Joint Ventures and Other Teaming Arrangements

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Agenda

- Teaming in General
- Teaming Agreements and Joint Ventures – Differences and Similarities
- Teaming Agreement Issues and Advantages
    - Enforceability
    - Spirit and Letter
- Joint Venture Issues and Advantages
    - “Populated” or “Unpopulated” ?
    - Affiliation and limits on awards
    - Mentor Protégé Joint Ventures

Teaming in General

Teaming under FAR 9.601

"Contractor team arrangement," means –

- Two or more companies form a *partnership or joint venture* to act as a potential prime contractor (horizontal teaming arrangement); or
- A potential *prime contractor agrees* with one or more other companies to have them *act as its subcontractors* under a specified Government contract or acquisition program (vertical teaming arrangement)

Why Team?

- FAR 9.602(a) explicitly recognizes that teams *may be* desirable from the Government's standpoint
- May enable companies to…
  - Complement each other's unique capabilities; and
  - Offer the Government the best combination of performance, cost, and delivery

Restrictions on Teaming

- Permitted in all types of acquisitions (FAR 9.602)
- Sometimes prohibited by solicitation provision
  - When requirements put heavy emphasis on security or control
  - When OCI is anticipated that could be exacerbated by teaming
- Sometimes limited by solicitation provision or clause
  - When the Government wants to evaluate all participants
  - When the Government wants to exclude one or more participants

Teaming Timing

- Arrangements normally formed *before* offer
  - Very common for competitions where primary advantage of teaming is expertise or past performance
  - Less common when sub's participation is seen as a commodity
- *May* be formed after award
  - Common for goods or services not part of evaluation
  - Rare for JV's

Teaming Agreements & Joint Ventures Differences & Similarities

Legal Differences

Prime/Sub Team

- Prime has sole interest and complete responsibility
- Team controlled by
  - Subcontracts written by Prime
  - Teaming agreement
- Prime has privity of contract
- Profits and losses earned per subcontracts

Joint Venture

- Separate Legal Entity with “Members” with proportionate “interests”
- “Special Purpose” entity
- Members usually jointly AND severally liable
- Profit and losses shared proportionately

More on Prime/Sub Teaming

- Team is controlled by the Prime
- Socio-Economic characteristics of the Team are driven by those of the Prime
  - Team with large Prime will be treated as large
  - Team with small/8(a)/SD/WO prime will be treated as Prime alone would be (usually)
- Quals and past performance of subs can contribute to Team eval, but usually only in area assigned to sub team member

More on Joint Ventures

- A Joint Venture can include two or more companies and could be…
  - Only small businesses or other special classes
  - Only large businesses
  - A mix of both
- *With limited exceptions*, a JV of a small business and a large business cannot qualify as “small” due to “affiliation”

Still *More* on Joint Ventures

- A Joint Venture may be populated or unpopulated
  - A "populated" JV is where the JV hires employees, leases space, owns equipment, etc.
  - An "unpopulated" JV is where the JV exists only on paper and Members provide employees, facilities, equipment etc. as a subcontractor to JV (some unpopulated JVs do lease space)

Teaming Agreement Issues and Advantages

Teaming Agreements in General

- Should state the purpose of the agreement
- Should define relationship between the parties (including what they are NOT to each other)
- Should declare the rights of the parties and any other general provisions
- Usually includes a promise to execute a more detailed subcontract upon the successful outcome of the proposal
- Teaming agreements are recognized under FAR, but state law, not federal, governs disputes as to enforceability because they are commercial contracts

More on Enforceability

- The flexibility and preliminary nature represents a risk to contractors
- Teaming agreements are contracts and subject to the rules regarding the enforceability of contracts
- U.S. District Court for the Eastern District of Virginia found a teaming agreement, between two government contractors, unenforceable under Virginia law

Cyberlock Consulting, Inc. v. Info. Experts, Inc., 2013 WL 1395742 (Apr. 3, 2013)

Still More on Enforceability

- Exclusivity provisions in teaming agreements may be enforceable to recover damages
- The Fifth Circuit court recently affirmed a jury verdict arising from the breach of an exclusive teaming agreement

X Technologies, Inc. v. Marvin Test Sys., Inc., No. 12-50230, 2013 WL 2493735 (June 11, 2013)

How the Parties May Protect Themselves

- Government contractors should consider including these elements in their agreements:
  - Clear statement of work;
  - Clear statement of subcontract pricing;
  - Duration of the teaming agreement;
  - Clear statement that Prime "shall" subcontract with the teammate; and
  - A T for C clause that permits the Prime to terminate sub only if and to extent Government terminates Prime

Wait a Minute!

- Isn’t that really the subcontract?
- To be enforceable, a teaming agreement must BE a contract
- Best practice is to negotiate the subcontract BEFORE the proposal is submitted and include it in the business volume
  - Sub’s “leverage” disappears when solicitation closes
  - Including executed sub in proposal usually satisfies the consent to subcontract requirement of FAR

Joint Venture Issues & Advantages

Primary Joint Venture Advantages

- JV provides "one stop shopping" to the Government for the combined resources of the Members (technical and other)
- JV has performance history that combines that of each Member
- JV allows each Member to cite the contract as past performance in future proposals
- JV allows small business to be competitive as a prime contractor

More Joint Venture Advantages

- JV allows Member greater control over prime contract performance than it would have as a sub
- In certain *limited circumstances*, can allow a large contractor access to work set aside for small businesses

Joint Venture Disadvantages

- Some officials not familiar with the model; concerns arise about responsibility for contract performance or nonperformance
- Can be a challenge for Members to "speak with one voice"
- Depending on JV structure, a Member may get less work than it would as a sub or a single Prime
- More paperwork and more complicated to set up a joint venture – can be more expensive

More Joint Venture Disadvantages

- ALL the liabilities are shared by ALL the Members
- Joint Venture relationships are harder to exit if they don’t work

Joint Venture Issues

Special requirements for a Joint Venture with small business Members bidding on a set-aside

- JV is a Limited Purpose Entity - individuals or companies that combine resources to *bid on specific opportunities*
- 3 in 2 rule - JV limited to three awards in two years
  - May receive more than 3 awards if offer leading to 4th award submitted prior to JV receiving third contract
  - May create additional JVs after receiving 3 awards

Joint Venture Issues

More on those special requirements …

- Members of an SBA Joint Venture are *affiliated* unless –
  - JV is between two or more small businesses *and* certain conditions are satisfied, or
  - JV is between a "Mentor" and a "Protégé" under SBA's 8(a) Program or DoD's Mentor/Protégé Program

More on Affiliation

- Members of a joint venture that submit an offer in response to a solicitation are ***presumed to be affiliated*** with each other for that procurement
  - The SBA will aggregate the number of employees or revenues (per the NAICS code) of ALL affiliated Members to determine EACH Member's size
  - If the aggregate of the affiliated Members exceeds the size standard of the NAICS code for a ***set-aside procurement***, the JV will ***not be eligible for the set-aside award*** – there are exceptions

Exceptions to Affiliation

- When ALL Members are "small" under the size standard for the NAICS code of solicitation ***and***
- Procurement is a bundled requirement
  or
  Procurement value is…
  - More than $10 million for employee-based size standards
  - More than one-half the applicable size standard for revenue-based size standards

Exceptions to Affiliation

- The Members are in an approved SBA 8(a) Program Mentor/Protégé Agreement
  or
  The Members are in an approved DoD Mentor/Protégé Agreement

- Certain special conditions apply to SBA 8(a) Mentor/Protégé Agreements

More on SBA Mentor/Protégé JVs

- JV must be approved by SBA pursuant to an existing SBA 8(a) Mentor/Protégé Agreement
- Mentor/Protégé Agreements
  - Mentor is a large business and generally cannot have more than three Protégés
  - Protégé is a small business ***in SBA's 8(a) Program*** and can generally have only one Mentor – also…
    - Protégé must be in good standing with 8(a) Program
    - Protégé is not within 6 months of nine year program term
    - Protégé is in developmental stage of 8(a) program (first 4 years), has never received an 8(a) contract or is half the size of its primary NAICS code

SBA M/P JV Advantages to Protégé

- Small business may pursue opportunities broader than small business would otherwise qualify for
- Small business gets “prime” past performance record and may use past performance record of partners
  - Advantageous where solicitation says past performance of subs will not be considered
- Small businesses qualify as “small” longer
  - Small businesses must include in receipts or headcount its proportionate share of joint receipts or joint employees

SBA M/P JV Advantages to Mentor

- Large business may pursue set-aside opportunities for which it is otherwise ineligible
  - Large business can perform up to 60% of the work as opposed to 49% as a sub to the small business Prime
- Large business may have control over contract performance than if it were a sub
  - For JVs under SBA-approved M/P Agreement, control over performance will not lead to "affiliation"
- Large business can gain entre to new agency or program where small business has history

Unique Characteristics of SBA 8(a) M/P JV

- JV agreement must be in writing
- JV must establish special bank account with *both Member signatures required to release funds from account*
- Both parties obligated to performance of 8(a) contracts even upon withdrawal of a Member
- 8(a) Protégé must own 51% of the JV and receive 51% of the profits
  - If unpopulated, JV is really a pass through and no profits remain in JV

Unique Characteristics of SBA 8(a) M/P JV

- JV may be informal (by agreement) or formal (LLC or corporation)
- JV may be populated or unpopulated

Work in SBA 8(a) M/P JVs

- The amount of work an 8(a) Member of a Joint Venture must perform depends on whether the JV is "populated" or "unpopulated"
  - If "unpopulated", 8(a) JV Member must perform at least 40% of the work of the JV and/or the Members as a *de facto* subcontractor
  - If "populated", 8(a) Member not required to perform any specific percentage of the work, but JV must be able to show that the 8(a) Member benefits from the allocation of work within the Joint Venture

Unpopulated SBA M/P Joint Venture

Joint Venture
Unpopulated

- Acts as a "pass through"
- JV must perform at least 51% of the cost of the JV contract incurred for personnel

Protégé

- *De facto* subcontractor
- Must perform at least 40% of JV contract
- Must receive 51% of the JV profits (but no profit remains in JV)

Subcontractors

- Can only perform up to 49% of the cost of the JV contract incurred for personnel
- Cannot be Mentor affiliate

Mentor

- *De facto* subcontractor
- Can perform up to 60% of JV contract
- May receive up to 60% of JV profits because no profit remains in unpopulated JV

Populated SBA 8(a) M/P Joint Venture

Joint Venture
Populated

- JV must perform at least 51% of the cost of the JV contract *incurred for personnel*

Protégé

- No minimum percentage of work obligation but Protégé must demonstrate how it is benefitting from allocation of work
- Must get 51% of JV profits

Mentor

- *De facto* subcontractor
- No restriction on performance of work
- Restricted to 49% of JV profits

Subcontractors

- Can only perform up to 49% of the cost of the JV contract incurred for personnel
- Cannot be the Mentor or a Mentor affiliate

Successful JV Lessons Learned

- They have “educated consumers” as customers
- The Members have a “shared vision”
  - Focus on Customer
  - Understanding of JV purpose
  - Understanding of JV agreement
- Most are a separate legal entity
- They operate under a written agreement with…
  - Clear Member roles on operations, contracts, books/records and finances
  - Clear processes for voting, termination, disputes

“Other” JV Lessons Learned

- Consumer does not understand the JV entity
- No clear, single objective
- No single POC/Lead Member/”single voice”
- No written agreement/general agreement
- Differing or unclear Member expectations
- Differing corporate cultures/operational styles
- Imbalance in expertise, resource contributions, or investment by Members

Accounting Considerations

- Role of the Accountants
- Potential Impacts
- Teaming Arrangements vs. Joint Ventures
- Overview of Accounting for Joint Ventures
- Variable Interest Entities (VIEs)
- Hypothetical Examples

Role of the Accountants

- Identify potential impacts to the Company
  - Financial statement impact
  - Loan covenant impact
  - Tax impact
- Early involvement is key

Potential Impacts

- Increased financial statement disclosure
- Equity method of accounting
- Consolidation
- Loan covenant issues

Looking Forward

- SBA's 8(a) Mentor/Protégé Program will be extended to all other SBA programs (SDVOSB, WOSB, HUBZone) and to small business in general
- Requirements likely to mirror those applicable to 8(a) Mentor/Protégé Program and Mentor/Protégé Joint Ventures
- SBA will administer all agency Mentor/Protégé programs

Questions?

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