursuant to paragraph (f)(2) of this section, the procuring activity contracting officer shall protest the SDB status of the firm to SBA pursuant to § 124.1010.

26. Amend § 124.305 by revising the first sentence of paragraph (a), and by revising paragraph (h) to read as follows:

§ 124.305 What is suspension and how is a Participant suspended from the 8(a) BD program?

(a) Except as set forth in paragraph (h) of this section, at any time after SBA issues a Letter of Intent to Terminate an 8(a) Participant pursuant to § 124.304, the AA/BD may suspend 8(a) contract support and all other forms of 8(a) BD program assistance to that Participant until the issue of the Participant's termination from the program is finally determined. * * *

* * * * *

(h)(1) SBA will suspend a Participant from receiving further 8(a) BD program benefits when termination proceedings have not been commenced pursuant to § 124.304 where:

(i) A Participant requests a change of ownership and/or control and SBA discovers that a change of ownership or control has in fact occurred prior to SBA's approval; or

(ii) A disadvantaged individual who is involved in the ownership and/or control of the Participant is called to active military duty by the United States, his or her participation in the firm's management and daily business operations is critical to the firm's continued eligibility, and the Participant elects not to designate a non-disadvantaged individual to control the concern during the call-up period pursuant to proposed § 124.106(h).

(2) A suspension initiated under paragraph (h) of this section will be commenced by the issuance of a notice similar to that required for termination-related suspensions under paragraph (b) of this section, except that a suspension issued under paragraph (h) not appealable.

(3) Where a Participant is suspended pursuant to paragraph (h)(1)(i) of this section and SBA approves the change of ownership and/or control, the length of the suspension will be added to the firm's program term only where the change in ownership or control results from the death or incapacity of a disadvantaged individual or where the firm requested prior approval and waited at least 60 days for SBA approval before making the change.

(4) Where a Participant is suspended pursuant to paragraph (h)(1)(ii) of this section, the Participant must notify SBA when the disadvantaged individual returns to control the firm so that SBA can immediately lift the suspension. When the suspension is lifted, the length of the suspension will be added to the concern's program term.

* * * * *

§ 124.403 [Amended]

27. Amend § 124.403 by removing paragraph (d).

28. Amend § 124.501 by revising the first sentence of paragraph (h) to read as follows:

§ 124.501 What general provisions apply to the award of 8(a) contracts?

* * * * *

(h) A Participant must certify that it qualifies as a small business under the size standard corresponding to the NAICS code assigned to each 8(a) contract. * * **?*

* * * * *

29. Amend § 124.503 by revising paragraph (h) to read as follows:

§ 124.503 How does SBA accept a procurement for award through the 8(a) BD program?

* * * * *

(h) *Task or Delivery Order Contracts*—(1) *Contracts set aside for exclusive competition among 8(a) Participants.* (i) A task or delivery order contract that is reserved exclusively for 8(a) Program Participants must follow the normal 8(a) competitive procedures, including an offering to and acceptance into the 8(a) program, SBA eligibility verification of the apparent successful offerors prior to contract award, and application of the performance of work requirements set forth in § 124.510, and the nonmanufacturer rule, if applicable, (*see* § 121.406(b).

(ii) Individual orders need not be offered to or accepted into the 8(a) BD program.

(iii) A concern awarded such a contract may generally continue to receive new orders even if it has grown to be other than small or has exited the 8(a) BD program, and agencies may continue to take credit toward their prime contracting goals for orders awarded to 8(a) Participants. However, a concern may not receive, and agencies may not take 8(a), SDB or small business credit, for an order where the concern has been asked by the procuring agency to re-certify its size status and is unable to do so (*see* § 121.404(g)), or where ownership or control of the concern has changed and SBA has granted a waiver to allow performance to continue (*see* § 124.515).

(2) *8(a) credit for orders issued under multiple award contracts that were not set aside for exclusive competition among eligible 8(a) Participants.* In order to receive 8(a) credit for orders placed under multiple award contracts that were not initially set aside for exclusive competition among 8(a) Participants:

(i) The order must be offered to and accepted into the 8(a) BD program;

(ii) The order must be competed exclusively among 8(a) concerns;

(iii) The order must require the concern comply with applicable limitations on subcontracting provisions (*see* § 125.6 of this chapter) and the nonmanufacturer rule, if applicable, (*see* § 121.406(b) of this chapter) in the performance of the individual order; and

(iv) SBA must verify that a concern is an eligible 8(a) concern prior to award of the order in accordance with § 124.507;

* * * * *

30–31. Amend § 124.504 by revising the first sentence of paragraph (a), by removing paragraph (d), by redesignating paragraph (e) as paragraph (d), and by revising redesignated paragraph (d) to read as follows:

§ 124.504 What circumstances limit SBA's ability to accept a procurement for award as an 8(a) contract?

(a) *Reservation as small business set-aside, or HUBZone or service disabled veteran-owned small business award.* The procuring activity issued a solicitation for or otherwise expressed publicly a clear intent to reserve the procurement as a small business set-aside or a HUBZone or service disabled veteran-owned award prior to offering the requirement to SBA for award as an 8(a) contract. * * *

* * * * *

(d) *Release for non-8(a) competition.* (1) Except as set forth in paragraph (d)(4) of this section, where a procurement is awarded as an 8(a) contract, its follow-on or renewable acquisition must remain in the 8(a) BD program unless SBA agrees to release it for non-8(a) competition. If a procuring agency would like to fulfill a follow-on or renewable acquisition outside of the 8(a) BD program, it must make a written request to and receive the concurrence of the AA/BD to do so. In determining whether to release a requirement from the 8(a) BD program, SBA will consider:

(i) Whether the agency has achieved its SDB goal;

(ii) Where the agency is in achieving its HUBZone, SDVO, WOSB, or small business goal, as appropriate; and

(iii) Whether the requirement is critical to the business development of the 8(a) Participant that is currently performing it.

(2) SBA may decline to accept the offer of a follow-on or renewable 8(a) acquisition in order to give a concern previously awarded the contract that is leaving or has left the 8(a) BD program the opportunity to compete for the requirement outside of the 8(a) BD program.

(i) SBA will consider release under this paragraph (d)(2) only where:

(A) The procurement awarded through the 8(a) BD program is being or was performed by either a Participant whose program term will expire prior to contract completion, or by a former Participant whose program term expired within one year of the date of the offering letter;

(B) The concern requests in writing that SBA decline to accept the offer prior to SBA's acceptance of the requirement for award as an 8(a) contract; and

(C) The concern qualifies as a small business for the requirement now offered to the 8(a) BD program.

(ii) In considering release under this paragraph (d)(2), SBA will balance the importance of the requirement to the concern's business development needs against the business development needs of other Participants that are qualified to perform the requirement. This determination will include consideration of whether rejection of the requirement would seriously reduce the pool of similar types of contracts available for award as 8(a) contracts. SBA will seek the views of the procuring agency.

(3) SBA will release a requirement under this paragraph only where the procuring activity agrees to procure the requirement as a small business, HUBZone, service disabled veteran-owned small business, or women-owned small business set-aside.

(4) The requirement that a follow-on procurement need must be released from the 8(a) BD program in order for it to be fulfilled outside the 8(a) BD program does not apply to orders offered to and accepted for the 8(a) BD program pursuant to § 124.503(h).

32. Amend § 124.506 by revising paragraph (a)(2)(ii), the example in paragraph (a) (3), and paragraph (b) to read as follows:

§ 124.506 At what dollar threshold must an 8(a) procurement be competed among eligible Participants?

* * * * *

(a) * * *

(2) * * *

(ii) The anticipated award price of the contract, including options, will exceed $5,500,000 for contracts assigned manufacturing NAICS codes and $3,500,000 for all other contracts; and * * *

* * * * *

(3) * * *

Example to paragraph (a)(3). If the anticipated award price for a professional services requirement is determined to be $3.2 million and it is accepted as a sole source 8(a) requirement on that basis, a sole source award will be valid even if the contract price arrived at after negotiation is $3.6 million.

* * * * *

(b) *Exemption from competitive thresholds for Participants owned by Indian tribes, ANCs and NHOs.* (1) SBA may award a sole source 8(a) contract to a Participant concern owned and controlled by an Indian tribe or an ANC where the anticipated value of the procurement exceeds the applicable competitive threshold if SBA has not accepted the requirement into the 8(a) BD program as a competitive procurement.

(2) SBA may award a sole source 8(a) contract to a Participant concern owned and controlled by an NHO on behalf of DoD where the anticipated value of the procurement exceeds the applicable competitive threshold if SBA has not accepted the requirement into the 8(a) BD program as a competitive procurement.

(3) There is no requirement that a procurement must be competed whenever possible before it can be accepted on a sole source basis for a tribally-owned or ANC-owned concern, or a concern owned by an NHO for contracts accepted on behalf of DoD, but a procurement may not be removed from competition to award it to a tribally-owned, ANC-owned or NHO-owned concern on a sole source basis.

(4) A joint venture between one or more eligible tribally-owned, ANC-owned or NHO-owned Participants and one or more non-8(a) business concerns may be awarded sole source 8(a) contracts above the competitive threshold amount, provided that no non-8(a) joint venture partner also acts as a subcontractor to the joint venture awardee.

* * * * *

33. Amend § 124.507 by adding paragraphs (c)(2)(i), (c)(2)(ii) and (c)(2)(iii) to read as follows:

§ 124.507 What procedures apply to competitive procurements?

* * * * *

(c) * * *

(2) * * *

(i) A Participant may have bona fide places of business in more than one location.

(ii) In order for a Participant to establish a bona fide place of business in a particular geographic location, the SBA district office serving the geographic area of that location must determine if that location in fact qualifies as a bona fide place of business under SBA's requirements.

(A) A Participant must submit a request for a bona fide business determination to the SBA district office servicing it.

(B) The servicing district office will forward the request to the SBA district office serving the geographic area of the particular location for processing.

(iii) In order for a Participant to be eligible to submit an offer for a 8(a) procurement limited to a specific geographic area, it must receive from SBA a determination that it has a bona fide place of business within that area prior to submitting its offer for the procurement.

* * * * *

34. Amend § 124.509(a)(1) by adding a new sentence at the end thereof to read as follows:

§ 124.509 What are non-8(a) business activity targets?

(a) *General.* (1) * * * Work performed by an 8(a) Participant for any Federal department or agency other than through an 8(a) contract, including work performed on orders under the General Services Administration Multiple Award Schedule program, and work performed as a subcontractor, including work performed as a subcontractor to another 8(a) Participant on an 8(a) contract, qualifies as work performed outside the 8(a) BD program.

* * * * *

35. Amend § 124.512 by adding a new sentence at the end of paragraph (a), by revising paragraph (b), and by adding a new paragraph (c) to read as follows:

§ 124.512 Delegation of contract administration to procuring agencies.

(a) * * * Tracking compliance with the performance of work requirements set forth in § 124.510 is included within the functions performed by the procuring activity as part of contract administration.

(b) This delegation of contract administration authorizes a contracting officer to execute any priced option or in scope modification without SBA's concurrence. The contracting officer must, however, submit copies to SBA of all modifications and options exercised within 10 business days of their occurrence.

(c) SBA may conduct periodic compliance on-site agency reviews of the files of all contracts awarded pursuant to Section 8(a) authority.

36. Amend § 124.513 by revising paragraphs (c)(3), (c)(6), (d), and (e), and adding a new paragraph (i) to read as follows:

§ 124.513 Under what circumstances can a joint venture be awarded an 8(a) contract?

* * * * *

(c) * * *

(3) Stating that the 8(a) Participant(s) must receive profits from the joint venture commensurate with the work performed by the 8(a) Participant(s);

* * * * *

(6) Specifying the responsibilities of the parties with regard to negotiation of the contract, source of labor, and contract performance, including ways that the parties to the joint venture will ensure that the joint venture and the 8(a) partner(s) to the joint venture will meet the performance of work requirements set forth in paragraph (d) of this section.

* * * * *

(d) *Performance of work.* For any 8(a) contract, including those between mentors and protégés authorized by § 124.520, the joint venture must perform the applicable percentage of work required by § 124.510, and the 8(a) partner(s) to the joint venture must perform at least 40% of the work performed by the joint venture. The work performed by 8(a) partners to a joint venture must be more than administrative or ministerial functions so that they gain substantive experience.

(e) *Prior approval by SBA.* (1) SBA must approve a joint venture agreement prior to the award of an 8(a) contract on behalf of the joint venture.

(2) Where a joint venture has been established and approved by SBA for one 8(a) contract, a second or third 8(a) contract may be awarded to that joint venture provided an addendum to the joint venture agreement, setting forth the performance requirements on that second or third contract, is provided to and approved by SBA prior to contract award.

* * * * *

(i) *Performance of work report.* At the completion of every 8(a) contract awarded to a joint venture, the 8(a) Participant(s) to the joint venture must submit a report to the local SBA district office explaining how the performance of work requirements were met for the contract.

37. Amend § 124.519 by revising paragraphs (a) and (f) to read as follows:

§ 124.519 Are there any dollar limits on the amount of 8(a) contracts that a Participant may receive?

(a) A Participant (other than one owned by an Indian tribe, ANC or NHO) may not receive sole source 8(a) contract awards where it has received a combined total of competitive and sole source 8(a) contracts in excess of the dollar amount set forth in this section during its participation in the 8(a) BD program.

* * * * *

(f) The AA/BD may waive the requirement prohibiting a Participant from receiving sole source 8(a) contracts in excess of the dollar amount set forth in this section where the head of a procuring activity represents that award of a sole source 8(a) contract to the Participant is needed to achieve significant interests of the Government.

38. Amend § 124.520 by:

A. Revising the heading,

B. Revising the first and last sentences of paragraph (a),

C. Revising paragraphs (b)(1)(i) and (iv), (b)(2), and (b)(3),

D. Revising paragraph (c)(1),

E. Adding a new sentence to the end of paragraph (c)(2),

F. Revising paragraph (c)(3),

G. Adding new paragraphs (c)(4) and (5),

H. Revising paragraph (d)(1),

I. Revising paragraph (e)(1), and the second sentence of (e)(2),

J. Redesignating paragraph (f) as paragraph (g),

K. Adding a new paragraph (f),

L. Redesignating newly designated paragraphs (g)(2) and (g)(3) as paragraphs (g)(3) and (g)(4),

M. Adding a new paragraph (g)(2), and

N. Adding a new paragraph (h)

The additions and revisions read as follows:

§ 124.520 What are the rules governing SBA's Mentor/Protégé program?

(a) *General.* The mentor/protégé program is designed to encourage approved mentors to provide various forms of business development assistance to protégé firms. * * * The purpose of the mentor/protégé relationship is to enhance the capabilities of the protégé, assist the protégé with meeting the goals established in its SBA-approved business plan, and to improve its ability to successfully compete for contracts.

* * * * *

(b) * * *

(1) * * *

(i) Possesses favorable financial health;

* * * * *

(iv) Can impart value to a protégé firm due to lessons learned and practical experience gained because of the 8(a) BD program, or through its knowledge of general business operations and government contracting.

(2) Generally a mentor will have no more than one protégé at a time. However, the AA/BD may authorize a concern to mentor more than one protégé at a time where the concern can demonstrate that the additional mentor/protégé relationship will not adversely affect the development of either protégé firm (*e.g.,* the second firm may not be a competitor of the first firm). Under no circumstances will a mentor be permitted to have more than three protégés at one time.

(3) In order to demonstrate its favorable financial health, a firm seeking to be a mentor must submit to SBA for review copies of the Federal tax returns it submitted to the IRS, or audited financial statements, including any notes, or in the case of publicly traded concerns the filings required by the Securities and Exchange Commission for the past three years.

* * * * *

(c) *Protégés.* (1) In order to initially qualify as a protégé firm, a Participant must:

(i) Be in the developmental stage of program participation; or

(ii) Have never received an 8(a) contract; or

(iii) Have a size that is less than half the size standard corresponding to its primary NAICS code.

(2) * * * Once a firm graduates from or otherwise leaves the 8(a) BD program, it will not be eligible for any further benefits from its mentor/protégé relationship (*i.e.,* the receipts and/or employees of the protégé and mentor will generally be aggregated in determining size for any joint venture between the mentor and protégé after the protégé leaves the 8(a) BD program).

(3) A protégé firm may generally have only one mentor at a time. The AA/BD may approve a second mentor for a particular protégé firm where (i) the second relationship pertains to an unrelated, secondary NAICS code; (ii) the protégé firm is seeking to acquire a specific expertise that the first mentor does not possess; and (iii) the second relationship will not compete or otherwise conflict with the business development assistance set forth in the first mentor/protégé relationship.

(4) A protégé may not become a mentor and retain its protégé status. The protégé must terminate its mentor/protégé agreement with its mentor before it will be approved as a mentor to another 8(a) Participant.

(5) SBA will not approve a mentor/protégé relationship for an 8(a) Participant with less than one year remaining in its program term.

(d) *Benefits.* (1) A mentor and protégé may joint venture as a small business for any government prime contract or subcontract, including procurements with a dollar value less than half the size standard corresponding to the assigned NAICS code and 8(a) sole source contracts, provided the protégé qualifies as small for the procurement and, for purposes of 8(a) sole source requirements, the protégé has not reached the dollar limit set forth in § 124.519.

(i) SBA must approve the mentor/protégé agreement before the two firms may submit an offer as a joint venture on a particular government prime contract or subcontract and receive the exclusion from affiliation.

(ii) In order to receive the exclusion from affiliation for both 8(a) and non-8(a) procurements, the joint venture must meet the requirements set forth in § 124.513(c).

(e) *Written agreement.* (1) The mentor and protégé firms must enter a written agreement setting forth an assessment of the protégé's needs and providing a detailed description and timeline for the delivery of the assistance the mentor commits to provide to address those needs (*e.g.,* management and/or technical assistance, loans and/or equity investments, cooperation on joint venture projects, or subcontracts under prime contracts being performed by the mentor). The mentor/protégé agreement must:

(i) Address how the assistance to be provided through the agreement will help the protégé firm meet the goals established in its SBA-approved business plan;

(ii) Establish a single point of contact in the mentor concern who is responsible for managing and implementing the mentor/protégé agreement; and

(iii) Provide that the mentor will provide such assistance to the protégé firm for at least one year.

(2) * * * The agreement will not be approved if SBA determines that the assistance to be provided is not sufficient to promote any real developmental gains to the protégé, or if SBA determines that the agreement is merely a vehicle to enable the mentor to receive 8(a) contracts.

* * * * *

(f) *Decision to decline mentor/protégé relationship.* (1) Where SBA declines to approve a specific mentor/protégé agreement, the protégé may request the AA/BD to reconsider the Agency's initial decline decision by filing a request for reconsideration with its servicing SBA district office within 45 calendar days of receiving notice that its mentor/protégé agreement was declined. The protégé may revise the proposed mentor/protégé agreement and provide any additional information and documentation pertinent to overcoming the reason(s) for the initial decline to its servicing district office.

(2) The AA/BD will issue a written decision within 45 calendar days of receipt of the protégé's request. The AA/BD may either approve the mentor/protégé agreement, deny it on the same grounds as the original decision, or deny it on other grounds. If denied, the AA/BD will explain why the mentor/protégé agreement does not meet the requirements of § 124.520 and give specific reasons for the decline.

(3) If the AA/BD declines the mentor/protégé agreement solely on issues not raised in the initial decline, the protégé can ask for reconsideration as if it were an initial decline.

(4) If SBA's final decision (either by allowing 45 calendar days to pass from receiving the initial decision or the decision by the AA/BD on reconsideration) is to decline a specific mentor/protégé agreement, the 8(a) firm seeking to be a protégé cannot attempt to enter another mentor/protégé relationship with the same mentor for a period of one year from the date of the final decision. The 8(a) firm may, however, submit another proposed mentor/protégé agreement with a different proposed mentor at any time after the SBA's final decline decision.

(g) * * *

(2) The protégé must report the mentoring services it receives by category and hours.

* * * * *

(h) *Consequences of not providing assistance set forth in the mentor/protégé agreement.* (1) Where SBA determines that a mentor has not provided to the protégé firm the business development assistance set forth in its mentor/protégé agreement, SBA will notify the mentor of such determination and afford the mentor an opportunity to respond. The mentor must respond within 30 days of the notification, explaining why it has not provided the agreed upon assistance and setting forth a definitive plan as to when it will provide such assistance. If the mentor fails to respond, does not supply adequate reasons for its failure to provide the agreed upon assistance, or does not set forth a definite plan to provide the assistance:

(i) SBA will recommend to the relevant procuring agency to issue a stop work order for each Federal contract for which the mentor and protégé are performing as a small business joint venture pursuant to paragraph (d)(1) of this section;

(ii) SBA will terminate its mentor/protégé agreement; and

(iii) The firm will be ineligible to again act as a mentor for a period of two years from the date SBA terminates the mentor/protégé agreement.

(2) SBA may consider a mentor's failure to comply with the terms and conditions of an SBA-approved mentor/protégé agreement as a basis for debarment on the grounds, including but not limited to, that the mentor has not complied with the terms of a public agreement under 2 CFR 180.800(b).

39. Amend § 124.601 by revising paragraph (a) to read as follows:

§ 124.601 What reports does SBA require concerning parties who assist Participants in obtaining Federal contracts?

(a) Each Participant must submit semi-annually a written report to its assigned BOS that includes a listing of any agents, representatives, attorneys, accountants, consultants and other parties (other than employees) receiving fees, commissions, or compensation of any kind to assist such participant in obtaining a Federal contract. The listing must indicate the amount of compensation paid and a description of the activities performed for such compensation.

* * * * *

40. Amend § 124.602 by revising paragraphs (a) introductory text, (b), and (c) to read as follows:

§ 124.602 What kind of annual financial statement must a Participant submit to SBA?

(a) Participants with gross annual receipts of more than $10,000,000 must submit to SBA audited annual financial statements prepared by a licensed independent public accountant within 120 days after the close of the concern's fiscal year.

* * * * *

(b) Participants with gross annual receipts between $2,000,000 and $10,000,000 must submit to SBA reviewed annual financial statements prepared by a licensed independent public accountant within 90 days after the close of the concern's fiscal year

(c) Participants with gross annual receipts of less than $2,000,000 must submit to SBA an annual statement prepared in-house or a compilation statement prepared by a licensed independent public accountant, verified as to accuracy by an authorized officer, partner, limited liability member, or sole proprietor of the Participant, including signature and date, within 90 days after the close of the concern's fiscal year.

41. Amend § 124.1002 by revising paragraph (d) and adding a new paragraph (h) to read as follows:

§ 124.1002 What is a Small Disadvantaged Business (SDB)?

* * * * *

(d) *Additional eligibility criteria.* (1) Except for tribes, ANCs, CDCs, and NHOs, each individual claiming disadvantaged status must be a citizen of the United States.

(2) The other eligibility requirements set forth in § 124.108 for 8(a) BD program participation do not apply to SDB eligibility.

* * * * *

(h) *Full-time requirement for SDB purposes.* An SDB is considered to be managed on a full-time basis by a disadvantaged individual if such individual works for the concern during all of the hours the concern operates. For example, if a concern operates 20 hours per week and the disadvantaged manager works for the firm during those twenty hours, that individual will be considered as working full time for the firm.

Karen G. Mills,

Administrator.

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