



SDVOSBLAW.COM NEWSLETTER

Will Your Operating Agreement Survive CVE Review or a Bid Protest?

INSIDE THIS ISSUE

- 1 Operating Agreement against CVE Review...
- 2 No Job experience needed to control your company...
- 3 Service- Disabled Veteran can now own more than one SDVOSB...
- 4 No right to appeal VA decisions on SDVOSB Protests...

A Service Disabled Veteran must control the day-to-day and long-term operations of his company. This regulatory requirement is designed to prevent SDVOSBs from acting as front companies.

The VA Center for Veterans Enterprise (CVE) may examine an SDVOSB's ownership records to verify that the service-disabled veteran is actually in control. Competitors may also challenge an SDVOSB's qualifications by filing a bid protest

An SDVOSB's Operating Agreement establishes the rights and responsibilities of its members. An Operating Agreement that does not give the service-disabled veteran full control over his company will result in immediate disqualification. The control requirements can be found at 13 C.F.R. Section 125.10, which provides that:

- The Service Disabled Veteran must control both the long-term decisions and day-to-day management and administration of the SDVOSB.
- The service-disabled veteran must hold the highest officer position in the company (usually President or Chief Executive Officer) and must have managerial experience of the extent and complexity needed to run the concern.
- The service-disabled veteran must have control over all of the decisions of the limited liability company and be the managing member.

- The service-disabled veteran must control the Board of Directors of a Corporation.
 - Day-to-day management means supervising the executive team, formulating sound policies and setting strategic direction.
 - Day-to-day operations mean the marketing, production, sales, and administrative functions of the firm.

(38 CFR Part 74.1)

In Wexford Group International, Inc., SDV-105, the SBA held that an Operating Agreement cannot restrict a service disabled veteran's ability to transfer his ownership interests whenever and to whomever he wants. In this regard, the SBA held that:

In the context of 13 C.F.R. § 125.9, unconditional necessarily means there are no conditions or limitations upon an individual's present or immediate right to exercise full control and ownership of the concern. Nor can there be any impediment to the exercise of the full range of ownership rights. Thus, a service-disabled veteran: (1) Must immediately and fully own the company (or stock) without having to wait for future events; (2) Must be able to convey or transfer interest in his ownership interest or stock whenever and to whomever they choose; and (3) Upon departure, resignation, retirement, or death, still own their stock and do with it as they choose. In sum, service-disabled veterans must immediately have an absolute right to do anything they want with their ownership interest or stock, whenever they want.

Hence, any restriction on the service-disabled veteran's ability to transfer his stock to anyone and at any price would violate the SDVOSB regulations. The Operating Agreement cannot, for example, state that the service-disabled veteran's membership interest in the LLC must be sold to other members of the LLC upon the service-disabled veteran's death or resignation.

The Operating Agreement cannot impose any supermajority voting requirements precluding the service-disabled veteran from running his company, including fixing salaries and firing employees. In CymSTAR, LLC, SBA No. VET-123, the LLC's Operating Agreement required a supermajority vote of 66% for certain decisions on how to run the company. Since the service-disabled Veteran did not hold a 66% membership interest, the LLC was stripped of an award it received under an SDVOSB set-aside procurement.

A non-compete provision in an Operating Agreement that restricts a service-disabled veteran's ability to obtain employment elsewhere was held invalid in Valor Contracting, LLC, VET-194. This was viewed as an undue restriction on the service disabled veteran's ability to leave his company and find another job.

All voting requirements in the Operating Agreement must allow for majority vote of 51% so that the service-disabled veteran is not precluded from controlling the company. The common pitfall is where

the Operating Agreement requires vote of all members for a specific act, or a supermajority vote. For example in the bid protest decision of VetIndy, LLC, VET-175, the Operating Agreement wrongly stated the service-disabled veteran could not, without the consent of all other Members, "undertake, including releasing company debts, engaging in transactions outside of the ordinary course of business, and selling or otherwise disposing of company assets" The SBA held that this supermajority provision improperly prevented the service-disabled veteran from exercising control over his company.

Whether faced with CVE review or a bid protest, the SDVOSB's Operating Agreement will be closely examined to determine whether the service-disabled veteran controls his company. A poorly written Operating Agreement may result in an inadvertent disqualification. It is therefore critical that your Operating Agreement be written with the SDVOSB regulations in mind. led veteran will subject his or her company to protest and jeopardize its SDVOSB status.■

Service Disabled Veteran Does Not Need Job Specific Experience to Control His Company.

Service-disabled veterans must control the day-to-day operations of the Service Disabled Veteran Owned Business ("SDVOSB"). Under 13 C.F.R. § 125.10(b), proof of control also requires the person having the legal ability to control the concern have managerial experience of the extent and complexity needed to run the concern, *i.e.*, the service-disabled veteran in legal control must actually have the capability to control the concern. This requirement is codified at 13 C.F.R. § 125.10(b), which states:

Managerial position and experience. A service-disabled veteran (or in the case of a service-disabled veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran) must hold the highest officer position in the concern (usually President or Chief Executive Officer) and must have managerial experience of the extent and complexity needed to run the concern. The service-disabled veteran manager (or in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran) need not have the technical expertise or possess the required license to be found to control the concern if the service-disabled veteran can demonstrate that he or she has ultimate managerial and supervisory control over those who possess the required licenses or technical expertise.

In Four Point Technology, Inc., SBA VET-120, the SBA held that the service-disabled veteran did have enough experience to control is company. The absence of any credible evidence describing the service-disabled veteran's experience led to that decision. The SBA noted that service-disabled veteran only provided "a vague thumbnail sketch" of his experience.

By contrast, in McGoldrick Construction Services, Inc., SBA VET-127, the SBA held that a Four-Star General had the necessary managerial experience to run a construction company. In this regard the SBA stated:

Furthermore, the record demonstrates General Habiger possesses the managerial experience necessary to operate SPD. General Habiger gained extensive managerial experience in the United States Air Force, including serving as a Four-Star General, as well as acquired managerial experience overseeing four thousand personnel as Security Czar within the Department of Energy and as the former president and chief executive of the San Antonio Water System. In addition to gaining managerial experience through

previous positions, the record demonstrates General Habiger has specific knowledge of the construction industry.

In Michael Ogden Pratt, SBA VET-200, the SBA held that specific job related experience is unnecessary. The service-disabled veteran must only have the experience to manage his company. Thus, in this protest, a service-disabled veteran, who also happened to also be a full time medical student, did have the requisite management experience. The SBA pointed out that proof of such experience is the fact that the service-disabled veteran was able to subcontract out that portion of the work his company could not do itself.

These cases illustrate the need for the service-disabled veteran to obtain the necessary skills and education to manage his or her SDVOSB. Contemporaneous documentation of the service-disabled veteran's education, certifications and real world experiences should be maintained in the event a protest is mounted.■

VA Regulations Changed to Allow Service-Disabled Veteran to Own More than One SDVOSB.

Effective February 18, 2011, the Department of Veteran Affairs' has changed the rules governing a service-disabled Veteran's management and control over a service-disabled Veteran Owned Small Business ("SDVOSB"). Prior to the change, a service-disabled Veteran could only own one SDVOSB at any given time. The logic behind that rule is that a service-disabled Veteran could not realistically manage and control more than one company at a time. The VA eliminated the one-company rule after public comment.

The VA agreed that the one-company rule was unfair to start-up SDVOSBs. With start-ups, the service-disabled Veteran may have to run an existing business until the start-up SDVOSB gets on its feet. The new rule also discards the requirement that the service-disabled Veteran must work full-time for an SDVOSB. In this regard, the new rule states that, "an applicant or participant must be controlled by one or more veterans who possess requisite management capabilities. Owners need not work full-time but must show sustained and significant time invested in the business."

Even with the VA's rule changes, a service-disabled Veteran must still pay close attention to the control and management requirements. Where a service-disabled Veteran owns an SDVOSB and another business, the service-disabled Veteran must submit a written supplemental statement to the VA, stating that this will not impede the service-disabled Veteran's ability to manage and control the SDVOSB. On this issue, the new regulation states:

(c)(1) An applicant or participant must be controlled by one or more veterans or service-disabled veterans who possess requisite management capabilities. Owners need not work full-time but must show sustained and significant time invested in the business. An owner engaged in employment or management outside the applicant concern must submit a written statement supplemental to the application which demonstrates that such activities will not have a significant impact on the owner's ability to manage and control the applicant concern. Applications form joint-ventures are exempt from the requirement to submit a supplemental written statement.

We therefore are faced with a new standard that the service-disabled Veteran must demonstrate a "sustained and significant time invested in the [SDVOSB] business." This provides the VA with some flexibility in determining whether a service-disabled Veteran has dedicated the necessary time to properly manage and control an SDVOSB. The service-disabled Veteran must be prepared to demonstrate that he is not spread too thin by owning more than one (1) business, and is able to manage and control his SDVOSB company. ■

For Now, No Right to Appeal VA Decisions on SDVOSB Protests.

Historically, the SBA has decided SDVOSB protests for VA procurements. The VA farmed-out this work to the SBA under an Interagency Agreement. If a contractor disagreed with the SBA's agency level determination on the protest, it could file an appeal before the SBA Office of Hearings and Appeals. Not anymore.

The VA did not renew its Interagency Agreement with the SBA. VA Acquisition Regulation §819.307 provides that the Executive Director of VA's OSDDBU will now decide SDVO SBC status protests involving VA acquisitions until an Interagency Agreement is executed. 48 C.F.R. § 819.307(a), (c). The rule also provides that "[t]he Executive Director's decision shall be final." 48 C.F.R. § 819.307(c). The VA regulation therefore does not provide for an appeal from a VA OSDDBU determination.

Thus, until either (1) the VA changes the VA Acquisition Regulations to allow for an appeal or (2) an Interagency Agreement is reached between the VA and the SBA, the private sector has been effectively stripped of any appeal rights on an SDVOSB protest involving a VA procurement. Let's hope the VA resolves this soon. ■

About Us

- The founder of the firm, John Manfredonia, is a former Government Trial Attorney with the Department of Veterans Affairs.
- We provide legal assistance to companies involved in civilian and military contracts with the federal government.
- We represent a number of SDVOSBs, 8(a) and other small businesses.
- We also represent large businesses in both military and civilian procurements.
- We can assist in bid protests, claims, changes, delays, differing site conditions, defective specs, terminations, Contract Disputes Act litigation, SDVOSB issues, and other federal procurement matters.

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