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Part VII

Small Business Administration

13 CFR Parts 121 and 124
Small Business Size Regulations; 8(a) Business Development/Small Disadvantaged Business Status Determinations; Final 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: Final rule.

SUMMARY: This rule makes changes to the regulations governing the section 8(a) Business Development (8(a) BD) program, the U.S. Small Business Administration's (SBA or Agency) size regulations, and the regulations affecting Small Disadvantaged Businesses (SDBs). It is the first comprehensive revision to the 8(a) BD program in more than ten years. 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 (NAICS).

DATES: *Effective Date:* This rule is effective March 14, 2011.

Compliance Dates: Except for 13 CFR 124.604, the revisions to 13 CFR part 124 apply to all applications for the 8(a) BD program pending as of March 14, 2011 and all 8(a) procurement requirements accepted by SBA on or after March 14, 2011. These rules do not apply to any 8(a) BD appeals pending before SBA's Office of Hearings and Appeals. The requirements of § 124.604 apply to all 8(a) BD program participants as of September 9, 2011, unless SBA further delays implementation through a Notice in the **Federal Register**. The amendments to 13 CFR part 121 apply with respect to all solicitations issued and all certifications as to size made after March 14, 2011.

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

SUPPLEMENTARY INFORMATION: On October 28, 2009, SBA published in the **Federal Register** a comprehensive proposal to revise the 8(a) BD program and several proposed revisions to SBA's size regulations. 74 FR 55694. Some of the proposed changes involve technical issues. Others are more substantive and result from SBA's experience in implementing the current regulations. In addition, SBA has made changes in this final rule in response to comments received to its notice of proposed rulemaking. SBA has learned through experience that certain of its rules governing the 8(a) BD program are too restrictive and serve to unduly preclude firms from being admitted to the program. In other cases, SBA determined that a rule is too expansive or indefinite and sought to restrict or clarify those rules. In one case, SBA made wording changes to correct past public or agency misinterpretation. Additionally, this rule makes changes to address situations that were not contemplated when the previous revisions to the 8(a) BD program were made. The proposed rule called for a 60-day comment period, with comments required to be received by SBA by December 28, 2009. The overriding comment SBA received in the first few weeks after the publication was to extend the comment period. Commenters felt that the nature of the issues raised in the rule and the timing of comments during the holiday season required more time for affected businesses to adequately review the proposal and prepare their comments. In response to these comments, SBA published a notice in the **Federal Register** on December 9, 2009, extending the comment period an additional 30 days to January 28, 2010. 74 FR 65040. In addition to providing a 90-day comment period, SBA also solicited the public's views regarding the proposal through a series of listening sessions held throughout the country. SBA held listening sessions in Washington, DC on December 10 and 11, 2009; in New York, New York on December 16, 2009; in Seattle, Washington on December 17, 2009; in Boston, Massachusetts on December 18, 2009; in Dallas, Texas on January 11, 2010; in Atlanta, Georgia on January 12, 2010; in Albuquerque, New Mexico and Miami, Florida on January 14, 2010; and in Chicago, Illinois and Los Angeles, California on January 19, 2010.

Additionally, SBA conducted Tribal consultations pursuant to Executive Order 13175, Tribal Consultations, on December 16, 2009 in Seattle, Washington; on January 14, 2010 in Albuquerque, New Mexico; and on January 27, 2010 for Anchorage, Alaska in Vienna, Virginia via a video teleconference with representatives located in Anchorage, Alaska.

In addition to the many comments received from those testifying at the various public forums and Tribal consultations conducted around the country, SBA received 231 timely written comments during the 90-day comment period, with a high percentage of commenters favoring the proposed changes. A substantial number of commenters applauded SBA's effort to clarify and address misinterpretations of the rules. For the most part, the comments supported the substantive changes proposed by SBA. Additionally, in response to specific requests for information, SBA received comments with alternative approaches on many aspects of the proposed rule.

The proposed rule contained changes to SBA's size regulations (part 121) and the regulations governing SBA's 8(a) BD program (part 124). SBA received substantive comments on the proposed changes to both of these program areas. With the exception of comments which did not set forth any rationale or make suggestions, SBA discusses and responds fully to all the comments below.

Summary of Comments and SBA's Responses

Part 121

SBA received a substantial number of comments addressing the proposed changes to the size rules.

Production Pools

In response to the proposed changes on affiliation, one commenter noted that § 121.103(b) was not entirely consistent with the statutory authority regarding exclusions from affiliation for certain types of small business pools. Specifically, section 9(d) of the Small Business Act (the Act), 15 U.S.C. 638(d), authorizes an exclusion from affiliation for research and development pools. Similarly, section 11 of the Act, 15 U.S.C. 640, authorizes an exclusion from affiliation for defense production pools. SBA's current regulation set forth in § 121.103(b)(3) inadvertently omitted the reference to defense production pools. It was never SBA's intent to exclude defense production pools from the exception to affiliation. The words "or for defense production" were inadvertently omitted from § 121.102(b)(3) after the words "joint program of research and development." Accordingly, this final rule corrects this omission.

Exception to Affiliation for Mentor/Protégé Programs

The proposed rule intended to 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. In practice, the former regulation was at times misconstrued by other Federal agencies that believed they could establish mentor/protégé programs and exempt protégés from SBA's size affiliation rules on their own. That was never SBA's intent. The

exception to affiliation contained in § 121.103(b)(6) is 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 remained in the rule as proposed. The proposed rule also clarified 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. The Supplementary Information to the proposed rule noted that SBA did not anticipate approving exceptions to affiliation to agencies seeking to have such an exception for their mentor/protégé programs except in limited circumstances. SBA reasoned that the 8(a) BD program is a unique business development program that is unlike other Federal programs.

SBA received a number of comments in response to this proposal. Several comments supported the current requirement, that was not amended in the proposed rule, that SBA would not find affiliation between a protégé firm and its mentor based solely on the assistance received under a mentor/protégé agreement. SBA does not change that provision in this final rule.

SBA received comments both in support and of and in opposition to the clarification contained in the proposed rule that other agencies could create mentor/protégé programs containing an exclusion to affiliation only where authorized by statute or by SBA after requesting such an exception under § 121.903 of SBA's size regulations. Those supporting the proposal recognized that were agencies able to waive SBA's affiliation rules whenever they thought it to be appropriate (*i.e.,* without requesting or receiving approval from SBA), legitimate small businesses could be adversely affected. Several commenters stated that other agencies should be able to construct mentor/protégé programs for their purposes as they see fit. Specifically, these commenters believed that if another agency wanted to allow an exclusion from affiliation for a joint venture between a protégé firm and its mentor for a program of that other agency, the agency should be able to do so. By statute, SBA is the agency authorized to determine size, specifically including whether a firm qualifies as a small business for any Federal program. *See* 15 U.S.C. 632(a). In particular, the Act specifies that "[u]nless authorized by statute, no Federal department or agency may prescribe a size standard for categorizing a business concern as a small business concern, unless such proposed size standard * * * is [among other things] approved by the [SBA] Administrator." 15 U.S.C. 632(a)(2)(C). SBA firmly believes that another agency should not be able to exempt firms from SBA's affiliation rules (and in effect make program-specific size rules) without SBA's approval. SBA's regulations set forth a formal process that a Federal department or agency must follow in order to request, and possibly receive SBA's approval, to deviate from SBA's size rules, including those relating to affiliation. *See* 13 CFR 121.903.

The 8(a) BD program is a unique Federal program. It is not a contracting program, but rather a business development program. The program is designed to assist in the business development of disadvantaged small businesses through management and technical assistance, contractual assistance, and other means. Requiring mentors to provide business development assistance to protégé firms in order for a mentor/protégé relationship to receive an exclusion from affiliation is merely one tool to assist in the business development of 8(a) firms. SBA's size regulations generally aggregate the receipts/employees of joint venture partners for size purposes, and SBA believes that is the correct approach since the combined resources of the partners are available to the joint venture. The exclusion to affiliation for mentor/protégé relationships approved for the 8(a) BD program is designed to encourage the business development purposes of the 8(a) BD program. Where a mentor/protégé program of another agency is also intended to promote the business development of specified small business concerns, SBA would be inclined to approve the agency's request for an exclusion from affiliation because it would serve the same purpose as the exclusion from affiliation for 8(a) mentor/protégé relationships. As such, the final rule continues to allow exclusions from affiliation for mentor/protégé relationships of other agencies only where specifically authorized by statute or where the agency asks for and SBA grants such an exclusion.

Joint Ventures

The proposed rule also amended the size rules pertaining 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. The proposed rule changed this requirement to allow a specific joint venture to be awarded three contracts over a two-year period. It also clarified that the partners to a joint venture 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 could lead to a finding of general affiliation, even in the 8(a) mentor/protégé joint venture context. The proposed rule also asked for comments on other alternatives, including limiting 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.

Many commenters supported the proposed change from three offers over two years to three contract awards over two years, noting that this change would provide more certainty to offerors. One commenter asked for more clarity regarding what constitutes a contract. That commenter was concerned that a contract could be awarded and then ultimately not performed due to a protest or otherwise and that such an award would still count against the three contract award limit for that joint venture. SBA does not see this as a significant problem. As previously noted, two partners could form an additional joint venture entity and that new entity could be awarded three additional contracts. The fact that one of the three contracts awarded to the first joint venture entity was not performed in no way inhibits the ability of the two firms from forming a new joint venture and receiving additional contracts. As such, SBA does not adopt the comment that recommended the word contract to mean only a contract that was kept and performed by the joint venture.

The majority of comments received also preferred limiting one joint venture to three contract awards (and allowing the firms to form additional joint venture entities for additional contract awards) rather than limiting the overall

number of contracts that two (or more) firms acting as a joint venture could receive. Several commenters contended that they often go after and are awarded many small dollar projects through joint venture relationships. Even though the combined value of the contracts awarded could be very small, the alternative option, which would prohibit no more than five total awards to two firms acting through a joint venture, would prohibit them from seeking and being awarded additional contracts. They felt that such a prohibition would adversely affect their overall business development. Other commenters observed that limiting the total number of contract awards to a specific number (*e.g.,* five) would make mentor/protégé relationships short term, which would encourage less business development assistance to protégé firms in the long term. SBA concurs with these comments and does not adopt this alternative in this final rule.

The proposed rule also clarified when SBA will determine whether the three contract awards in two years requirement has been met. The proposal set the time at which compliance with the three awards in two years rule should be determined as of the date a concern submits a written self-certification that it is small as part of its initial offer including price. This point in time coincides with the time at which size is determined and SBA believed that consistency dictated this approach. Commenters supported this approach, particularly favoring allowing joint venture offerors the flexibility to ultimately be awarded more than three contracts if they had not yet received three awards as of the date they submitted several offers and happened to win more than one of the awards pertaining to those offers. A few commenters specifically supported the example contained in the supplementary information to the proposed rule and suggested that it be included in the actual regulatory text. SBA sees no reason not to include the example in the regulation if that will help further clarify SBA's intent. As such, SBA has added the example to the regulatory text for § 121.103(h) in this final rule.

The proposed rule also clarified that while a joint venture may or may not be a separate legal entity (*e.g.,* a limited liability company (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 clarified SBA's longstanding policy that a joint venture may or may not be populated (*i.e.,* have its own separate employees). The supplementary information to the proposed rule indicated that whether a joint venture needs to be populated or have separate employees would depend upon the legal structure of the joint venture. If a joint venture is a separate legal entity, SBA thought that it must have its own employees. If a joint venture merely exists through a written agreement between two or more individual business entities, then SBA felt that it need not have its own separate employees and employees of each of the individual business entities may perform work for the joint venture. SBA received several comments on this interpretative language. A few commenters asked SBA to clearly delineate what "populated" means in the regulatory text. The final rule adopts this comment and has identified that a populated joint venture is joint venture formed as a separate legal entity that has its own separate employees.

The majority of comments on the provision addressing the population of joint ventures believed that any regulation that required a populated joint venture would unintentionally deprive joint venture partners of the opportunity to structure joint ventures as LLCs because of the requirements contained in other regulatory provisions. For example, in an 8(a) joint venture, § 124.513(c)(2) requires an employee of the 8(a) Participant to be the project manager. If an LLC was populated, so that it hired its own employees to perform an 8(a) contract, the project manager hired by the LLC to oversee the project (even if he/she came from the 8(a) Participant) would not be an employee of the 8(a) Participant. Similarly, § 124.513(d) requires the 8(a) Participant to a joint venture to perform a specific percentage of work ("a significant portion" in the regulations prior to this final rule, and at least 40% of the work done by the joint venture in this final rule). If an LLC is populated, the LLC is performing the work; the work is not being performed individually by the two (or more) partners to the joint venture. SBA understands these concerns and has made several changes in this final rule in response to them. SBA believes that the individual businesses involved in the joint venture should determine whether to form a separate legal entity for the joint venture (*e.g.,* LLC) and, if they do, whether or not to populate the new entity. SBA will not require any joint venture to be populated, and will not find a joint venture ineligible merely because it is or is not populated. In addition, SBA believes clarifications need to be made in the substantive 8(a) rules between populated and unpopulated joint ventures. The requirement contained in § 124.513(d) that an 8(a) Participant must perform at least 40% of the work done by a joint venture, and the requirement contained in § 124.513(c)(2) that the project manager be an employee of the 8(a) Participant, make sense only for unpopulated joint ventures or joint ventures populated only with administrative personnel. For joint ventures populated with individuals intended to perform any awarded contracts, the joint venture must demonstrate that the 8(a) Participant to the joint venture controls the joint venture, is responsible for the books and records of the joint venture, owns at least 50% of the joint venture, and receives profits commensurate with its ownership interest. SBA has made these clarifications in § 124.513 of the final rule. A detailed description of these changes is included below in the discussion of the comments on Part 124.

A few commenters questioned SBA's application of the ostensible subcontractor rule in § 121.103(h)(4). Specifically, they sought clarification as to whether SBA applied the ostensible subcontractor rule only at the time of size certification (as part of the firm's offer for a particular contract) or if it also applied after contract performance. SBA believes that it would not make sense to allow a firm to submit an offer proposing how it will perform a contract in which it will perform the primary and vital portions of a contract, and thus qualify individually as a small business, and then subcontract out the entire contract after award and have the contract count as an award to small business. SBA believes that if options are exercised on such a contract, the options should not count as a small business award if the aggregate size of the contractor and its ostensible subcontractor exceeds the applicable size standard. The final rule adds clarifying language to a new § 121.404(g)(4).

Exclusion From Affiliation for Mentor/Protégé Joint Ventures

The proposed rule also attempted to clarify 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. For purposes of clarification § 124.513(d) references the percentage of work requirements of § 124.510 which include the percentage of work requirements set forth in § 125.6.

In connection with a size protest, one commenter opposed requiring the 8(a) joint venture rules to be met in order for a mentor/protégé joint venture to receive an exclusion from affiliation for a non-8(a) contract. This commenter did not believe it was appropriate to apply 8(a) rules to non-8(a) contracts, thinking that such a requirement would impose an undue burden on 8(a) firms seeking non-8(a) contracts. SBA disagrees. Receiving an exclusion from affiliation for any non-8(a) contract is a substantial benefit that only SBA-approved mentor/protégé relationships can receive. The intent behind the exclusion generally is to promote business development assistance to protégé firms from their mentors. Without a requirement that a protégé firm must be the project manager and take an active and substantial role in contract performance on a non-8(a) joint venture with its mentor, the entire small business contract could otherwise be performed by an otherwise large business.

Overall, however, SBA received many favorable comments to this proposed change. Commenters noted that without such a clarification, a joint venture between an 8(a) protégé firm and its large business mentor on a non-8(a) small business contract could perform the contract with minimal work being performed by the protégé 8(a) firm. The commenters believed such a scenario was inappropriate. SBA agrees. SBA recognized this potential abuse of small business contracting programs and has not changed the requirement in this final rule that a mentor/protégé joint venture seeking an exception to affiliation on a non-8(a) contract must follow the 8(a) requirements regarding control and performance by the 8(a) protégé firm.

SBA also requested comments on whether to continue to allow the exclusion to affiliation for mentor/protégé joint ventures on non-8(a) contracts, or whether the exclusion to affiliation should apply only to 8(a) contracts. Related to this inquiry was the proposed change that would allow the exclusion to apply not just to Federal prime contracts, but to subcontracts as well. This change was particularly important to the Department of Energy, 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. The overwhelming majority of comments supported permitting the exclusion to affiliation for both 8(a) and non-8(a) contracts. They believed that performing non-8(a) contracts is just as or more important in a firm's business development than performing 8(a) contracts. They noted that understanding and being able to perform non-8(a) government contracts is critical to a firm's ultimate survival and success after leaving the 8(a) BD program, and getting that experience through a mentor/protégé relationship while still in the 8(a) BD program is essential. In addition, the majority of commenters supported the proposed change applying the exclusion to affiliation to both government subcontracts as well as prime contracts. They viewed this extension as further assisting 8(a) Participants realize the business development purposes of the 8(a) BD program. As such, this final rule continues to allow the exclusion to affiliation for mentor/protégé joint ventures for all government prime contracts and subcontracts.

Classification of a Procurement for Supplies

SBA's regulations provide that acquisitions for supplies must be classified under the appropriate manufacturing NAICS code, not under a wholesale trade NAICS code. The proposed rule amended the size regulations to clarify that a procurement for supplies also cannot be classified under a retail trade NAICS code. SBA received seven comments supporting and three comments opposing this proposed change. SBA continues to believe that procurements for supplies should be classified under the appropriate manufacturing or other supply NAICS code. The retail trade NAICS code is appropriate for financial assistance (*e.g.,* loans), but not for the procurement of specified supply items. As such, SBA does not change this provision in the final rule.

Application of the Nonmanufacturer Rule

The proposed rule also attempted to 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). The proposed rule explicitly provided 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.

In addition, the proposed rule clarified that the nonmanufacturer rule applies only to the manufacturing or supply component of a manufacturing procurement. 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. The proposed rule further defined 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.

In response to the proposed changes to the nonmanufacturer rule, 12 commenters addressed the proposal to require a nonmanufacturer to take possession of the items with its own facilities, equipment or personnel in a manner consistent with industry practice. Eight commenters supported the change, while four opposed it. Those in opposition believed that the change would limit opportunities for small businesses. Two commenters also stated that taking possession of supply items is not consistent with industry practices. Those supporting the change believed that it was a reasonable requirement to ensure that small business nonmanufacturers were providing some value to the procurement other than their status as small or small 8(a) businesses. These commenters particularly thought that the proposal made sense in the scenario outlined in the **SUPPLEMENTARY INFORMATION** for the proposed rule, where there are no small business manufacturers available for the contract (and either a class or individual waiver to the nonmanufacturer rule is granted). In such a case, small business participation is minimal, yet the entire value of the contract is counted as an award to small business for goaling purposes. In response to these comments, SBA first notes that the proposed rule did not require a small business nonmanufacturer to take possession of the supply items in every case. It required that the nonmanufacturer take ownership *or* possession. If the nonmanufacturer arranged for transportation of the supply items (*e.g.,* it uses trucks it owns or leases to transport the items to the final destination), then it need not take ownership of the supply items. If it does not arrange for the transportation, then it must at least take ownership of the supply items. SBA recognizes the validity of small business dealers and does not seek to harm legitimate small business dealers. SBA continues to believe, however, that the ownership or possession requirement provides a necessary safeguard to abuse. A multi-million dollar supply contract in which a large business manufacturer provides the supply items directly to the Government procuring agency and the small business nonmanufacturer provides nothing more than its status as a small business does not foster small business development. As such, this provision is not changed in the final rule.

One commenter disagreed with the proposal to limit application of the nonmanufacturer rule to acquisitions that have been classified with a manufacturing NAICS code. The commenter argued that some supply contracts cannot be classified as manufacturing. We agree. Thus, we have removed this requirement from the final rule. The commenter further argued that SBA should allow procuring agencies to assign wholesale NAICS codes to procurements because not all supply contracts can be classified under a manufacturing or supply NAICS code. We disagree. First, the Small Business Act and SBA's regulation do not contain performance requirements applicable to wholesale or retail contracts. Thus, wholesale and retail NAICS codes cannot be used for government procurement purposes. The wholesale and retail trade NAICS codes are for purposes of SBA financial assistance only. Second, a contracting officer should assign the NAICS code to a procurement which best describes the principal purpose of the acquisition. While some procurements call for the provision of supplies and services, a procurement should be classified as one or the other, and cannot be classified as both. The classification dictates what an offeror must perform in order to qualify as a small business concern for a small set aside procurement. These limitations on subcontracting performance requirements vary depending on whether the contract is classified as a service, supply, construction or specialty trade construction procurement. If a contract is classified as a service contract, then only the requirements pertaining to service contracts apply. There is no requirement that the ultimate contractor meet any performance of work requirements relating to the manufacture of products, which may be ancillary to the services contract. The relevant consideration is the cost of the contract incurred for personnel. If a contract is classified as a supply contract, then only the requirements pertaining to supply contracts apply. The concern must either be the manufacturer of the items being procured or be a dealer that supplies the products of a small business manufacturer (unless a waiver to the nonmanufacturer rule applies), and there is no requirement that the concern provide any ancillary services. The relevant consideration is the cost of manufacturing the supplies or products. In the acquisition described by the commenter, for the delivery of fruits and vegetables, if a manufacturing or supply NAICS code is not appropriate then the procurement should be classified under a warehousing or delivery service NAICS code. In response to this comment, the final rule also clarifies that a waiver of the nonmanufacturer rule does not waive the requirement that a nonmanufacturer not exceed the 500 employee size standard or the requirement that the nonmanufacturer must take ownership or possession of the items with its personnel, equipment or facilities. A waiver of the nonmanufacturer rule only applies to the requirement that a nonmanufacturer supply a product of a small business concern made in the United States.

Finally, one commenter recommended that § 121.406 specifically reference the service disabled veteran-owned (SDVO) program as a program to which the nonmanufacturer rule applies. Section 125.15(c) currently states that the nonmanufacturer rule applies to SDVO requirements for supplies. Thus, although it is not necessary to also add that requirement to § 121.406 of the size regulations, this final rule has done so in order to provide more clarity regarding the rule's application. Similarly, the final rule also clarifies in § 121.406 that the nonmanufacturer rule applies to women-owned small business (WOSB) and economically disadvantaged women-owned small business (EDSOB) requirements for supplies. Again, § 127.505 of SBA's regulations currently states that the nonmanufacturer rule applies to WOSB and EDWOSB requirements for supplies, but it is added to § 121.406 as well for clarity purposes.

Request for Formal Size Determination

The proposed rule also amended § 121.1001(b) to give the SBA's 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. SBA received several comments regarding the proposed change to allow the SBA's OIG to ask for formal size determinations. All but one commenter supported the change. The dissenting commenter believed that the change is unnecessary and would give the OIG too much power. SBA believes that it is reasonable for the OIG to be able to request a formal size determination where it deems it to be appropriate, and, thus, has not changed this provision in this final rule.

Part 124

Because the primary focus of the October 28th proposed rule was to comprehensively revise the regulations relating to the SBA's 8(a) BD program, the vast majority of the comments SBA received pertained to proposed changes to part 124. SBA will address each of the substantive comments made regarding proposed changes to part 124 in turn.

Completion of Program Term

The proposed rule clarified that every firm that completes its nine-year program term will not be deemed to "graduate" from the 8(a) BD 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). After nine years in the program, a firm will be deemed to graduate only where SBA determines that is has substantially achieved the targets, objectives and goals set forth in its business plan. Where those targets, objectives and goals have not been substantially achieved, the firm will merely be deemed to have completed its nine-year program term. The proposed rule made changes to §§ 124.2, 124.301 and 124.302 to effect this change. In addition, the proposed rule added a new § 124.112(f) to require SBA to determine if a firm should be deemed to have graduated from the 8(a) BD program at the end of its nine-year program term or to merely have completed its 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 will determine whether the firm has met the targets, objectives and goals set forth in its business plan and whether it has "graduated" from the program.

Several commenters voiced support for the clarification to distinguish between graduation and completion of a firm's program term, but did not provide reasoning for their support. Other commenters misinterpreted the purpose of the proposed change, believing that SBA intended to extend the program term beyond nine years. This conclusion was incorrect. A few commenters recommended extending the program term beyond nine years. That is something SBA cannot do. The Small Business Act specifically restricts the maximum amount of time a firm may participate in the BD program to nine years; no more than four years in the developmental stage and no more than five years in the transitional stage. *See* 15 U.S.C. 636(j)(15). As such, SBA is precluded by statute from extending a firm's participation in the program beyond nine years, and the nine-year program term remains in this final rule. The final rule also retains the proposed language pertaining to graduation and program term completion with minor changes in wording.

Finally, two commenters recommended that the nine-year program term begin on the date that a firm receives its first 8(a) contract award, stating that many firms are in the 8(a) BD program for four, five or more years before receiving their first 8(a) contract, and believing that true business development does not begin until contractual assistance is received. Again, the Small Business Act prevents such a change. Specifically, the Act states that a firm cannot participate in the 8(a) BD program "for a total period of not longer than nine years, measured from the date of its certification" into the 8(a) BD program. 15 U.S.C. 636(j)(15). Thus, SBA does not have the discretion to change the date upon which the nine-year program term begins to run.

Definitional Changes

The proposed rule amended § 124.3, to add a definition of NAICS code. It also proposed to change the term "SIC code" 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. Commenters applauded SBA changing the references in the 8(a) BD regulations from SIC codes to NAICS codes, believing it was long overdue and would eliminate any confusion to those new to the Government contracting arena. Specifically, in this final rule, the term "NAICS code" replaces 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 proposed rule also amended the definition of primary industry classification to specifically recognize that a Participant may change its primary industry classification over time. Specifically, the proposed rule authorized 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. The vast majority of comments supported the proposed change. One commenter recommended that the language be changed from "SBA may permit" a change in a firm's primary industry classification to "SBA shall permit" to make it clear that no criteria other than a demonstration that the source of a firm's revenues has changed from one NAICS code to another is required for SBA to recognize such a NAICS code change. A few other commenters suggested that SBA should define the term "majority of its revenues" and describe specifically SBA's analysis and the process by which a firm can demonstrate that the "majority of its revenues" have evolved from one NAICS code to another. One commenter opposed the proposed language believing that a firm should be able to change its primary NAICS code at any time without any demonstration to SBA as it is a business decision for the concern.

SBA agrees that the wording of the provision should be clarified to make it clear that a primary industry classification change is entirely within the control of a Participant. If the Participant can show that the majority of the revenues that it has received have changed from one NAICS code to another, that is all that is needed. SBA will not look at any other factors. SBA does not believe, however, that a firm can independently deem that its primary NAICS code has changed without providing any support to demonstrate that the work that it performs (and thus the firm's primary industry classification) has in fact changed over time. Thus, the final rule clarifies that SBA will look only at a

firm's total revenues. SBA intended that the majority of a firm's revenues means that NAICS code accounting for the largest amount of all of its revenues from whatever source. If the firm performs work only in two NAICS codes, then a majority would mean at least 51% of its revenues. If a firm performs work in more than two NAICS codes, the new primary industry would be that NAICS code accounting for the most dollars. For example, if a firm comes into the program with a primary industry classification in NAICS code X, but also does work in NAICS codes Y and Z, and over time its revenues change so that for the last two years it has 40% of its revenues in NAICS code Y, 30% in NAICS code X and 30% in NAICS code Z, then its primary industry would change to NAICS code Y. That interpretation is consistent with how SBA defines "revenues" for size purposes (*i.e.,* to specifically include all receipts from whatever source). As such, SBA does not believe that further clarification of that term is required.

In addition, one commenter was concerned that only the Participant should be able to initiate a primary NAICS code change, and did not believe that SBA should be able to force such a change on its own initiative. It was never SBA's intent that SBA would be able to change a firm's primary NAICS code on its own. However, SBA does not believe that a change is needed to the regulations since § 124.112(e) recognizes only the right of a Participant to request a change in primary industry classification.

The proposed rule also added 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. The proposed rule took this definition from current SBA policy contained in SBA's Standard Operating Procedures. Several commenters supported this change. In particular, commenters supported the clarification contained in the supplementary information that although 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 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. One commenter recommended that this clarification be included in the actual regulatory text. SBA agrees and has made that change in this final rule.

Fees for Applicant and Participant Representatives

SBA has permitted firms applying to the 8(a) program and Participants in the program seeking contracts to hire agents or representatives to assist them in that process. In response to concerns that SBA's policy is not set forth in the regulations, this final rule adds a new § 124.4 to address fees for agents and representatives. The final rule provides that the compensation received by any agent or representative of an 8(a) applicant or Participant for assisting the applicant in obtaining 8(a) certification or for assisting the Participant in obtaining 8(a) contracts must be reasonable in light of the service(s) performed by the agent or representative. The rule captures SBA's current policy and responds to concerns raised that some applicants and Participants have paid unreasonable amounts to representatives. In particular, several commenters believed that some representatives have obtained compensation that has been a percentage of gross contract value, that unsophisticated 8(a) firms may not have fully understood what fee they were agreeing to, and that such a fee is unreasonable. In response, the final rule provides that the compensation received by any agent or representative assisting the 8(a) firm, both at time of application or any other assistance to support program participation, must be reasonable. Compensation that is a percentage of the gross contract value will be prohibited. Additionally, compensation that is a percentage of profits may be found to be unreasonable. The final rule sets out procedures by which SBA will suspend or revoke an agent's or representative's privilege to assist applicants. SBA's authority to suspend or revoke an agent's or representative's privileges is already contained in § 103.4 and is included here for purposes of ease and clarity.

Residence in the United States

Under the basic requirements a firm must meet in order to be eligible for the 8(a) BD program, the proposed rule added a provision to § 124.101 requiring individuals claiming social and economic disadvantage status to reside in the United States. SBA received four comments to this proposed change. All four supported the change thinking that such a requirement is reasonable in light of the benefits afforded through the program. As such, this provision remains unchanged in the final rule.

Size for Primary NAICS Code

The proposed rule sought 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 sought 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 received numerous comments to this proposed change which were overwhelmingly opposed to the proposed change.

Several commenters believed that looking at a firm's size over a two year period was inconsistent with the Agency's size regulations, which determines size for a firm with a revenue-based primary NAICS code over a three year period. Other commenters questioned the purpose and wisdom of this entire provision, believing that the natural progression of many small businesses necessarily leads them into various business opportunities and SBA should not inhibit firms' growth. They argued that the proposed change would have a chilling effect on the growth of small businesses and in essence penalized firms for succeeding in the program.

The 8(a) program is a business development program designed to assist Participant firms advance toward competitive viability. Where a firm has grown to be other than small in its primary NAICS code, SBA believes that the program has been successful and it is reasonable to conclude that the firm has achieved the goals and objectives of its business plan. Because the Small Business Act authorizes early graduation where a firm has met the targets, goals and objectives set forth in its business plan, SBA believes that growing to other than small in a firm's primary industry classification similarly warrants consideration of early graduation. The program would resemble a contracting program more than a business development program where a firm is permitted to remain in the program after it has grown to be other than small in its primary NAICS code and be able to shop for contracting opportunities in NAICS codes having accompanying larger size standards. A firm that is other than small in its primary NAICS code is, and has always been, ineligible to be admitted to the 8(a) BD program. That being the case, SBA believes that it follows that a firm that grows to exceed its primary NAICS code once in the 8(a) BD program and does not intend to change its primary

NAICS code may no longer need the business development assistance the program provides and should be early graduated from the program. SBA recognizes, however, that it would be unfair to early graduate a firm from the 8(a) BD program where it has one very successful program year that may not again be repeated. In response to the comments received, the final rule changes the number of years that a Participant must exceed its primary NAICS code before SBA will consider early graduation from two years (as proposed) to three years. Additionally, in response to the many comments received regarding this provision, the rule allows a firm to demonstrate that it has made attempts and continues to move to one of the secondary NAICS codes identified in its business plan and that it will change the primary NAICS code accordingly. This will more closely align to the way SBA determines size under § 121.104.

This provision is not meant to conflict with the change made to the definition of primary industry classification in § 124.3 that permits a Participant to change its primary NAICS code during its participation in the 8(a) BD program. Where a firm demonstrates that it has changed its primary NAICS code, SBA would consider early graduation only where the Participant exceeds the size standard corresponding to its new primary NAICS code for three successive program years.

Definition of American Indian

A few commenters asked for clarification of the term "American Indian" in § 124.103. Section 124.103(b) includes Native Americans as individuals who are presumptively socially disadvantaged. The previous regulatory provision defined Native Americans to be "American Indians, Eskimos, Aleuts, or Native Hawaiians." This final rule clarifies that an individual must be an enrolled member of a Federally or State recognized Indian Tribe in order to be considered an American Indian for purposes of presumptive social disadvantage. This definition is consistent with the majority of other Federal programs defining the term Indian. An individual who is not an enrolled member of a Federally or State recognized Indian Tribe will not receive the presumption of social disadvantage as an American Indian. Nevertheless, if that individual has been identified as an American Indian, he or she may establish his or her individual social disadvantage by a preponderance of the evidence, and be admitted to the 8(a) BD program on that basis. In addition, the rule inserts the words "Alaska Native" to take the place of Eskimos and Aleuts.

Economic Disadvantage

SBA proposed several revisions to § 124.104 *Who is Economically Disadvantaged?,* including: A clarification regarding how community property laws affect an individual's economic disadvantage; adding a provision to exempt certain Individual Retirement Accounts (IRAs) from SBA's net worth calculation; clarifications relating to S corporations; and adding objective standards by which an individual can qualify as economically disadvantaged based on his or her income and total assets. SBA received a substantial number of comments regarding these proposed changes. Overall, the comments to the proposed changes supported the revisions. However, several commenters opposed the requirement that individuals remain economically disadvantaged after their admission into and throughout their participation in the 8(a) BD program. SBA believes that the Small Business Act requires individuals upon whom program eligibility is based to remain economically disadvantaged throughout the program term of the Participant firm. Specifically, the Small Business Act authorizes firms owned and controlled by socially and economically disadvantaged individuals to be eligible for the program. Where one of these underlying requirements is not met (*e.g.,* the individual owners no longer qualify as economically disadvantaged), the firm ceases to be eligible for the program. Several other commenters recommended that net worth, personal income and total asset standards should vary either by industry or geographically. SBA believes that any such change would require additional public comment and could not be made final in this rule. As such, SBA has not addressed these comments in this rule, but will consider them for a possible future proposed rulemaking. The specific comments regarding economic disadvantage are addressed below.

A few commenters addressed the proposed change to add a sentence to paragraph (b)(2) to clarify that SBA does not take community property laws into account when determining economic disadvantage. Those that did generally supported the change. Pursuant to the change, 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. 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.

Several commenters expressed concern with the proposed amendment to paragraph (b)(2) that would allow SBA to consider a spouse's financial situation in determining an individual's access to capital and credit. The commenters suggested that a spouse's finances should be reviewed only if the spouse is active in the business or lending money to the company. This was particularly true of individuals who intentionally have kept separate finances from their spouses. They felt that the proposed rule did not look at their individual economic disadvantage status as required by the Small Business Act, but rather at their joint economic condition with their spouses. Several commenters suggested that SBA should clarify the limited circumstances when SBA will consider the financial situation of a socially disadvantaged owner's spouse. After careful review, SBA has determined that a spouse's financial condition should not be attributed to the individual claiming disadvantaged status in every case. Instead, SBA will consider a spouse's financial condition only when the spouse has a role in the business (*e.g.,* an officer, employee or director) or has lent money to, provided credit support to, or guaranteed a loan of the business.

Several commenters believed that the provision requiring SBA to consider the financial condition of the applicant compared to the financial profiles of small businesses in the same industry which are not owned by socially and economically disadvantaged individuals confused personal economic disadvantage with the applicant firm's potential for success. They believed that the applicant firm's financial condition was already considered under the potential for success requirement and that it has no relationship as to whether an individual qualifies as economically disadvantaged. SBA believes that the financial condition of the applicant firm could have a bearing on whether an individual is considered to have access to credit and capital, but understands the confusion noted by the commenters. To eliminate any confusion and because SBA already reviews the financial condition of the applicant as part of its potential for success determination, this rule deletes from an individual's personal economic disadvantage review the requirement that SBA compare the financial condition of the applicant to

that of non-disadvantaged small businesses.

SBA's proposed treatment of income from an S corporation and exclusion of IRAs from an individual's net worth determination in paragraph (c)(2) received wide support. Several commenters suggested that all IRA accounts should be excluded from the net worth calculation whether there is a penalty or not. SBA continues to believe, however, that the presence of a penalty with a retirement account will lessen the potential for abuse of this provision. Individuals will be less likely to attempt to hide current assets in funds labeled "retirement accounts" when there is a substantial penalty for accessing the account. A significant penalty would be one equal or similar to the penalty assessed by the Internal Revenue Service (IRS) for early withdrawal. Although, as one commenter notes, it is true that the practical effect of the rule may treat older individuals differently than younger individuals because individuals of a certain age will not incur a penalty with a withdrawal, SBA believes that any account that may be accessed immediately without a penalty must be treated as a present asset and included within an individual's net worth determination. If an individual invests funds from a retirement account into the participant concern, those funds would be excluded from the net worth analysis as part of the exclusion of business equity even where there was not a significant penalty for access to the "retirement" funds prior to the investment in the business. The applicant may be required to submit evidence that the funds were invested into the participant concern.

One commenter suggested Participants should be required to submit retirement account statements when applying for 8(a) certification and filing their 8(a) status updates, and the Participants should have to certify that the funds remain in "legitimate" retirement accounts. SBA agrees that some verification of retirement account information should be required. As such, the final rule provides that 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 and certify in writing that the "retirement account" is legitimate.

SBA also proposed an amendment to paragraph (c)(2) to exempt income earned from an S Corporation from the calculation of both an individual's 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. This change will result in equal treatment of corporate income for C and S corporations. Most commenters applauded SBA's consideration of the tax treatment for S corporations. A few commenters believed that the clarification contained in the supplementary information that S corporation losses are losses to the company only, and not losses to the individual, should be specifically set forth in the regulatory text to clear up confusion on this issue. SBA agrees and has included that clarification in this final rule. In addition, the final rule has clarified that the treatment of S corporation income applies to both determinations of an individual's net worth and personal income. Several commenters also recommended that Limited Liability Companies (LLCs) and other pass-through entities be treated the same way as S corporations for purposes of an individual's net worth and personal income. SBA agrees. S corporations, LLCs and partnerships should all be treated similarly since all pass income through to the individual owners/members/partners.

The proposed rule added a new § 124.104(c)(3) 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 for initial 8(a) BD eligibility and $250,000 for continued 8(a) BD eligibility. SBA received numerous comments on the proposed change to income thresholds. Several commenters opposed any objective thresholds; others recognized the precedential case law of SBA's Office of Hearings and Appeals (OHA) and supported the inclusion of standards in the regulations for clarity purposes. Still others suggested alternative methodologies, including comparing income to W–2 data, as opposed to adjusted gross income (AGI), or comparing industry data and similarly situated business owners. SBA considered the alternate approaches and has determined that a set threshold amount is consistent with the requirements of determining economic disadvantage and is not only a fair and reasonable approach, but is one that is easily understandable by all potential applicants. As noted, the proposed rule established $200,000 as the amount of personal income below which an individual would be considered economically disadvantaged for initial 8(a) BD eligibility. In formulating what the personal income threshold should be, the supplementary information to the proposed rule explained that SBA considered statistical data from the IRS. The $200,000 figure closely approximated the income level corresponding to the top two percent of all wage earners, which has been upheld by OHA as a reasonable indicator of a lack of economic disadvantage. Since SBA published its proposed rule, the IRS has released new statistical data pertaining to high income wage earners in the United States. The current IRS statistical data on wage earners in the United States shows individuals earning an AGI of approximately $260,000 fall in the top two percentile of all wage earners. Accordingly, SBA believes that the personal income threshold should be adjusted upward to align more closely with the new IRS statistical data. As such, this final rule has adjusted the personal income threshold amount to $250,000. Although a $250,000 personal income threshold may seem high, SBA notes that this amount is being used only to presume, without further information, that the individual is or is not economically disadvantaged. SBA may consider an income lower than $250,000 as indicative of lack of economic disadvantage in appropriate circumstances. SBA also notes that the average income for a small business owner is generally higher than the average income for the population at large and, therefore, what appears to be a high benchmark is merely reflective of the small business community. In all cases, SBA's determination is based on the totality of the circumstances.

The final rule establishes a three year average income level of $350,000 for continued 8(a) BD program eligibility. Considering the new IRS statistical data and the threshold established for initial 8(a) BD eligibility, the $250,000 proposed figure for continued 8(a) BD eligibility was inappropriate. It seems obvious to SBA that as a firm becomes more developed and sophisticated, the income levels for its owners and managers will most often increase. Increasing the personal income threshold for continued 8(a) BD eligibility to $350,000 will allow the Participant to attract and retain higher skilled employees, since the disadvantaged owner/manager must be the highest compensated individual in the firm, with limited exceptions. This will enable the Participant to more fully develop, thereby further serving the purposes of the 8(a) BD program.

Several commenters also recommended that the snapshot that SBA looks at for determining whether an individual's personal income

exceeds the applicable standard should be three years instead of two years. These commenters noted that income for a small business owner is not constant and could fluctuate dramatically in volatile economic times. They argued that a small business could have two very good years, provide higher incomes to its owners during those two years, and be deemed ineligible for future 8(a) BD participation because of the income given. They believed such a result was unfair, particularly when the two good years were followed by several bad years. One commenter also pointed to the three year average annual receipts review for purposes of determining a firm's size for receipts-based size standards and felt that personal income should similarly be evaluated over a three year period. SBA believes these comments are valid and has adjusted the evaluation period to three years in the final rule. However, SBA does not seek to make it more difficult for firms that have already applied to the 8(a) BD program before the date this final rule is published. As such, firms that have applied to the 8(a) BD program prior to the date of publication of this final rule may elect to have their applications continued to be processed based on two years personal income data instead of three years and would not be required to submit additional information relating to a third year's personal income. If any such firms would like to have their applications evaluated based on three years personal income data instead of two years, they must notify SBA within 30 days after the date of publication of this final rule in the **Federal Register**.

The final rule continues to 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 $6 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 $6 million inheritance would render the individual not economically disadvantaged based on total assets.

The proposed rule also sought 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 was not certain. The proposed rule established $3 million in total assets as the standard for initial 8(a) BD eligibility and $4 million in total assets as the standard for continued 8(a) BD eligibility. SBA based these standards on OHA cases supporting SBA's determination that an individual was not economically disadvantaged with total asset levels of $4.1 million and $4.6 million. *See Matter of Pride Technologies,* SBA No. 557 (1996), and *SRS Technologies* v. *U.S.,* 843 F. Supp. 740 (D.D.C. 1994). Several commenters believed that both of these proposed standards were too low. Because the value of the applicant or Participant concern is included within the total assets standard, several commenters believed that the proposed standards contradicted the business development purposes of the 8(a) BD program. One commenter wondered whether SBA intended that only less developed firms be admitted to the 8(a) BD program because a $3 million total asset standard that included the value of the applicant firm would not permit applicants which had been successful prior to the date of application. Other commenters questioned how firms could truly develop in the 8(a) BD program if their value could increase only $1 million during the course of nine years because to increase in value by more than $1 million could cause the individuals upon whom eligibility was based to no longer be considered economically disadvantaged. Similarly, several commenters felt that the proposed total asset standards would have a chilling effect on business growth because they would discourage reinvestment into the firm. SBA understands these concerns. It was never SBA's intent to limit in any way an 8(a) firm's ability to fully develop its business during its participation in the 8(a) BD program. First, considering that the personal income standards have been increased in this final rule, SBA believes that it makes sense to also increase the total assets standards. In addition, to dismiss any concern that the proposed standards would have hindered Participants' business development during their nine years in the 8(a) BD program, this final rule allows the total assets of a disadvantaged individual to increase by more than $1 million during the firm's participation in the program. Thus, pursuant to this final rule, an individual will not be considered economically disadvantaged if the fair market value of all his or her assets exceeds $4 million at the time of 8(a) application and $6 million for purposes of continued 8(a) BD program participation. This means that SBA will presume that an individual does not qualify as economically disadvantaged if the fair market value of all his or her assets is $4 million and one dollars for initial eligibility and $6 million and one dollars for purposes of continuing eligibility. Unlike the net worth analysis, SBA does not exclude the fair market value of the primary residence or the value of the applicant/participant concern in determining economic disadvantage in the total asset analysis. The only assets excluded from this determination are funds invested in a qualified IRA account.

Changes to Ownership Requirements

SBA proposed two amendments to the ownership requirements for 8(a) BD participation. First, SBA proposed to amend § 124.105(g) to provide more flexibility in determining whether to admit to the 8(a) BD program companies owned by individuals where such individuals have immediate family members who are owners of current or former 8(a) concerns. Second, SBA also proposed to amend § 124.105(h)(2) to add the words "or a principal of such firm" which were inadvertently omitted from the previous regulations. SBA received 29 comments to the proposed changes in this section. All of the comments received pertained to the immediate family member issue, and SBA received no comments on correcting the inadvertent omission. As such, SBA adopts the language as proposed for § 124.105(h)(2) without any change, and addresses the specific comments regarding § 124.105(g).

Prior to any change, the language of § 124.105(g) provided 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 was forced to deny 8(a) program admission to companies solely because the owners of those firms had family members who were disadvantaged owners of other 8(a) concerns. In some cases, the two firms were in different industries and located in different parts of the country. SBA thought that that language was too restrictive and attempted to allow some flexibility in the proposed rule.

The majority of those commenting on this section supported the increased flexibility for firms owned by immediate family members set forth in the proposed rule. A few commenters believed that the proposed language was still too restrictive, while others thought that immediate family members of a disadvantaged individual in one 8(a) firm should never be allowed to qualify a second firm for 8(a) participation. SBA continues to believe 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. There are some cases where it is clear that an absolute ban on an immediate family member owning a second 8(a) Participant is inappropriate. For example, if one sibling lives in California and one sibling lives in New York and they each operate a business in different industries, it makes no sense not to allow the second firm to participate in the 8(a) BD program. In such a case, there is no likelihood that the current or graduated 8(a) firm is seeking to prolong its participation in the 8(a) BD program through the second firm. Although there may be situations in which SBA chooses to deny admission to a firm based on a family member's program participation, such a decision will be made on a case-by-case basis.

Several commenters recommended that SBA should allow immediate family members to qualify independent businesses for 8(a) participation provided the family members do not live in the same household. SBA does not believe that the recommended restriction goes far enough. SBA has a legitimate interest in preventing disadvantaged individuals from using family members to extend their program terms by creating fronts whereby a disadvantaged individual controls and operates a second firm owned by an immediate family member. This control can occur whether or not the two family members are living in the same household. SBA believes that the restriction contained in the proposed rule, that an immediate family member of a current or former 8(a) firm can qualify a second firm for the 8(a) BD program where there are no or negligible connections between the two firms and he or she can demonstrate sufficient management and technical experience to independently operate the firm, is a more appropriate approach. If there are in fact connections between the two firms or if the individual claiming disadvantaged status for the second firm does not possess sufficient management and technical experience to operate the firm, the firm would be ineligible for 8(a) participation whether or not the two family members live in the same household. SBA also believes that the narrow exception to the general prohibition against family members owning 8(a) concerns in the same or similar line of business contained in the proposed rule will permit the Agency sufficient flexibility to admit firms where they are clearly operating separately and independently from the relative's firm. As such, this final rule does not alter the language contained in the proposed rule regarding participation by immediate family members.

Changes to Control Requirements

The proposed rule amended three provisions pertaining to the control requirements set forth in § 124.106 for 8(a) applicants and Participants. First, it added an additional 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. Second, it clarified that control restrictions applying to non-disadvantaged managers, officers and directors applied to all non-disadvantaged individuals in an applicant or Participant firm. Third, it added a new § 124.106(h) to address control of an 8(a) Participant where a disadvantaged individual upon whom eligibility is based is called up to active duty in the United States military. SBA received over 40 comments relating to the proposed changes to § 124.106. We will address the comments relating to each proposed provision in turn.

SBA received 35 comments in response to the proposed amendment to § 124.106(a)(2). The comments identified two issues: residence in the United States, and physical presence by the disadvantaged manager at the firm for some portion of each month. Most commenters agreed that it makes sense to require a full-time disadvantaged manager of an 8(a) applicant or Participant to be physically located in the United States. Commenters noted that the program is intended to assist disadvantaged businesses develop in the United States and that it was a reasonable requirement to require one or more disadvantaged managers to reside in the United States as well. However, many commenters disagreed with the requirement that a disadvantaged manager must spend part of every month physically present at the primary offices of the applicant or Participant. They felt that some sort of minimum or nominal presence was arbitrary and meaningless. Commenters also agreed with the statements made in supplementary information to the proposed rule that 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. They believed that individual managers who are not physically present should be required to demonstrate that they control the day-to-day operations of the firm, but that such demonstration should be on a case-by-case basis and should not be tied to any specific hourly presence requirement at the headquarters or principal office of the firm. After considering the comments, SBA believes that the best approach is to determine day-to-day control on a case-by-case basis. As such, this final rule retains the requirement that the disadvantaged manager of an 8(a) applicant or Participant must reside in the United States, but eliminates the added requirement that he or she must also spend part of every month physically present at the primary offices of the applicant or Participant. One commenter recommended that SBA more clearly define what it means to "reside" in the United States. Specifically, the commenter questioned whether physical presence was required or whether an individual who lives in another country but files taxes and votes in the United States could satisfy this requirement. In order to eliminate any assertion that an individual "resides" in the United States because he or she has maintained a residence in the United States despite living in another country, the final rule clarifies that a disadvantaged manager must be physically located in the United States.

SBA received no comments to the proposed change to § 124.106(e), clarifying that restrictions imposed on

non-disadvantaged managers apply to all non-disadvantaged individuals. As such, the final rule adopts the language contained in the proposed rule.

Proposed § 124.106(h) added a new provision 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. Specifically, the proposed rule permitted 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 also amended § 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. All comments received regarding this provision supported the proposed change. As such, the changes made to §§ 124.106(h) and 124.305 in the proposed rule to protect reservists called to active duty are finalized in this final rule without change.

Benchmarks

The proposed rule removed § 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. These industry categories have never been revised since the initial publication, and SBA believed that references to them are outdated and should be removed. SBA received six comments in response to this proposal. All six comments supported the proposed change. This final rule adopts the proposed language without change.

Changes Applying Specifically to Tribally-Owned Firms

In the proposed rule, SBA offered or considered changes to five provisions contained in the 8(a) BD regulations that apply specifically to Indian Tribes or Alaska Native Corporations (ANCs). Those proposed changes were: (1) How best to determine whether a Tribe is economically disadvantaged; (2) prohibiting work in a secondary NAICS code that is (or was within the last two years) the primary NAICS code of another 8(a) firm owned by the same Tribe or ANC; (3) clarifying the potential for success requirement as it is applied to Tribes and ANCs; (4) making it clear that any Tribal member may participate in the management of a Tribally-owned firm and need not individually qualify as economically disadvantaged; and (5) requiring 8(a) firms owned by Tribes and ANCs to submit information identifying 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. SBA received more than 100 comments relating to proposed changes to § 124.109. The comments pertaining to each of the five areas of consideration are discussed below in turn.

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 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. The proposed rule requested comments on how best to determine whether a Tribe should be considered "economically disadvantaged." Specifically, SBA sought comments as to whether the current approach to economic disadvantage for Tribes should continue, or whether a bright line assets or net worth test for Tribes should be used instead. The current regulation also requires a Tribe to demonstrate its economic disadvantage only once. SBA also sought comments regarding whether this one time demonstration of economic disadvantage makes sense.

SBA received more than 40 comments responding to its request for comments on economic disadvantage for Indian Tribes. Several commenters believed that Tribes should be afforded the same presumption of economic disadvantage as that given to ANCs. It is SBA's view that it does not have the authority to make such a change. SBA is constrained by the specific language of the Small Business Act, which requires firms to be owned by an "economically disadvantaged" Indian Tribe. While ANSCA provides economic disadvantage status to ANCs so that SBA does not have to determine whether any specific ANC is economically disadvantaged, Tribes have not been given similar statutory treatment. Thus, SBA must determine whether a specific Tribe may be considered economically disadvantaged. Regarding the best approach SBA should take to determine whether a Tribe qualifies as economically disadvantaged, commenters universally rejected any bright line asset or net worth test. Several commenters noted that it would be difficult to structure a bright line test suited to all Tribes given the vast differences among Tribes as to the number of Tribal members, number of members living on Tribal land, and other demographics, such as the average age of the membership. Other commenters believed that any asset or net worth test ignores historical data and the unique circumstances of Tribes, and would be subject to claims that it involves culturally biased criteria. Most commenters believed that the current approach to economic disadvantage for Tribes, although not perfect, makes the most sense. It allows an individual Tribe to address economic disadvantage in ways most relevant to that Tribe. SBA understands that every Tribe does not always possess or it may be very difficult for the Tribe to obtain data relating to Tribal unemployment rate, per capita income of Tribal members, or the percentage of the Tribal population below the poverty level. After considering the concerns raised in the comments, SBA agrees that an asset or net worth test could be misleading, and has not changed how it will determine economic disadvantage for Tribes. In addition, SBA has added to this final rule a provision authorizing a Tribe, where the Tribe deems it to be helpful, to request a meeting with SBA prior to submitting an application for 8(a) BD participation for its first applicant firm

to better understand what SBA requires. Several commenters also recommended that SBA clarify the requirement that a Tribe demonstrate its economic disadvantage only in connection with its first Tribally-owned firm applying for 8(a) BD participation. In response, SBA has clarified that SBA does not expect a Tribe to demonstrate economic disadvantage as part of every Tribally-owned 8(a) application.

The final rule also clarifies that ownership of an 8(a) applicant or Participant by a Tribe or ANC must be unconditional. The requirement that ownership be unconditional is contained in the Small Business Act, and the final rule merely incorporates that language to avoid any confusion.

The proposed rule prohibited a newly certified Tribally-owned Participant from receiving 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. The supplementary information to the proposed rule also identified an alternative proposal that allowed 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 sought comments on both approaches. SBA received a substantial number of comments responding to this proposal. Several commenters opposed allowing Tribes to own more than one firm in the 8(a) BD program generally, believing that such an occurrence creates an unfair competitive advantage. Congress has specifically authorized Tribal/ANC ownership of firms in the 8(a) BD program. Such ownership serves a broader purpose than mere business development. SBA does not believe that it can restrict a Tribe to own only one firm in the 8(a) BD program under the current statutory authority. As such, this final rule does not change the authority of a Tribe or ANC to own more than one firm in the 8(a) BD program. None of the commenters who addressed the proposed language supported the strict prohibition on receiving any 8(a) contracts in a secondary NAICS code that was the primary NAICS code of a sister company. Commenters believed that such a rule would hinder the growth and diversification of firms owned by Tribes and ANCs. Many commenters also opposed the alternative proposal allowing secondary work up to a specified percentage of the firm's overall 8(a) revenues for the same reason. They believed that any restriction on a firm's ability to diversify as that firm deems appropriate would hamper the firm's growth and ultimate ability to remain a viable business after leaving the 8(a) BD program. While some commenters opposed the alternative proposal allowing secondary work on a limited basis, they considered it to be a better approach than the strict ban as proposed. A few commenters offered additional alternatives. One commenter recommended that if SBA was concerned that one Tribally-owned or ANC-owned firm would be the successor contractor for an 8(a) contract previously performed by another 8(a) Participant owned by the Tribe or ANC then the regulation should address that concern specifically and not prohibit work in secondary NAICS codes generally. SBA agrees. As noted in the supplementary information to the proposed rule, when SBA certifies two or more firms owned by a Tribe or ANC for participation in the 8(a) BD program, SBA expects that each firm will operate and grow independently. The purpose of the 8(a) BD program is business development. Having one business take over work previously performed by another does not advance the business development of two distinct firms. SBA does not believe that a Tribally-owned or ANC-owned firm should be able to perform a specific 8(a) contract for many years and then, when it leaves the 8(a) BD program, to pass that contract on to another 8(a) firm owned by the Tribe or ANC. In such a case, the negative perception is that one business is operating in the 8(a) BD program in perpetuity by changing its structure or form in order to continue to perform the contracts that it has previously performed. SBA seeks to address this concern without unduly restricting a Participant's ability to grow and diversify. Thus, SBA adopts the comment to restrict a Tribe's or ANC's ability to pass an 8(a) contract from one firm that it owns and operates to another. Specifically, the final rule provides that a firm owned by a Tribe or ANC may not receive a sole source 8(a) contract that is a follow-on contract to an 8(a) contract that was performed immediately previously by another Participant (or former Participant) owned by the same Tribe. One commenter recommended that the same rules regarding work in secondary NAICS codes should apply equally to firms owned by Native Hawaiian Organizations (NHOs). SBA agrees, but also believes that the same is true for Community Development Companies (CDCs). This final rule makes the provisions pertaining to Tribes, ANCs, NHOs and CDCs consistent.

Finally, one commenter recommended that SBA more fully define what the term primary NAICS code means for purposes of determining whether a new applicant owned by the Tribe could be eligible for 8(a) BD participation. Specifically, the commenter noted that several NAICS codes identified in SBA's size regulations are further divided by specific subcategory having differing size standards for two or more subcategories. The commenter questioned whether SBA's regulations permitted a Tribe to own two firms with the same primary six digit NAICS code, but different subcategories of work with different corresponding size standards. For example, NAICS code 541330 is divided into four subcategories: Engineering Services, with a corresponding size standard of $4.5 million in average annual receipts; Military and Aerospace Equipment and Military Weapons, with a corresponding size standard of $27 million in average annual receipts; Contracts and Subcontracts for Engineering Services Awarded Under the National Energy Policy Act of 1992, with a corresponding size standard of $27 million in average annual receipts; and Marine Engineering and Naval Architecture, with a corresponding size standard of $18.5 million in average annual receipts. SBA's Office of Size Standards has identified that these subcategories are different enough to warrant separate recognition and that the industries are different enough to warrant distinct size standards. SBA believes that general Engineering Services, with a corresponding size standard of $4.5 million in average annual receipts, is vastly different from Military and Aerospace Equipment and Military Weapons, with a corresponding size standard of $27 million in average annual receipts. As such, it is SBA's view that a Tribe could own one Participant in the 8(a) BD program with a primary NAICS code of 541330 doing marine engineering and naval architecture and qualify a new firm with a primary NAICS code of 541330 doing general engineering services, provided the current firm did not start off in the general engineering services subcategory and switch to a different subcategory with a larger size standard within the last two years. SBA believes the regulations should clarify SBA's intent on this issue. Thus, the final rule makes clear that the same primary NAICS code

means the six digit NAICS code having the same corresponding size standard.

The proposed rule clarified the potential for success requirement for Tribally-owned applicants contained in § 124.109(c)(6). Specifically, in addition to the current ways in which SBA may determine that a firm has the potential for success required to participate in the 8(a) BD program, the proposed rule authorized SBA 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. SBA received overwhelming support for this proposed provision. Many of the comments praised SBA for recognizing that unlike a firm owned by one or more individuals, the viability of a firm owned by a Tribe or ANC is not dependent only on the firm's profitability. Several commenters recommended that similar treatment should be afforded to NHOs. As with the issue relating to work in secondary NAICS codes, SBA believes that this provision should apply equally to firms owned by Tribes, ANCs, NHOs and CDCs. This final rule makes the changes necessary for such equal treatment. As such, the final rule permits an applicant concern owned by a Tribe, ANC, NHO or CDC to establish potential for success where the Tribe, ANC, NHO or CDC has made a firm written commitment to support the operations of the applicant concern and it has the financial ability to do so.

The proposed rule also deleted 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. This change was made to allow Tribally-owned firms to attract the most qualified Tribal members to assist in running 8(a) Tribal businesses. SBA received 35 comments regarding this provision. Although most commenters agreed that this proposed change was an improvement over the previous regulatory language, they questioned whether the proposed language went far enough in clarifying that a Tribe had the discretion to hire any individual, whether or not a member of any Tribe, to run the day-to-day operations of a Tribally-owned 8(a) Participant. SBA believes that the proposed regulatory text gives that discretion to Tribes. Tribes must demonstrate that they control Tribally-owned firms. Tribes are then given flexibility to structure the control as they deem it best for their circumstances. It may be through committees, teams or Boards of Directors which are controlled by Tribal members, or it may be through non-disadvantaged employees who can be hired and fired and are controlled by the Tribe. Where non-disadvantaged employees manage a Tribally-owned firm, the regulations have required that the Tribally-owned firm have a management development plan showing how Tribal members will gain management experience to be able to manage the concern or similar Tribally-owned concerns in the future. SBA continues to believe that is a good policy. However, in response to these comments, SBA has made minor language revisions to more clearly state SBA's position.

In response to audits of the 8(a) BD program conducted by the Government Accountability Office (GAO) and SBA's OIG, SBA proposed an amendment to the annual review provisions contained in § 124.112(b) to require each Participant owned by a Tribe, ANC, NHO or CDC to submit information demonstrating 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 proposed rule identified that each firm should submit information relating to funding cultural programs, employment assistance, jobs, scholarships, internships, subsistence activities, and other services to the affected community.

SBA received more than 60 comments addressing this proposed change. Most commenters opposed the requirement, expressing concern about the lack of specificity in the proposed rule and the difficulty firms would have in trying to report this information at the Participant level. Several commenters pointed out that a uniform data source for the information being requested does not currently exist and the benefits vary widely among the groups and cannot be uniformly quantified. Commenters noted that it would be nearly impossible to separate the benefits a Tribe or ANC community receives from individual 8(a) contracts or even individual 8(a) firms, especially where a Tribe has multiple 8(a) firms receiving both 8(a) and non-8(a) contracts. A few commenters noted that 8(a) firms owned by ANCs do not necessarily contribute benefits directly to the shareholders, but rather direct their profits to the parent ANC who in turn distributes the benefits. Most expressed concern that the potential end result of the requirement will be burdensome, intangible and difficult to quantify. Commenters recommended that if this requirement remained, benefits should be reported at the Tribe/ANC/NHO/CDC level, instead of requiring each Participant individually to try to somehow track benefits flowing from it back to the affected community. Although SBA understands the concerns raised generally in opposition to reporting benefits, SBA feels compelled to address the recommendations made by the GAO and OIG. As such, the requirement to report benefits that flow to Tribal or native members and/or the Tribal, native or other community is retained in this final rule. However, SBA agrees with the majority of commenters that it would be virtually impossible for individual 8(a) firms to track and report on benefits that ultimately flow to the affected community because of their 8(a) participation. In an effort to strike a balance between the concerns raised regarding SBA's monitoring and oversight of the 8(a) BD program and those raised by entity-owned 8(a) Participants regarding their ability to generate meaningful information, only the parent corporations, not the individual subsidiary 8(a) Participants, will be required to submit the requested information. Therefore, the final rule specifies that those 8(a) Participants owned by ANCs, Tribes, NHOs, and CDCs will submit overall information relating to how 8(a) participation has benefited the Tribal or native members and/or the Tribal, native or other community as part of each Participant's annual review submissions, including information about funding cultural programs, employment assistance, jobs, scholarships, internships, subsistence activities, and other services to the affected community. SBA expects that two Participants owned by the same Tribe, ANC, NHO or CDC will submit identical data describing the benefits provided by the Tribe, ANC, NHO or CDC.

Several commenters opposed the reporting of any information relating to benefits flowing to Tribal or native members and/or the Tribal, native or other community, and questioned whether the Federal Government was attempting to dictate how Tribes should provide benefits to their respective communities. A few commenters also noted that this was an added burden imposed on Tribal and ANC-owned Participants that was not required for individually-owned Participants. One comment found it offensive for a non-Tribal government to determine the success or failure of a Tribal effort. Others expressed concern that the data would be used against the program Participants required to provide the data. Several commenters also

recommended that if any reporting requirement relating to benefits flowing to the native or Tribal community remain in the final regulation, then it should not be included within a section entitled "What criteria must a business meet to remain eligible to participate in the 8(a) BD program" because that implies that SBA will somehow evaluate the benefits reported and could determine a firm to be ineligible for further program participation if the reported benefits were deemed insufficient. It was never SBA's intent to evaluate or otherwise determine whether the benefits reported by Tribes, ANCs, NHOs and CDCs were or were not acceptable as compared to the value of 8(a) contracts received by firms owned by those entities. SBA did not intend future eligibility of an 8(a) Participant to be dependent on the amount or the type of benefits provided by the parent Tribe, ANC, NHO or CDC. As such, SBA agrees that the requirement to provide information related to benefits flowing to Tribal or native members and/or the Tribal, native or other community should be contained in a section of SBA's regulations relating to reporting requirements as opposed to the section relating to what a Participant must do to remain eligible to participate in the 8(a) BD program. This final rule moves the proposed provision from § 124.112(b)(8) to a new § 124.604.

Finally, several commenters recommended that SBA delay implementation of any reporting of benefits requirement to allow affected firms to gather and synthesize this data. In addition, these commenters encouraged SBA to establish a task force, comprised of native leaders and SBA, to further study how this requirement could be best implemented without imposing an undue burden on Tribes, ANCs, NHOs or CDCs, or on their affected 8(a) Participants. SBA agrees that further refinement of this requirement may be needed. As such, SBA has delayed implementation of new § 124.604 for six months after the effective date for the other provisions of this final rule. If further refinement takes longer than six months, SBA may delay implementation further. If further delay is necessary, SBA will publish a notice in the **Federal Register** to that effect. During the delayed six months implementation period, SBA anticipates meeting with members of the affected communities to further study and possibly improve this requirement and to develop best practices for utilizing the data collected.

Changes Applicable to Concerns Owned by NHOs

In addition to the changes identified above relating to follow-on contracts and potential for success and the change below regarding sole source limits for NHO-owned concerns, the final rule clarifies other requirements for NHO-owned concerns. Several commenters noted that SBA requires NHOs to be economically disadvantaged and to establish that their business activities will principally benefit Native Hawaiians, but believed that SBA's implementation of these requirements was not clearly set forth in the regulations. A few commenters recommended that SBA's requirement that a majority of an NHO's members must establish that they individually qualify as economically disadvantaged should be included within the regulatory text. Other commenters recommended clarifications relating to the control requirement. In response to these comments, the final rule adds clarifications regarding the current policy on how an NHO qualifies as economically disadvantaged, demonstrates that its business activities benefit Native Hawaiians, and controls an NHO-owned concern. To determine whether an NHO is economically disadvantaged, SBA considers the individual economic status of the NHO's members. The majority of an NHO's members must qualify as economically disadvantaged under § 124.104. For the first 8(a) applicant owned by a particular NHO, individual NHO members must meet the same initial eligibility economic disadvantage thresholds as individually-owned 8(a) applicants (*i.e.,* $250,000 net worth; $250,000 income; and $4 million in total assets). Once that firm is approved for participation in the 8(a) program, it will continue to qualify as economically disadvantaged provided a majority of its members meet the economic disadvantage thresholds for continued eligibility (*i.e.,* $750,000 net worth; $350,000 income; and $6 million in total assets). Because SBA will consider a firm to continue to be owned by an economically disadvantaged NHO where a majority of the NHO's members meet the thresholds for continued eligibility, SBA does not believe that the same NHO should be considered not economically disadvantaged for purposes of qualifying a new applicant if it exceeds one or more of the thresholds for initial eligibility. As such, for any additional 8(a) applicant owned by the NHO, this rule provides that individual NHO members must meet the economic disadvantage thresholds for continued 8(a) eligibility even though the determination is being made with respect to the initial eligibility of that applicant.

The final rule also incorporates the statutory requirement that an NHO must control the applicant or Participant firm. To establish control, the NHO must control the board of directors of the applicant or Participant. There is no statutory requirement that the day-to-day operations of an NHO-owned firm be controlled by Hawaiian Natives of the NHO. The requirement is merely that the NHO controls the firm. As such, an individual responsible for the day-to-day management of an NHO-owned firm need not establish personal social and economic disadvantage.

Excessive Withdrawals

The final rule amends § 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 new definition of withdrawal better addresses the original legislative intent behind the prohibition against excessive withdrawals.

By statute, SBA is directed to limit withdrawals made "for the personal benefit" of a Participant's owners or any person or entity affiliated with such owners. 15 U.S.C. 637(a)(6)(D). Where such withdrawals are "unduly excessive" so that they are "detrimental to the achievement of the targets, objectives, and goals contained in such Program Participant's business plan," SBA is authorized to terminate the firm from further participation in the 8(a) BD program. *Id.* SBA's previous regulations broadly defined what a withdrawal was and did not adequately tie termination to withdrawals that were detrimental to the achievement of the Participant's targets, objectives and goals. This unnecessarily hampered a Participant's ability to recruit and retain key employees or to pay fair wages to its officers. The proposed rule amended the definition of what constitutes a "withdrawal" in order to permit a Participant to more freely use its best business judgment in determining compensation. It modified the definition of withdrawal to generally eliminate the inclusion of officers' salaries from the definition of withdrawal and excluded other items currently included within such definition.

SBA received comments both in favor and opposed to the excessive withdrawal provisions contained in the proposed rule. Several commenters suggested eliminating the excessive withdrawal analysis entirely. Many suggested that SBA should look to the

totality of the circumstances to determine if withdrawals are excessive, and not use the thresholds as a bright line test. All commenters that addressed excessive withdrawals suggested that the existing threshold amounts be increased. The comments, however, were not uniform in their approach, and recommended many alternatives as to how SBA should determine excessive withdrawals. Many commenters suggested specific dollar amounts, such as $100,000 more than the proposed thresholds. A few commenters suggested that excessive withdrawals should be based on a reasonable percentage of revenue rather than a fixed dollar value. Several commenters recommended that excessive withdrawals should vary by industry or depending upon the geographic location of the firm. Several commenters suggested that there not be any limits or thresholds and firms be allowed to compensate the owners, officers and employees of the organization based on the viability of the business.

As noted above, the excessive withdrawal concept comes straight from the language of the Small Business Act. As such, SBA does not have the discretion to eliminate this requirement entirely as a few commenters recommended. SBA considered the alternate approaches suggested in the comments, but decided to retain the thresholds based on the revenues generated by the Participant as the most fair and reasonable approach. SBA believes that thresholds that vary from industry to industry or from one geographic location to another would be difficult to implement fairly. In addition, either approach would require further refinement through an additional proposed rule and public comment process. In response to comments, the final rule amends § 124.112(d)(3) to increase each of the current "excessive" withdrawal amounts by $100,000. Thus, for firms with sales of less than $1,000,000 the excessive withdrawal amount would be $250,000 instead of $150,000, for firms with sales between $1,000,000 and $2,000,000 the excessive withdrawal amount would be $300,000 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.

The final rule also clarifies that withdrawals that exceed the threshold amounts indentified in the regulations in the aggregate will be considered excessive. SBA believes that this makes sense because officers' salaries generally will not be included within what constitutes a withdrawal. Under the previous regulations, although it was not specifically spelled out, it appeared that withdrawals were excessive if they exceeded the thresholds in the aggregate, not by the individual owner or manager. This was a problem where officers' salaries were included within withdrawals. SBA was concerned that the excessive withdrawal provisions conflicted with the individual economic disadvantage provisions. For example, two disadvantaged individuals could own and operate an applicant or Participant firm and each could receive an income of $190,000 and be considered economically disadvantaged. Where officers' salaries counted as withdrawals, however, a Participant could nevertheless be terminated from the program because the $380,000 in combined salaries exceeded the excessive withdrawal threshold, even for Participants large total revenues. SBA thought that this inconsistency was unfair. One approach could have been to continue to count officers' salaries as withdrawals and determine excessive withdrawals by the individual owner or manager. SBA believes that such an approach would allow too much to be withdrawn from a Participant without adverse consequences and would be detrimental to the overall development of Participant firms. Excluding officers' salaries generally from withdrawals, but looking at withdrawals in the aggregate appears to be a fairer approach to SBA.

SBA recognizes that some firms may try to circumvent the excessive withdrawal limitations through the distribution of salary or by other means. As such, the final rule authorizes SBA to look at the totality of the circumstances in determining whether to include a specific amount as a "withdrawal," and specifically clarifies that 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.

Additionally, in order to more closely comply with statutory language, the final rule further clarifies that in order for termination or graduation to be considered by SBA, funds or assets must be withdrawn from the Participant for the personal benefit of one or more owners or managers, or any person or entity affiliated with such owners or managers, and any withdrawal must be detrimental to the achievement of the targets, objectives, and goals contained in the Participant's business plan. These requirements were not clearly contained in the previous regulations. Adding this language is consistent with the Small Business Act and with the intent of the original statutory provision, which sought to reach "individuals who have engaged in unduly excessive withdrawals." H.R. Conf. Rep. No. 100–1070, at 7 (1988). In determining whether a withdrawal meets this definition, the person or entity receiving the withdrawal will have the burden to show that the withdrawal was not for its personal benefit.

Finally, several commenters suggested that the excessive withdrawal prohibition not apply to firms owned by Tribes, ANCs, NHOs or CDCs. They believed that the community development purposes of the 8(a) BD program for entity-owned Participants is inconsistent with the excessive withdrawal provisions. As long as the Tribe, ANC, NHO or CDC has committed to supporting the firm, the commenters felt that any withdrawals made for the benefit of the Tribe, ANC, NHO or CDC (or community served by such entity) should be permitted. SBA agrees. As stated above, the original statutory provision was intended to apply to individuals who have withdrawn funds from the Participant that are unduly excessive and thus detrimental to the Participant's achievement of the targets, objectives, and goals contain it its business plan. Funds benefitting a Tribe or Tribal community serve a different purpose. SBA does not believe that it should prohibit a Participant owned by Tribe, ANC, NHO or CDC from benefitting the entity or the native or shareholder community. However, if SBA determines that the withdrawals from a firm owned by a Tribe, ANC, NHO or CDC are not for the benefit of the native or shareholder community, then SBA may determine that the withdrawal is excessive. For example, if funds or assets are withdrawn from an entity-owned Participant for the benefit of a non-disadvantaged manager or owner that exceed the withdrawal thresholds, SBA may find that withdrawal to be excessive.

Applications to the 8(a) BD Program

The proposed rule made 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 are to be submitted in an electronic format. SBA received only positive comments to these proposed changes. As such, the final rule does not change these provisions from those proposed. Despite the preference for an electronic application, SBA again wants to clarify that nothing in the proposed rule or in this final rule would prohibit hard copy 8(a) BD applications from being submitted to and processed by SBA.

Firms that prefer to file a hard copy application may continue to do so.

The proposed rule also changed the location of SBA's initial review of applications from ANC-owned firms from SBA's Anchorage, Alaska District Office to SBA's San Francisco unit of the Division of Program Certification and Eligibility (DPCE). Most comments opposed this move, believing that the SBA Alaska District Office better understood issues relating to ANCs and ANC-owned applicants. Commenters expressed concern about making interactions between ANC-owned applicants and the initial SBA reviewers more difficult because of the time difference or the imposition of a travel burden. Several commenters suggested SBA establish one or more offices to review only those applications from Tribally-owned concerns. Other commenters suggested that SBA take the provision identifying the San Francisco DPCE unit as the office that would initially review applications from ANC-owned concerns out of the regulations in order to provide flexibility to possible future changes in application processing. SBA has two DPCE units, one in San Francisco and the other in Philadelphia. All applications for participation in the 8(a) BD program, whether from ANC-owned, Tribally-owned or individually-owned firms, are processed by one of these two offices. The concerns raised by commenters about the possible difficulty of interacting with a reviewing office that is located in another State are no different than those faced by many individually-owned applicant firms. Both DPCE units interact daily with applicants located in other States. In addition, applications from ANC-owned firms come from firms located throughout the United States, not just from those located in Alaska. ANC-owned applicant firms not located in Alaska have historically dealt with an SBA processing office in another State (before this change, the Alaska District Office) without trouble. Thus, SBA does not see this physical presence issue as a problem. SBA has staffed the offices and for consistency purposes has designated the San Francisco DPCE unit to review and process all applications from ANC-owned firms. SBA agrees, however, that there is no need for the regulations to specifically address which DPCE unit will process specific types of applications. That can be done through internal guidance which can be changed more easily than regulations, and will provide more flexibility to SBA for possible future changes in application processing. As such, the final rule does not specifically state that applications from ANC-owned firms will be processed by the San Francisco DPCE unit even though it is SBA's intent to continue that policy. SBA will use its discretion to have the Philadelphia DPCE unit process applications from ANC-owned applicants in appropriate circumstances, such as where there is an uneven distribution of applications and the San Francisco DPCE unit has a backlog of cases while the Philadelphia DPCE unit does not.

SBA believes this is the best use of its currently available resources. Applicants to the 8(a) BD program are welcomed and encouraged to tap the Alaska District Office for assistance in the application process and SBA does not expect or require applicants to travel to DPCE units in order to complete the application process. As previously discussed, SBA encourages applicants to apply to the program through electronic means and these applications are available online. Additionally, SBA conducts training in the area of initial 8(a) eligibility on an ongoing basis and regularly includes components in the training which address areas unique to the Tribally-owned concerns.

The proposed rule also added 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 permitted SBA to presume that information requested but not submitted would be adverse (adverse inference). SBA received comments both in favor and opposed to this adverse inference concept. Those in favor recognized that the burden of proof for establishing eligibility must rest with the applicant. To do otherwise (*e.g.,* to require SBA to prove that an applicant does not meet the eligibility requirements) would not make sense. Those commenters opposed to the change expressed concern that information may be inadvertently omitted and the application process unreasonably extended. SBA disagrees. The burden of proof for establishing eligibility rests with the applicant and SBA believes that this clarification will streamline the application process. Requiring an applicant to submit all requested information when SBA makes a specific request for information it deems to be relevant is critical to the application process and is reasonable. When that information is not provided, it is rational for SBA to 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. SBA's intended effect is to eliminate the delay that results from making repeat information requests. A similar provision has existed as part of SBA's size and HUBZone regulations for many years and is cited regularly in eligibility determinations relating to those programs.

Finally, in response to GAO Report Number: GAO–10–353, entitled, "Steps Have Been Taken to Improve Administration of the 8(a) Program, but Key Controls for Continued Eligibility Need Strengthening" with regard to the submission of tax returns and forms, this final rule clarifies that an application must include copies of signed tax returns and forms. Although this is not a new requirement, one of the conclusions reached in the audit by GAO is that not all copies of tax returns contained in SBA's application files were signed.

Graduation

The proposed rule amended §§ 124.301 and 124.302 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. Several commenters supported the distinction made in the proposed rule between graduating and exiting the 8(a) BD program. A few commenters disagreed with allowing SBA to "kick out" any firms before their nine year program term expires. SBA believes that early graduation is not only supported by the statutory language of the Small Business Act, it is in fact required where a firm meets the goals and objectives set forth in its business plan, regardless of how long a firm has been in the 8(a) BD program. As such, the final rule continues to authorize early graduation in appropriate circumstances. Many commenters opposed proposed § 124.302(c), which authorized early graduation where a Participant exceeded the size standard corresponding to its primary NAICS code for two successive program years. Commenters believed such a rule was contrary to the business development purposes of the 8(a) program, and did not take into account the cyclical nature of small businesses where revenues can vary greatly from one year to the next. One commenter believed that this proposed provision would be a disincentive for firms to enter the 8(a) program in industries with small size standards. SBA does not intend to discourage any Participant from expanding or seeking business opportunities in diverse areas. However, as previously stated, where a firm has grown to be other than small in its

primary NAICS code, SBA believes that the program has been successful and it is reasonable to conclude that the firm has achieved the goals and objectives of its business plan. Where a firm's business plan goals and objectives have been achieved, early graduation is appropriate.

Termination From the 8(a) BD Program

The proposed rule made three amendments to § 124.303 regarding termination from the 8(a) BD program. First the proposed rule amended § 124.303(a)(2) to 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. SBA received no comments regarding this provision, and the final rule adopts the proposed language. Second, the proposed rule amended § 124.303(a)(13) to be consistent with the proposed changes to § 124.112(d)(13) regarding excessive withdrawals being a basis for termination. Several commenters supported the proposed changes. The final rule makes minor changes to more closely align this provision with § 124.112(d) and the statutory authority regarding termination for excessive withdrawals. The proposed rule authorized termination where an excessive withdrawal was deemed to "hinder the development of the concern." SBA believes that this proposed language did not precisely capture the statutory authority. Specifically, § 8(a)(6)(D) of the Small Business Act, 15 U.S.C. 637(6)(D), authorizes SBA to terminate a firm from participating in the 8(a) BD program where SBA determines that the withdrawal of funds was "detrimental to the achievement of the targets, objectives, and goals contained in such Program Participant's business plan." SBA has adopted that language in this final rule. Third, the proposed rule amended § 124.303(a)(16) 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. The two comments SBA received regarding this provision did not pertain to the ministerial change to the reference citation, but, rather, questioned whether a voluntary exclusion should be a basis for possible termination. This basis for possible termination existed prior to the proposed rulemaking process. It was not a change to which public comment was appropriate. SBA also notes that the first sentence in § 124.303(a) clearly makes termination discretionary, depending upon the good cause shown. As such, SBA continues to believe that a voluntary exclusion may be good cause for termination depending upon the underlying facts which caused the voluntary exclusion.

Effect of Early Graduation or Termination

The proposed rule also amended § 124.304(f) regarding the effect an early graduation or termination would have. It provided that a firm which early graduates or is terminated from the 8(a) BD program could generally not self certify its status 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. The proposed rule also provided that 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. SBA received several comments supporting the clarification that a firm could not self-certify its SDB status without addressing a previous termination or early graduation from the 8(a) BD program. Several commenters, however, also believed that a contracting officer should not be required to protest a firm's SDB status in every instance in which the firm identifies that it had been terminated or early graduated from the 8(a) BD program. They felt that contracting officers should have the discretion to determine if the information provided by a firm with its SDB certification was sufficient for the contracting officer to believe that the firm qualified as an SDB at the time of its certification. They believed that a contracting officer should protest a firm's SDB status only where he or she did not believe that the firm currently meets the SDB requirements. SBA agrees and has changed this provision to allow a contracting officer to accept an SDB certification where he or she believes that the firm currently qualifies as an SDB, and to protest the firm's SDB status to SBA where he or she continues to have questions about the firm's current SDB status.

Suspensions for Call-Ups to Active Duty

As noted above, the proposed rule amended § 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. SBA received mostly favorable comments in response to this provision. A few commenters sought clarification of a few points. One commenter stated that not all activities as reservists require deployment, and that activation is not the same as deployment. SBA does not use the word deployment in the regulation. Any reservist called to active duty who can no longer run the day-to-day operations of his or her 8(a) Participant firm could elect to be suspended during the call-up period. SBA believes that is clear from the regulatory text and that no further clarification is needed. Another commenter requested clarification as to whether a firm can continue to perform 8(a) contracts already awarded if the firm chooses to be suspended during the call-up period. As with any suspension, a firm is always required to complete performance of contracts it was awarded prior to the suspension. SBA believes this is clear from the current regulatory text in § 124.305(b)(4), but has added a new paragraph (i) to clarify SBA's intent nevertheless.

Task and Delivery Order Contracts

The proposed rule amended § 124.503(h) to address task and delivery order contracts. In order to help 8(a) concerns compete in the current multiple-award contracting environment, SBA proposed 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. SBA received more than 20 comments in support of this proposal. Commenters specifically agreed that procuring

agencies should not be able to take 8(a) credit for the award of an order to an 8(a) Participant that was not competed solely among eligible 8(a) Participants. The final rule adopts the proposed language and merely allows contracting officers the discretion to reserve orders for 8(a) concerns if they so choose. The rule does 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, but could not count the order as an 8(a) award.

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

The proposed rule amended § 124.504(a) 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 service disabled veteran-owned (SDVO) small business award prior to offering the requirement to SBA for award as an 8(a) contract. The previous regulation identified the small business set aside program, but not the HUBZone or SDVO small business programs. Commenters supported this change, specifically recognizing SBA's position relating to parity among the various small business contracting programs. One commenter recommended that the women-owned small business (WOSB) program be added to the list of small business programs that would limit SBA's ability to accept a requirement for the 8(a) BD program. SBA agrees. As such the final rule would limit SBA's ability to accept a requirement for the 8(a) BD program where a procuring agency expresses a clear intent to make a small business set-aside, or HUBZone, SDVO small business, or WOSB award prior to offering the requirement to SBA for award as an 8(a) contract.

The proposed rule also amended § 124.504(e) to 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. This had been SBA's policy, but had not been previously incorporated into the regulations. 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, SDVO, or WOSB 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. SBA received nine comments in support of this provision. The commenters believed that incorporating this policy into the regulations was an important safeguard to ensuring that the business development purposes of the 8(a) BD remain strong. The final rule adopts the proposed language.

Competitive Threshold Amounts

The proposed rule amended § 124.506 to adjust the competitive threshold amounts to $5,500,000 for manufacturing contracts and $3,500,000 for all other contracts to align with the changes made to the Federal Acquisition Regulation (FAR) to implement an inflationary adjustment authorized by 41 U.S.C. 431a. *See* 71 FR 57363 (September 28, 2006). Several commenters supported the change to incorporate the competitive threshold amounts contained in the FAR. They believed that removing the conflict between SBA's regulations and the FAR will also eliminate possible confusion in the contracting community. Several commenters recommended increasing the competitive threshold amounts, believing that such a change would better promote business development by making larger 8(a) contracts easier for procuring agencies to award and thus providing easier access to larger contracts for 8(a) Participants. Since the publication of the proposed rule, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (Councils) have determined that a further inflation adjustment to the 8(a) competitive threshold amounts is warranted and have set the new amounts at $6,500,000 as the competitive threshold for contracts assigned a manufacturing NAICS code and $4,000,000 as the competitive threshold for all other contracts. 75 FR 53129 (Aug. 30, 2010). The councils are authorized by section 807 of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 to adjust acquisition-related thresholds every five years for inflation using the Consumer Price Index (CPI) for all urban consumers, except for Davis-Bacon Act, Service Contract Act, and trade agreements thresholds. As these thresholds are statutory and SBA cannot change them administratively, the final rule adopts the language from the final rule amending the FAR.

Several commenters opposed allowing sole source contracts above the competitive threshold amounts to firms owned by ANCs, Tribes, and, for Department of Defense (DoD) contracts, NHOs. The authority to permit these sole source awards is statutory and cannot be changed administratively by SBA. As such, the authority for these awards continues to be incorporated in the final rule.

In addition, in order to address the perceived problem of non-8(a) firms unduly benefitting from the 8(a) BD program through joint ventures with 8(a) firms owned by ANCs, Tribes and NHOs, the proposed rule prohibited non-8(a) joint venture partners to 8(a) sole source contracts above the competitive thresholds from also being 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. 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, the change to disallow subcontracts to non-8(a) joint venture partners is not meant to penalize Tribal, ANC and NHO 8(a) firms, but, rather, to ensure that the benefits of the program flow to its intended beneficiaries. SBA received a substantial number of comments in response to this proposal. There were a large number of comments on both sides of this issue. Many commenters supported the proposed change as a legitimate way to ensure that non-8(a) firms do not control or dominate the performance of 8(a) contracts. Other commenters opposed the change because they did not want to discourage firms from serving as mentors and providing needed business development assistance to protégé firms. A few of these commenters also recommended that SBA increase its oversight of mentor/protégé relationships instead of prohibiting all subcontracting to non-8(a) joint venture partners. Several commenters recommended that the restriction that non-8(a) joint venture partners cannot also be subcontractors to the joint venture prime contract should be extended beyond sole source 8(a) contracts above the competitive threshold amounts. These commenters believed that it is important to ensure

that non-disadvantaged businesses, particularly large businesses in the context of any joint venture between a protégé firm and its mentor, do not obtain more benefits from an 8(a) contract than the 8(a) Participant itself does. SBA agrees and has made a change to § 124.513(d) that would generally prohibit a non-8(a) joint venture partner, or any of its affiliates, from acting as a subcontractor to the joint venture awardee on any 8(a) contract. The restriction is intended to apply to all subcontracting tiers, so that a non-8(a) joint venture partner could not receive a subcontract from a firm that was acting as a subcontractor to the joint venture or another subcontractor of the joint venture. In response to a commenter that was concerned that there might not be an appropriate subcontractor available if SBA prohibited non-8(a) joint venture partners from acting as subcontractors across the board, the final rule allows a non-8(a) joint venture partner, or an affiliate of the non-8(a) joint venture partner, to act as a subcontractor where the AA/BD determines that other potential subcontractors are not available. This could be because no one else has the capability to do the work, or because those firms that have the capability are busy with other work and not available to be a subcontractor on the 8(a) contract in question. If a non-8(a) joint venture partner seeks to do more work, the additional work must generally be done through the joint venture, which would require the 8(a) partner(s) to the joint venture to also do additional work to meet the 40% requirement set forth in § 124.513(d)(1).

Several commenters noted that prohibiting a non-8(a) partner to a joint venture from subcontracting with the joint venture did not make sense in the context of an unpopulated joint venture where both the 8(a) and non-8(a) partners must technically be subcontractors to the joint venture. SBA agrees. In order to ensure that the 8(a) partner(s) to a joint venture perform at least 40% of the work performed by an unpopulated joint venture, § 124.513(d)(2)(ii) of the final rule provides that the total amount of work done by the partners on the contract (at any level) will be aggregated and the work done by the 8(a) partner(s) must be at least 40% of the total done by all partners. In determining the amount of work done by a non-8(a) partner, all work done by the non-8(a) partner and any of its affiliates at any subcontracting tier will be counted.

The final rule eliminates the reference in § 124.506(b)(4) that a joint venture between one or more eligible Tribally-owned, ANC-owed or NHO-owned Participants and one or more non-disadvantaged business concerns could be awarded a sole source 8(a) contract above the competitive threshold amounts provided that no non-8(a) joint venture partner also acts as a subcontractor to the joint venture awardee. In light of the changes made to § 124.513, it is not necessary to repeat those same requirements in § 124.506. As such, the final rule provides in § 124.506 that a joint venture with a non-8(a) firm can receive an 8(a) contract above the competitive threshold amounts if it meets the requirements of § 124.513.

The supplemental information to the proposed rule noted that SBA considered other alternatives to disallowing subcontracting to a non-8(a) joint venture partner, and asked for comments on those and other alternatives. Commenters did not believe that eliminating joint ventures on sole source awards above the competitive threshold amounts was a reasonable approach. They felt that such an alternative would discourage firms from being mentors for Tribal, ANC and NHO-owned Participants and, thus, would significantly hamper the ability of such firms to fully receive valuable business development assistance. Commenters also believed that the alternative that permitted 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 of the entire contract itself was unworkable. They observed that one of the principle reasons that a firm enters into a joint venture relationship in order to perform a contract is because the firm lacks the resources necessary to perform the contract on its own. In the case of an 8(a) or small business set aside procurement, this means that the firm is generally unable to meet the 50% performance of work requirement by itself and, therefore, looks to another firm to assist it in meeting that requirement and in performing the overall procurement. For the larger contracts to which this restriction would apply (*i.e.,* the sole source contracts above the competitive threshold amounts), a firm may not only not be able to perform 50% of the entire contract, it may also not be able to perform a smaller percentage (*e.g.,* 40%) of the entire contract. As such, commenters did not believe this alternative would be conducive to joint venture relationships and should not be pursued. Finally, a few commenters also thought that the alternative that would require 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 was not an attractive alternative. While they believed that attempting to ensure that small businesses performed a certain percentage of subcontracting work was a good objective, they felt that this alternative would impose a subcontracting plan requirement on small businesses that are currently exempt from having subcontracting plans. In addition, they questioned the logic of requiring subcontract work be performed by small businesses when the prime contractor qualified as small and was already performing a significant portion of the work on the contract. They reasoned that such an approach would give small business prime contractors fewer subcontracting options and could adversely affect their ability to fulfill the procurement at a fair price. Based on the comments received, SBA believes that the proposed approach is the best alternative and has finalized it in this rule.

Bona Fide Place of Business

The proposed rule clarified the procedures a Participant must follow to establish a bona fide place of business in a new location pursuant to § 124.507(c)(2). The rule clarified 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.

All but one of those submitting comments in response to this proposal supported the proposed change as a necessary clarification. One commenter opposed any geographic limitations for 8(a) contracts, believing that firms should be free to seek contracts anywhere they deem appropriate, whether or not they have a separate

office in a particular location. The bona fide place of business requirement for 8(a) construction contracts is derived from the statutory requirement that "[t]o the maximum extent practicable, [8(a)] construction * * * contracts * * * shall be awarded within the county or State where the work is to be performed." 15 U.S.C. 637(a)(11). Thus, SBA does not believe that it has the unfettered discretion to eliminate all geographic location requirements for 8(a) construction procurements. Through regulations, SBA has permitted a firm to establish a new bona fide place of business in the geographic location where it expects to seek and be awarded 8(a) contracts. SBA believes that this is as far as it may go and still remain consistent with the statutory authority. Several commenters were frustrated by the lack of coordination in the past that has caused a sometimes lengthy process for a Participant to establish a bona fide place of business within the geographical area served by another SBA district office. They anticipated that the new provision would clear up confusion between the various SBA district offices and accelerate the process to establish a new bona fide place of business. A few commenters recommended that SBA clarify the point at which a bona fide business is deemed to exist. In response, this final rule clarifies that the effective date of a bona fide place of business is the date that the evidence (paperwork) shows that the business in fact regularly maintained its business at the new geographic location. The district office needs to look at the written evidence, including leases, payroll records (showing the hiring of one or more individuals at the new location), date of filings with the State to do business in the State, and bills. Although the facts showing exactly when a firm has a bona fide place of business may not be precise, based on the evidence, a district office does have some discretion to determine when it believes the bona fide place of business was established. However, it is not reasonable for SBA to say that a firm does not have a place of business until such time as SBA does the analysis or does a site visit to determine that a bona fide office exists at a particular point in time. The determination is based on the facts as supported by the evidence not when SBA makes the determination. Similarly, the date of the site visit is not the determinative date of when a bona fide place of business was established.

Competitive Business Mix

The proposed rule amended § 124.509(a)(1) 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. This change was made to respond to specific questions raised concerning whether orders off the GSA Schedule and subcontracts on 8(a) contracts counted against their competitive business mix requirement. The majority of commenters supported the clarification. A few commenters recommended that SBA count competitive 8(a) awards towards the non-8(a) business activity targets. They argued that these targets are meant to wean Participants away from sole source 8(a) contracting so that the firms are able to compete and survive after leaving the 8(a) BD program, and that 8(a) competition is more like non-8(a) competition than it is like 8(a) sole source awards. SBA does not believe that such a recommendation is consistent with the statutory authority. In authorizing the non-8(a) business activity targets, the Small Business Act speaks of "contracts awarded other than pursuant to section 8(a)." 15 U.S.C. 636(j)(10)(I). Competitive 8(a) contracts are obviously awarded pursuant to section 8(a) of the Small Business Act, and, thus, cannot be included as "contracts awarded other than pursuant to section 8(a)."

Several commenters recommended that where an 8(a) contract is awarded to a joint venture, only the revenue going to the 8(a) Participant should count as 8(a) revenue for competitive business mix purposes. While this approach is initially appealing, SBA believes that it would lead to skewed results. First, procuring agencies count the entire 8(a) award toward their small disadvantaged business goal, and the entire contract amount is coded as an 8(a) award. It seems inconsistent to count the entire contract amount as an 8(a) award for one purpose (goaling) but not another (competitive business mix). Second, if SBA counted only the revenues going to the 8(a) partner(s) in an 8(a) joint venture contract, others would argue that work performed and revenues received by subcontractors should also not be counted as 8(a) revenue for the 8(a) Participant prime contractor. Thus, SBA has not made the recommended change.

Administration of 8(a) Contracts

The proposed rule also added clarifying language to § 124.512 to make clear that tracking compliance with the performance of work requirements is a contract administration function which is performed by the procuring activity. SBA received a few comments supporting and a few comments opposing this clarification. One commenter thought that it made sense to put this clarification in the regulation because the regulation would then conform with the Partnership Agreement, which delegates contract execution and administration functions to procuring agencies. Another commenter opposed the change, mistakenly thinking that such a change was inconsistent with the Partnership Agreements. Also included within the delegation of contract administration is the authority to exercise priced options and issue appropriate modifications. The previous regulation 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. The proposed rule required contracting officers to submit copies of modifications and options to SBA within 10 days of their issuance or exercise. While several commenters supported the proposed change as requiring timely communication of options and modifications, others believed that the 10-day turnaround time was too short and burdensome. One commenter recommended that 10 business days be changed to 15 business days to be consistent with the Partnership Agreements. The final rule amends the provision to require a contracting officer to submit copies to SBA of all modifications and options exercised within 15 business days of their occurrence, or by another date agreed upon by SBA.

In addition, this rule adds clarifying language to § 124.510(b) to make it clear that the initial determination of whether a firm submitting an offer for an 8(a) contract will meet the applicable performance of work requirement is made by the procuring agency contracting officer. SBA may provide input if requested.

Changes to Joint Venture Requirements

The proposed rule made four amendments to the joint venture requirements contained in § 124.513(c)(3). Specifically, the amendments provided that (1) 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); (2) 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; (3) 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; and (4) each 8(a) firm that performs an 8(a) contract through a joint venture must 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. SBA received over 100 comments regarding the proposed changes to § 124.513, and will address the comments to each of the four proposals in turn.

First, the majority of commenters supported the proposal that 8(a) Participant(s) to an 8(a) joint venture must receive profits from the joint venture commensurate with the work they performed. Those in support believed that this provision makes sense in light of the change specifying that the 8(a) partner(s) to a joint venture must perform at least 40% of the work performed by the joint venture. In a situation where the joint venture performs 100% of the contract, 40% by an 8(a) Participant and 60% by a non-8(a) firm, these commenters believed that it was not reasonable for the 8(a) firm to receive 51% of the profits when it performed only 40% of the work. SBA continues to agree. SBA believes that requiring an 8(a) firm to receive 51% of the profits in all instances could discourage legitimate non-8(a) firms from participating as joint venture partners in the 8(a) BD program, or encourage creative accounting practices in which a significant amount of revenues flowing to a non-8(a) joint venture partner would be counted as costs to the contract instead of profits in order to meet the SBA requirement. SBA does not believe that either of those outcomes is positive. As such, this provision is retained in this final rule.

Second, the comments responding to the proposed rule requiring the 8(a) Participant(s) to a joint venture for an 8(a) contract to perform at least 40% of the work done by the joint venture were diverse. Many commenters supported the proposal as a reasonable implementation of the previous "significant portion" rule. Several commenters believed that 40% was not sufficient to ensure that 8(a) Participants received a significant benefit from the joint venture contract. Theses commenters believed that a 50% performance requirement for the 8(a) partner(s) to a joint venture would more likely result in 8(a) partners receiving a significant benefit from the joint venture contract. Conversely, several other commenters opposed any objective measure, believing that the "significant portion" language was more appropriate because a suitable portion for an 8(a) firm to perform will vary based on the type and size of the project. These commenters believed the "significant portion" approach provided needed flexibility and was preferred to the proposed amendment. SBA believes that the rule requiring an 8(a) Participant to a joint venture to perform a significant portion of the work, without identifying a specific percentage, did not provide sufficient guidance to 8(a) firms and contracting officers as to what was expected of those firms. In addition, it allowed non-sophisticated 8(a) firms to be taken advantage of by certain non-8(a) joint venture partners. SBA believes that the best way to ensure that the 8(a) partners to a joint venture gain valuable experience from the joint venture is to require the 8(a) partners to perform a specific percentage of work. SBA does not agree with the commenter recommending that the 8(a) partner(s) perform at least 50% of the work done by the joint venture. The fundamental reason to have a joint venture is because one firm cannot act as prime and perform the contract by itself. Where an 8(a) contract is awarded to an 8(a) Participant directly (and there is no joint venture) the 8(a) firm must meet the performance of work requirement (*i.e.,* generally 50%) with its own work force. If SBA required the 8(a) partner to a joint venture to perform at least 50% of the work of the joint venture and the joint venture intended to perform the entire contract itself, then the 8(a) firm would be in the same position it would be in if it did not have a joint venture; it would be required to perform 50% of the entire contract. There would be no benefit to having a joint venture. As such, SBA continues to believe that the proposed 40% makes the most sense. It ensures that the 8(a) partners perform a significant amount of work, but also recognizes that 8(a) firms in a joint venture cannot generally accomplish the task by themselves. Thus, it provides some needed flexibility.

The final rule makes a distinction between populated and unpopulated joint ventures in terms of the performance of work requirement. For a populated joint venture, the requirement that the 8(a) partner must perform at least 40% of the work done by the joint venture may not always make sense. Where the joint venture is populated with one administrative person, then it continues to make sense that the 8(a) partner must perform at least 40% of the work done by the aggregate of the joint venture partners. However, where the joint venture itself hires the individuals necessary to perform the contract, the work of the joint venture will be done by the joint venture entity itself. An 8(a) partner to such a joint venture must demonstrate clearly how it will benefit or otherwise develop its business from the joint venture relationship. Where an 8(a) Participant cannot clearly demonstrate the benefits it will receive, SBA will not approve the joint venture. It may be easier for an 8(a) Participant to show that it will perform 40% of the work of an unpopulated joint venture (or 40% of a joint venture populated with administrative personnel only) than it will to demonstrate that it will substantially benefit from the work done by a populated joint venture.

Third, SBA received five comments responding to the proposal to clarify that once a joint venture is approved by SBA for one contract the 8(a) Participant need only supply an addendum to the joint venture agreement, setting forth the performance requirements on that second or third contract, for SBA approval. The commenters supported this change, but three commenters asked for further amplification to clarify that SBA's approval of the addendums for a second and third contract under the joint venture consisted only of SBA reviewing the work to be done under those two additional contracts and not a repeat of the structure of the joint venture for every contract. They stressed that this approach would reduce costs and increase efficiency. It was always SBA's intent to review only the addendums to the joint venture for the additional contracts to be awarded under the joint venture. As such, the final rule adds clarifying language to accomplish this result.

Fourth, SBA received two comments supporting the proposal to require each 8(a) firm that performs an 8(a) contract through a joint venture to report to SBA how the performance of work requirements were met on the contract. SBA believes that this requirement is needed to reinforce the performance of work requirements. Several audits performed by SBA's OIG 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

Section 124.519 generally 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 proposed rule added 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. SBA received 31 comments in response to this proposal. The comments overwhelmingly supported exempting NHOs from the sole source limitations. Only one commenter opposed the change (and that commenter believed that firms owned by Tribes and ANCs should also not have a sole source exemption) and one responded that it was "neutral" to the proposed change. All others commenting on the proposal supported it. One commenter supported the inclusion of NHOs and suggested that all 8(a) firms should be exempt from sole source dollar limits. SBA believes that the exemption that allows firms owned by Tribes, ANCs and NHOs to receive sole source 8(a) contracts even where the firm has received 8(a) contracts totaling in excess of the identified limitations is consistent with the statutory authority that permits these firms to be awarded sole source 8(a) contracts above the competitive threshold amounts. That statutory authority does not appear to limit sole source awards to firms owned by Tribes, ANCs or, with respect to DOD contracts, NHOs in any way. SBA believes that any regulatory provision that limits sole source awards to firms owned by these entities could be inconsistent with that statutory authority. No other firms have that statutory authority. Thus, it makes sense to SBA to allow only firms owned by Tribes, ANCs and NHOs to receive sole source 8(a) awards in excess of the limitations set forth in § 124.519. A few commenters suggested that option years should not be included in the calculations for the total contract value because option year funding is not guaranteed. SBA did not propose a change as to how 8(a) contracts should be counted in determining whether a firm has reached the threshold above which it may not receive additional sole source 8(a) awards. As such, this recommendation is beyond this rulemaking, and SBA does not change the provision in this final rule.

The proposed rule also changed the 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 from the SBA Administrator to the AA/BD. SBA received no comments to this proposed change. As such, SBA adopts that change in this final rule.

Changes to Mentor/Protégé Program

The proposed rule made several changes to § 124.520, governing SBA's mentor/protégé program. The proposed changes to this section generated a great deal of interest and comment. SBA received 206 separate comments to the various proposed revisions to § 124.520.

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 thought that it was 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. SBA received two comments supporting this change as a logical clarification and one comment opposing it as not allowing sufficient flexibility. The commenter who opposed the clarification noted that circumstances change quickly in the beginning phases of 8(a) program participation and new opportunities may not be included within a firm's business plan. In such a case, a firm may not be eligible for the mentor/protégé program because its business plan did not reflect its new vision. SBA believes that a firm's business plan is an ever-evolving document. At each annual review a firm may adjust its business plan to account for changed circumstances. As long as a firm makes the necessary adjustments at each annual review, its business plan should be current and the assistance to be provided through a proposed mentor/protégé agreement should be consistent with and tied to the business plan. As such, the final rule adopts the language contained in the proposed rule.

The proposed rule made several changes to requirements relating to mentors. First, while stating that a mentor would generally have one protégé firm, the proposed rule amended § 124.520(b)(2) to limit the number of protégés any mentor could have to three. SBA proposed 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 received comments both supporting and opposing the provision. The majority of comments believed the provision limiting mentors to having three protégé firms at a time was reasonable. Commenters agreed that allowing a mentor to have an unlimited number of protégé firms could permit a mentor to unduly benefit from the 8(a) program. In addition, one commenter believed the limitation to be reasonable because it ensures that 8(a) firms receive more individualized attention and assistance from their mentor. Several of these commenters, however, recommended that the rule more clearly provide that the limitation is not an absolute limit, but only a limit on the number of protégés a mentor can have at a time. Those opposing the provision feared that limiting the number of protégés a mentor could have would hurt the availability of mentors. To date, SBA has generally permitted a mentor to have one protégé firm, and in some cases two protégé firms. SBA has not heard that there has been a scarcity of mentors or that potential protégé firms could not find suitable mentor firms. This rule would expand the number of protégés a mentor could have to three. Thus, the rule should actually increase the availability of mentors, not curtail it. SBA did not intend this provision to be an absolute limit (*i.e.,* a total of three protégé firms), but rather that it could not have more than three at any point in time. SBA believes that the proposed language states that clearly and that no further change is necessary to capture its intent.

Second, the proposed rule amended § 124.520(b)(3) 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 previous requirement that a proposed mentor must submit Federal tax returns in all instances had proven to be impracticable, particularly in the case of very large firms. The proposed rule allowed a proposed mentor to submit Federal tax returns, but also allowed it to demonstrate its favorable financial health by other means, including submitting audited financial statements or in the case of publicly traded

concerns the filings required by the Securities and Exchange Commission (SEC). SBA received one comment on this proposed change. The commenter supported the change, believing that it provided needed flexibility. The final rule adopts the proposed language.

The supplemental information to the proposed rule advised that SBA was considering making a change to § 124.520(b) to specifically allow non-profit business entities to be mentors, and sought public comment on this issue. Sixteen commenters supported allowing non-profit entities to serve as mentors. These commenters believed that expanding the mentor/protégé program to include well-managed non-profit corporations to serve as mentors would increase the pool of good mentors and the scope of the program. A few of these commenters also believed that a non-profit mentor could benefit a protégé firm by providing developmental assistance to the protégé in the same way as a for-profit could. One commenter opposed non-profit mentors, believing that non-profits could not provide the same assistance because they have not actively participated in the Federal marketplace. Because the commenters overwhelmingly supported allowing non-profit entities to be mentors, the final rule amends § 124.520(b) to specifically allow non-profit business entities to be mentors. This authority merely gives firms seeking to be protégés an additional avenue to find mentors that meet their needs. If a firm, like the one commenter opposing allowing non-profits to be mentors, does not believe a non-profit entity can supply it with needed developmental assistance, that firm would not enter a mentor/protégé relationship with a non-profit. However, another firm that sees a benefit to such a relationship will now be able to have such a relationship.

The proposed rule added 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. 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. SBA received 16 comments in response to this proposal. All 16 supported the change. Most of the commenters, however, also recommended that SBA further clarify the provision to specify that any contract awarded to a joint venture between a protégé and its mentor prior to the termination of the mentor/protégé relationship does not automatically end when the mentor/protégé relationship ends, and that the parties remain obligated to perform the contract to completion. SBA believes that to be fundamental. As with any contract awarded to any firm, contract performance continues. If a firm graduates or otherwise leaves the 8(a) BD program, the firm is bound to continue performance on any 8(a) contracts previously awarded. That is the same for any contract awarded to a joint venture, including joint ventures between a protégé and its mentor. If a protégé firm graduates from the 8(a) BD program, it would no longer be eligible for the exclusion from affiliation that is available to current protégé firms and their mentors for future contracts, but its leaving the 8(a) BD program does not affect the status of previously awarded contracts. In addition, the status of the joint venture as a small business for a previously awarded contract does not change where the protégé firm graduates or otherwise leaves the 8(a) BD program. Upon further reflection, SBA believes that this provision should be moved from § 124.520(c), which identifies the requirements for protégé firms, to § 124.520(d), which addresses the benefits available to mentor/protégé relationships. The final rule does that, and also adds clarifying language to clear up any confusion regarding what happens to previously awarded contracts.

The proposed rule amended § 124.520(c)(3) to allow a protégé to have a second mentor where it 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. All 20 comments SBA received in response to this provision supported the proposed change. The commenters believed that this will allow protégé firms to develop expertise in different areas more quickly than if they only had one mentor, and will more fully promote the business development purposes of the 8(a) BD program. One commenter recommended that a firm should be able to have a second mentor in all instances where the mentor is in a different NAICS code. SBA believes that NAICS codes alone do not adequately determine whether a firm is in a different or related industry. As commenters have pointed out in addressing other provisions of the proposed rule, many times contracting officers classify the same work in different NAICS codes. Work done in different NAICS codes could relate to one another and two such mentor/protégé relationships could conflict with each other. SBA believes that requiring a protégé to demonstrate that the second mentor possesses specific expertise that the first does not have and that the two relationships will not compete or otherwise conflict with each other provide important safeguards to ensuring that protégés benefit from their mentor/protégé relationships. As such, the final rule adopts the proposed language.

The proposed rule also added a provision to preclude 8(a) firms from being mentors and protégés at the same time. Under the amendment, 8(a) concern must give up its status as a protégé if it becomes a mentor. SBA received one comment supporting this provision as reasonable and two comments opposing it. The comments opposing the rule believed that a firm could act as a mentor and assist a firm less sophisticated than it is and still qualify as a protégé itself to obtain assistance in more highly developed areas from a larger, more diversified firm. SBA disagrees. If a firm was permitted to be both a protégé and a mentor at the same time, SBA believes that a conflict could easily develop between the two relationships. It is possible that there would be procurements that both protégé firms would want to compete for, which could cause friction between the parties. In the end, it is likely that the smaller protégé firm would not get the full benefits of a mentor/protégé relationship. As such, the final rule retains the prohibition against a firm being a protégé and mentor at the same time.

SBA received 27 comments in response to proposed § 124.520(c)(5), which prohibited SBA from approving a mentor/protégé agreement if the proposed protégé firm has less than one year remaining in its program term. Three commenters supported the rule as proposed. One commenter thought that mentor/protégé agreements should not be permitted in the last 18 months of a firm's program term. The remainder of the commenters believed that the one-year limit was too harsh. Many of these commenters believed that SBA approval should be based upon the particular agreement, and whether it provided for meaningful developmental support to the protégé firm, and not on the time remaining in the program. Other commenters believed that a shorter length of time to disallow new mentor/protégé relationships was more

appropriate. One commenter recommended nine months, three commenters recommended six months, and three commenters recommended three months. Several commenters were concerned that because the process for SBA to approve a mentor/protégé agreement may take a long time, an agreement might be denied because of SBA's inaction. As stated in the supplemental information to the proposed rule, SBA was concerned that mentor/protégé relationships approved within one year of the end of a firm's program term would not provide the agreed upon assistance to the protégé firm. An agreement may appear valid on its face, but SBA's oversight of the firm and what assistance it actually obtains ends when the firm leaves the program. SBA cannot ensure that the protégé ever receives the agreed upon assistance. In many of the cases SBA has seen where a mentor/protégé agreement is submitted within the last year of a firm's program term, the proposed mentor is looking to benefit from the 8(a) BD program through the award of an immediate joint venture contract. After the contract award, there are no assurances that the protégé ever receives developmental assistance. SBA also understands, however, that certain firms nearing the end of their program terms could benefit from mentor/protégé relationships if they in fact received the agreed upon assistance. Because this rule imposes new consequences for a mentor that has not provided the assistance set forth in its mentor/protégé agreement, SBA believes that the one year restriction may be too limiting. As such, this final rule prohibits SBA from approving a mentor/protégé agreement if the proposed protégé firm has less than six months remaining in its program term.

The proposed rule amended § 124.520(d)(1) to allow a joint venture between a mentor and protégé to be small for Federal subcontracts. All nine comments responding to this provision supported allowing the exclusion from affiliation for subcontracts. One commenter thought the exclusion from affiliation should be limited only to the unique contracting situation of the Department of Energy, 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 did not previously apply. The other eight commenters thought that the exclusion from affiliation should be applied equally to all subcontracts of Federal prime contracts. These commenters thought that it made no sense to distinguish between types of subcontracts. They viewed allowing the exclusion from affiliation on all subcontracts as another business development tool. The final rule retains the exclusion from affiliation for all Federal subcontracts.

The proposed rule also clarified that a mentor/protégé agreement must be approved by SBA before the two firms can submit an offer as a joint venture to take advantage of the special exception to the size requirements for that procurement. 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. 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. SBA received no substantive comments on this provision, and it remains unchanged in this final rule.

In addition, the proposed rule added 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). SBA received no comments on this proposal. 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. SBA believes that it would not make sense for the requirement that the protégé firm perform 40% of the work performed by the joint venture 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 final rule adopts the proposed language.

The proposed rule also clarified procedures for requesting reconsideration of SBA's decision to deny a proposed mentor/protégé agreement. No reconsideration process was authorized under previous regulations. Under the procedures, 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 is then able to 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. The proposed rule also provided that 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 could, however, submit a proposed mentor/protégé agreement with a different proposed mentor at any time after the SBA's final decline decision. SBA received two comments responding to this proposal. While the comments supported authorizing a reconsideration process, they opposed the provision requiring a prospective protégé to wait one year after its mentor/protégé agreement was denied to submit a new mentor/protégé agreement with the same proposed mentor. The commenters viewed this proposal as a punitive measure that does not benefit any party involved. SBA agrees that requiring the same two parties to wait a year before submitting a new mentor/protégé agreement does not serve the business development purposes of the program. However, SBA continues to believe that some waiting period makes sense to ensure that the parties properly understand SBA's requirements and take some time to draft an agreement that meets those requirements. Thus, this final rule reduces the one-year waiting period for the same parties to submit a new mentor/protégé agreement to 60 calendar days.

The proposed rule also added a new § 124.520(h), which set forth consequences for a mentor that fails to provide the assistance it agreed to provide in its mentor/protégé

agreement. 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. Under the proposed rule, 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). SBA received over 50 comments responding to this proposal. Many commenters opposed the stop work order authority because they feared that it would harm protégé firms and discourage procuring agencies from awarding contracts to mentor/protégé joint ventures. Any stop work order issued under this section is intended to be temporary to encourage the mentor to come into compliance with its mentor/protégé agreement. SBA anticipates that it will 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. SBA continues to believe that some seemingly harsh measure must be imposed to ensure that protégé firms obtain the business development assistance promised to them in their various mentor/protégé agreements. SBA has no other way to compel mentors to comply with their mentor/protégé agreements. Without such authority, SBA fears that protégé firms will continue to be taken advantage of by firms who merely want to get access to 8(a) contracts that they would not otherwise be able to do without the mentor/protégé relationship. SBA understands the concerns raised by commenters who view a stop work order as something that will hurt protégé firms in addition to not obtaining the agreed-upon development assistance through their mentor/protégé agreements. However, SBA believes that this is a valuable tool to maintain the integrity of small business programs. Large business mentors that are performing significant portions of 8(a) and small business contracts that they otherwise would not be eligible for should not be able to continue to benefit from such contracts when they are not meeting SBA's requirements. Instead of providing that SBA will recommend the issuance of a stop work order in every case where the mentor 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, the final rule gives SBA the authority to recommend a stop work order, but makes it discretionary. SBA will look at the circumstances in each case before deciding whether to make such a recommendation. In addition, the final rule adds further language to attempt to protect protégé firms. Specifically, the final rule provides that where a protégé firm is able to independently complete performance of any contract awarded to a joint venture between it and its mentor, SBA may authorize a substitution of the protégé firm for the joint venture. This would allow the protégé firm to continue to perform the contract without the mentor.

The proposed rule also authorized SBA to terminate a mentor/protégé agreement where the mentor has failed to provide the agreed upon developmental assistance, and render the mentor firm 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. Several commenters believed that a firm should be forever barred from again acting as a mentor if it failed to provide the agreed upon developmental assistance to the protégé firm in one mentor/protégé relationship. SBA takes seriously a mentor's failure to live up to its mentor/protégé agreement, particularly where the mentor has benefited from the 8(a) BD program through joint venture contracts. However, SBA believes that a permanent ban is too restrictive, and that two years is an appropriate penalty. If after two years the firm seeks to be a mentor for another 8(a) Participant, SBA would require the firm to demonstrate when and how it will provide developmental assistance to the protégé firm, and it may not approve any joint venture between the mentor and protégé until the firms demonstrate that the protégé has already received some developmental assistance.

Reporting Requirement and Submission of Financial Statements

The proposed rule amended § 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 previous 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. SBA received several comments supporting this change. Two commenters believed that semi-annual reporting will add an unnecessary burden to 8(a) Participants. Again, SBA is merely changing the regulation to coincide with statutory authority.

The proposed rule also amended § 124.602 regarding the submission of audited and reviewed financial statements. SBA proposed 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. The proposed rule required reviewed financial statements 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 received more than 40 comments supporting the changes in the levels of gross annual receipts that require a firm to submit audited and reviewed financial statements. One commenter recommended that audited financial statements be required only of firms with more than $15,000,000 in gross annual receipts, and another commenter recommended that reviewed financial statements be required only for firms with gross annual receipts between $5,000,000 and $10,000,000. Because

SBA did not receive any other comments questioning the levels for audited and reviewed financial statements and the vast majority of comments supported the changes, SBA believes that the proposed levels are appropriate. Several commenters recommended that SBA allow for a transition for firms who for the first time exceed $10,000,000 in gross annual receipts and who would, therefore, be required to submit audited financial statements for the first time. These commenters believed that it would be difficult for a firm to provide audited financial statements in the first year it exceeds the $10,000,000 receipts figure. This is because audited income and cash flow statements generally require an audited balance sheet for both the beginning and the end of the period covered by the income and cash flow statements. One commenter noted that it is technically difficult for an auditor to recreate an audited balance sheet for a prior period and costly for the client company. For example, if a company has inventories and accounts receivable, the commenter observed that Generally Accepted Auditing Standards would generally require that the auditors observe the taking of the physical inventory and confirm the receivables with the debtors. The commenter believed that it is challenging and expensive for the auditor to carry out these tasks a year later if the client company discovers that its sales have increased to the point that an audit will be required. In response to these comments, SBA has added a provision to the regulations allowing 8(a) Participants to provide an audited balance sheet for the first year an audit is required, with the income and cash flow statements receiving the level of service required for the previous year (review or none, depending on sales the year before the audit is required).

Additionally, during the Tribal consultations, two Tribal representatives believed that it was unduly expensive and burdensome for Tribally-owned firms to submit separate audited financial statements for each individual 8(a) Participant. They recommended that where an audited financial statement is required for one or more Tribally-owned firms, the firm be able to submit audited consolidated financial statements that include audited schedules for each 8(a) Participant. They understood that SBA needs separate financial information for each Participant to monitor 8(a) compliance, but believed that this information is already provided within the schedules which are attached to the consolidated financial statements. In addition, they felt that requiring a separate, stand alone audit for each 8(a) Participant would not provide additional, meaningful detail for the SBA, but would impose substantial costs on the Tribe, ANC, NHO, or CDC. SBA recognizes the unique nature of ANC, NHO, CDC and Tribal participation in the 8(a) BD program. Provided that consolidated financial statements contain audited schedules for each 8(a) Participant, SBA agrees that separate audited financial statements for each entity-owned 8(a) Participant are not necessary. As such, this final rule amends § 124.602 by adding a new paragraph (g) making it clear that SBA will accept audited consolidated financial statements that contain audited schedules for each 8(a) Participant. It will be up to each Participant how it wishes to meet the audited financial statements requirement. If there is only one 8(a) Participant that must submit an audited financial statement, it may make sense for that Participant to provide separate, individual audited financial statements. If there are two or more 8(a) Participants that must submit audited financial statements, or if it otherwise makes sense for the 8(a) Participant, the Participant may provide audited consolidated financial statements with audited schedules for each 8(a) Participant. Even if there is only one 8(a) Participant required to submit audited financial statements, it may make sense to provide consolidated financial statements with audited schedules where the audited consolidated statements with audited schedules already exists for other purposes and it would be an added cost to have audited financial statements of the one 8(a) Participant.

Several commenters also noted that the previous regulations authorize the appropriate SBA district director to waive the requirement for audited financial statements where good cause is shown, but do not authorize the district director to waive the requirement for reviewed financial statements in similar circumstances. These commenters recommended that the appropriate district director to waive the requirement for reviewed financial statements where good cause similar to that permitted to waive audited financial statements is shown. SBA agrees and has added such a waiver to § 124.602(b)(2). If a waiver is granted, the Participant would be permitted to submit a compilation statement instead of reviewed financial statements.

Finally, as noted above in the discussion under the heading *Changes Applying Specifically to Tribally-Owned Firm,* this final rule moves the proposed provision requiring each Participant owned by a Tribe, ANC, NHO or CDC to submit information demonstrating 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 from § 124.112(b)(8) to a new § 124.604. That section discusses the other changes made to that requirement in this rule.

Requirements Relating to SDBs

This rule amends § 124.1002, which defines what is an SDB. SBA first adds 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 will merely be determining whether a concern is owned and controlled by one or more individuals who qualify as socially and economically disadvantaged. SBA will 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.

This rule also adds 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 in operation only 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 received eight comments in response to the proposed changes and all but one supported the proposed changes to the SDB regulations. One commenter disagreed that SDB is not a business development program. SBA does not currently provide business development assistance to those firms that self certify their SDB status.

Finally, SBA amends § 124.1009, *Who decides disadvantaged status protests?*, clarifying that the AA/BD, or designee,

will determine whether the concern is disadvantaged. This change is required due to the recent suspension of SBA's receipt of applications for the SDB program. 73 FR 54881(September 23, 2008). SBA no longer processes applications for SDB certification and therefore no longer has the position Division Chief, Small Disadvantaged Business Certification and Eligibility.

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

OMB has determined that this rule is a "significant" regulatory action under Executive Order 12866. In the proposed rule, the SBA set forth its initial regulatory impact analysis, which addressed the following: Necessity of the regulation; alternative approaches to the proposed rule; and the potential benefits and costs of the regulation. The SBA did not receive any comment specifically addressing its regulatory impact analysis. However, numerous commenters agreed that the proposed changes were necessary and positive. Several commenters commended SBA's efforts to address certain program abuses and described the changes as a strong effort to improve the program for legitimate 8(a) BD program participants. In addition, the SBA received numerous comments supporting its proposed approaches to the specific provision changes. The specific comments on these approaches are discussed above. Although SBA received comments not in favor of specific provisions in the rule overall the comments generally supported the proposed changes and recognized SBA's requirements and effort to remove confusion. Those provisions that received unanimous opposition were removed or amended in consideration of the well-founded comments received. SBA also considered a number of alternatives to the proposed rule and requested comments from the public concerning those alternatives. The comments on the alternative approaches and SBA's response are also discussed above.

For these reasons, and those set forth in the preamble, the SBA adopts as final its initial regulatory impact analysis.

Executive Order 12988

This action meets applicable standards set forth in Sec. 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 a Tribal implications.

In drafting this final 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. In addition, SBA conducted Tribal consultations on December 16, 2009 in Seattle, Washington, on January 14, 2010 in Albuquerque, New Mexico, and on January 27, 2010 for Anchorage, Alaska in Vienna, Virginia via a video teleconference with representatives located in Anchorage, Alaska.

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. Many Tribal representatives discussed 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 also 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 believes the final rule, as drafted, considered the comments and testimony received from the Native communities impacted by this rule change. Additionally, SBA has delayed the effective date for certain provisions for a period of six months so that additional discussions may take place with the Native communities regarding the Annual Review reporting requirements and how best to implement.

Regulatory Flexibility Act

The SBA set forth an Initial Regulatory Flexibility Analysis (IRFA) addressing the impact of the proposed rule in accordance with section 603, title 5, of the United States Code. The IRFA examined the objectives and legal basis for this proposed rule; the kind and number of small entities that may

be affected; the projected recordkeeping, reporting, and other requirements; whether there are any Federal rules that may duplicate, overlap, or conflict with this proposed rule; and whether there are any significant alternatives to this proposed rule.

SBA identified six specific provisions of the proposed rule which it anticipated may have a significant impact on a substantial number of small businesses. Those provisions were: (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.

SBA received a couple of comments directly addressing the IRFA and several comments discussing provisions of the proposed rule that addressed included subjects addressed in the IRFA. The SBA received a comment that correctly pointed out that the statement that the rule imposes no additional reporting requirement or recordkeeping requirements was inaccurate. This same commenter correctly pointed out that the Annual Review reporting requirement for Tribes is new. Several comments stated that SBA should consider the costs and burdens of the reporting and recordkeeping requirements for the Native owned firms and the consistency of the data.

SBA notes that Annual Review reporting and recordkeeping requirements are necessary to reduce fraud in the program and to ensure that the intended beneficiaries receive the benefits of the program and only eligible businesses participate. SBA's rule adopts methods and processes aimed at meeting these objectives, while also minimizing, as much as possible, the burden on small businesses.

In addition to public comments, the Office of Advocacy (Advocacy), an independent office within SBA, also provided comments on the proposed rule. In the comments Advocacy commends SBA for its efforts in making necessary revisions to the 8(a) BD program rules, moving some of the internal practices to a regulatory framework, and recognizing cost burdens that 8(a) companies encounter in complying with the program requirements for audited financial statements. Advocacy supports SBA's changes to the economic disadvantage analysis and treatment of IRAs and applauded SBA's efforts to seek broad public input in this rulemaking. In addition to noting the positive aspects of the proposed rule, Advocacy also expressed concern with certain of the proposed changes which SBA addresses here.

Residency Requirement

In response to the comments SBA received regarding the physical presence requirement and as explained in the preamble above, SBA has removed the requirement from the final rule.

Program Graduation

Although Public Law 95–507 was the enabling statute for the 8(a) BD program, Public Law 100–656 specifically required graduation based on the economic disadvantaged condition only. *See* section 8(a)(6)(C)(ii) of the Small Business Act. Because the final rule as written is consistent with the Small Business Act as amended, SBA adopts the final rule.

Administration of 8(a) Contracts

SBA believes that Advocacy has misinterpreted the delegation of contract administration with the delegation of program administration. SBA does not delegate the administration of the 8(a) BD program to other agencies. The changes to § 124.512 address the delegation of contract administration, not program administration as suggested by Advocacy in its comments. SBA has historically delegated contract administration and contract execution to procuring agencies, but has maintained program administration responsibilities and the setting of policy with regard to the 8(a) BD program. Additionally, the FAR specifically addresses the delegation of contract execution authority from SBA to other procuring activities.

Nothing has changed with regard to the assistance provided by SBA to 8(a) BD program Participants as delivered through the Business Development Specialist serving as advocates and administering assistance.

Requirements Relating to SDBs

Advocacy objects to the change to allow "part time companies" to participate in the SDB program and suggests that SBA does not have the legal authority to change its definition of small business concern and the legislative history of the socially and economic disadvantaged programs does not seem to support or encourage the participation of part-time business owners. Although true for the 8(a) program (eligibility is based on the full time devotion of the disadvantaged individual(s) upon whom eligibility is based) for Small Disadvantaged Businesses the requirement is for an award to a small business concern owned and controlled by socially and economically disadvantaged individuals. SBA defines a small business as a business entity organized for profit, with a place of business located in the United States, and which operates primarily within the United States or which makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor. *See* 13 CFR 121.105(a). The definition does not have a full time devotion requirement, consequently SBA believes a firm run part time by one or more socially and economically disadvantaged individuals meets this definition. If an agency determines that the SDB has the capability to perform a subcontract and that firm is owned and controlled by a socially and economically disadvantaged individual who manages the firm on a part time basis, in the SDB context, SBA believes the firm is eligible assuming the other eligibility criteria for SDB are met.

In response to Advocacy's recommendation that SBA conduct an economic impact analysis based on the concerns it raised, as addressed above, SBA does not believe it is necessary because in one instance SBA has made the recommended change and as for the remaining comments, Advocacy's interpretation and suggested results are not consistent with the actual application of the rule.

For these reasons, and the reasons set forth in the preamble, the SBA adopts the IRFA as final.

Finally, Advocacy recommended that SBA provide the public with an opportunity to review the comments from the regional hearings. SBA has summarized the comments received on the listening tour and has audio tapes of those hearing, but no transcripts. Someone seeking to listen to the tapes of one or more hearings may request SBA for such access.

Paperwork Reduction Act

For purposes of the Paperwork Reduction Act, 44 U.S.C. Chapter 35, SBA has determined that the rule imposes new reporting and recordkeeping requirements. Specifically, the final rule imposes a new requirement on each Participant owned by a Tribe, ANC, NHO, and CDC to submit information to SBA that evidences how participation in the 8(a) program has benefited the Tribal or native members and/or communities. This provision, as proposed in § 124.112(b)(8), required each Participant to report how its participation in the 8(a) BD program benefited the Tribal or native members and/or communities. In response to public comments on this requirement, SBA has decided that it would be less onerous on the 8(a) firms if the reporting requirement was at the parent corporation level as opposed to the individual firm level. In addition, because 124.112 relates to eligibility criteria and not reporting requirements, SBA has relocated this new requirement to a new § 124.604, to avoid any confusion as to the purpose for the information requested.

As discussed above, several commenters recommended that SBA delay implementation of this reporting requirement to allow affected firms additional time to gather and synthesize the data and for the Agency to analyze the requirement further. In response SBA has decided to delay implementation for a minimum of six months from the effective date of this final rule.

Although this reporting requirement was identified in the proposed rule, SBA unintentionally stated that there were no additional reporting or recordkeeping requirement resulting from this rule, and further did not submit the information collection to OMB for review and approval as required by the Paperwork Reduction Act, and OMB information collection regulations. In order to meet these requirements, SBA will publish a notice in the **Federal Register** to request comments on, among other things, the need for the information, who is expected to respond to the request for the information, and the estimated hour and cost burden on these respondents as a result of the requirement. This action will not impact implementation of the other aspects of the rule, since, in any event, implementation of the reporting requirement has been delayed for six months.

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 amends 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 as follows:
■ a. Revise paragraphs (b)(3) and (b)(6);
■ b. Revise paragraph (h) introductory text; and
■ c. Revise paragraph (h)(3)(iii).

§ 121.103 How does SBA determine affiliation?

* * * * *

(b) * * *

(3) Business concerns which are part of an SBA approved pool of concerns for a joint program of research and development or for defense production as authorized by the Small Business Act are not affiliates of one another because of the pool.

* * * * *

(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) *Affiliation based on joint ventures.* A joint venture is an association of individuals and/or concerns with interests in any degree or proportion consorting to engage in and carry out no more than three specific or limited-purpose business ventures for joint profit over a two year period, for which purpose they combine their efforts, property, money, skill, or knowledge, but not on a continuing or permanent basis for conducting business generally. 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. Once a joint venture receives one contract, SBA will determine compliance with the three awards in two years rule for future awards 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 if it is a separate legal entity it may (but need not) be populated (*i.e.,* have its own separate employees). SBA may also determine that the relationship between a prime contractor and its subcontractor is a joint venture, and that affiliation between the two exists, pursuant to paragraph (h)(4) of this section.

Example 1 to paragraph (h) introductory text. 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.

Example 2 to paragraph (h) introductory text. Joint Venture XY receives a contract on December 19, year 1. It may receive two additional contracts through December 19, year 3. On August 6, year 2, XY receives a second contract. It receives no other contract awards through December 19, year 3 and has submitted no additional offers prior to December 19, year 3. Because two years have passed since the date of the first contract award, after December 19, year 3, XY cannot receive an additional contract award. The individual parties to XY must form a new joint venture if they want to seek and be awarded additional contracts as a joint venture.

Example 3 to paragraph (h) introductory text. Joint Venture XY receives a contract on December 19, year 1. On May 22, year 2, XY submits an offer for Solicitation 1. On June 10, year 2, XY submits an offer for Solicitation 2. On June 19, year 2, XY receives a second contract responding to Solicitation 1. XY is not awarded a contract responding to Solicitation 2. On December 15, year 3, XY submits an offer for Solicitation 3. In January, XY is found to be the apparent successful offeror for Solicitation 3. XY is eligible for the contract award because compliance with the three awards in two years rule is determined as of the date of the initial offer including price, XY submitted its offer prior to December 19, year 3, and XY had not received three contract awards prior to its offer on December 15.

* * * * *

(3) * * *

(iii) Two firms approved by SBA to be a mentor and protégé under § 124.520 of these regulations 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 § 124.519 of these regulations. 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. In either case, after contract performance is complete, the 8(a) partner to the joint venture must submit a report to its servicing SBA district office explaining how the applicable performance of work requirements were met for the contract.

* * * * *

■ 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 or supply NAICS code, not under a wholesale trade or retail trade NAICS code. A concern that submits an offer or quote for a contract where the NAICS code assigned to the contract 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 § 121.404 by adding a new paragraph (g)(4) to read as follows:

§ 121.404 When does SBA determine the size status of a business concern?

* * * * *

(g) * * *

(4) If during contract performance a subcontractor performs primary and vital requirements of a contract, the contractor and its ostensible subcontractor will be treated as joint venturers. *See* § 121.103(h)(4). If the two firms exceed the applicable size standard in the aggregate, the contractor cannot continue to certify as small for that contract or for any task order under that contract.

* * * * *

■ 5. Amend § 121.406 as follows:

■ a. Revise the section heading and paragraphs (a) introductory text, and (a)(1);

■ b. Revise paragraph (b)(1) introductory text;

■ c. Remove the word "and" at the end of paragraph (b)(1)(ii);

■ d. Revise paragraph (b)(1)(iii);

■ e. Add a new paragraph (b)(1)(iv);

■ f. Redesignate paragraphs (b)(3), (b)(4) and (b)(5) as paragraphs (b)(5), (b)(6), and (b)(7), respectively, and add new paragraphs (b)(3) and (b)(4); and

■ g. Revise 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 a small business set-aside, service-disabled veteran-owned small business set-aside, WOSB or EDWOSB set-aside, or 8(a) contract?

(a) *General.* In order to qualify as a small business concern for a small business set-aside, service-disabled veteran-owned small business set-aside, WOSB or EDWOSB 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) * * *

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

* * * * *

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

(iv) 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 or supply NAICS code. The nonmanufacturer rule does not apply to contracts that have been assigned a service, construction, or specialty trade construction NAICS code.

(4) The nonmanufacturer rule applies only to the supply component of a requirement classified as a manufacturing or supply 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.

* * * * *

■ 6. Amend § 121.1001(b) by adding a new paragraph (b)(10) at the end thereof 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

■ 7. 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.

§§ 124.110, 124.111, 124.502, 124,503, 124.505, 124.507, 124.513, 124.514, 124.515, 124.517, 124.519, and 124.1002 [Amended]

■ 8. Remove the term "Standard Industrial Classification" in § 124.1002(b)(1) and add, in its place the term "North American Industry Classification System"; and 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) introductory text;
■ 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) introductory text, (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)(i), and (b)(1)(ii); and
■ u. § 124.1002(f)(3).

■ 9. Revise § 124.2 to read as follows:

§ 124.2 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 (including voluntary early graduation) or voluntary withdrawal as provided for in this subpart.

■ 10. Amend § 124.3 as follows:
■ a. By amending the definition of "Alaska Native" by adding in the first sentence, the phrase ", as defined by the Alaska Native Claims Settlement Act (43 U.S.C. 1602)," before the word "means";
■ b. By adding a definition of "NAICS code";
■ c. By revising the definitions of "Primary industry classification" and "Same or similar line of business,"; and
■ d. By adding a definition of the term "Regularly maintains an office" 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. A Participant may change its primary industry classification where it can demonstrate to SBA by clear evidence that the majority of its total 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 lease agreements, payroll records, advertisements, bills, correspondence, 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. Although 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 be required to have an additional construction license or other specific type of license in order to regularly maintain an office.

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.

* * * * *

■ 11. Add § 124.4 to read as follows:

§ 124.4 What restrictions apply to fees for applicant and Participant representatives?

(a) The compensation received by any packager, agent or representative of an 8(a) applicant or Participant for assisting the applicant in obtaining 8(a) certification or for assisting the Participant in obtaining 8(a) contracts, or any other assistance to support program participation, must be reasonable in light of the service(s) performed by the packager, agent or representative.

(b) In assisting a Participant obtain one or more 8(a) contracts, a packager, agent or representative cannot receive a fee that is a percentage of the gross contract value.

(c) For good cause, the AA/BD may initiate proceedings to suspend or revoke a packager's, agent's or representative's privilege to assist applicants obtain 8(a) certification, assist Participants obtain 8(a) contracts, or any other assistance to support program participation. Good cause is defined in § 103.4 of these regulations.

(1) The AA/BD may send a show cause letter requesting the agent or representative to demonstrate why the agent or representative should not be suspended or proposed for revocation, or may immediately send a written notice suspending or proposing revocation, depending upon the evidence in the administrative record. The notice will include a discussion of the relevant facts and the reason(s) why the AA/BD believes that good cause exists.

(2) Unless the AA/BD specifies a different time in the notice, the agent or representative must respond to the notice within 30 days of the date of the notice with any facts or arguments showing why good cause does not exist. The agent or representative may request additional time to respond, which the AA/BD may grant in his or her discretion.

(3) After considering the agent's or representative's response, the AA/BD will issue a final determination, setting forth the reasons for this decision and, if a suspension continues to be effective or a revocation is implemented, the term of the suspension or revocation.

(d) The AA/BD may refer a packager, agent, or other representative to SBA's Suspension and Debarment Official for possible Government-wide suspension or debarment where appropriate, including where it appears that the packager, agent or representative assisted an applicant to or Participant in the 8(a) BD program submit information to SBA that the packager, agent or representative knew was false or materially misleading.

■ 12. 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.

■ 13. 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, as adjusted, for three successive program years, unless the firm demonstrates that through its growth and development its primary industry is changing, pursuant to the criteria described in 13 CFR 121.107, to a related secondary NAICS code that is contained in its most recently approved business plan. The firm's business plan must contain specific targets, objectives, and goals for its continued growth and development under its new primary industry.

* * * * *

§ 124.103 [Amended]

■ 14. Amend § 124.103(b)(1) by removing the parenthetical "(American Indians, Eskimos, Aleuts, or Native Hawaiians)" and by adding in its place, the parenthetical "(Alaska Natives, Native Hawaiians, or enrolled members of a Federally or State recognized Indian Tribe)".

■ 15. Amend § 124.104 as follows:

■ a. Revise paragraph (b)(2);

■ b. Revise paragraph (c), introductory text;

■ c. Redesignate paragraph (c)(2)(ii) as paragraph (c)(2)(iv), and add new paragraphs (c)(2)(ii) and (c)(2)(iii); and

■ d. Add 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 will consider a spouse's financial situation in determining an individual's access to credit and capital where the spouse has a role in the business (*e.g.,* an officer, employee or director) or has lent money to, provided credit support to, or guaranteed a loan of the business. SBA does not take into consideration community property laws when determining economic disadvantage.

* * * * *

(c) *Factors to be considered.* In considering diminished capital and credit opportunities, SBA will examine factors relating to the personal financial condition of any individual claiming disadvantaged status, including income for the past three years (including bonuses and the value of company stock received in lieu of cash), personal net worth, and the fair market value of all assets, whether encumbered or not. An individual who exceeds any one of the thresholds set forth in this paragraph for personal income, net worth or total assets will generally be deemed to have access to credit and capital and not economically disadvantaged.

* * * * *

(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 and certify that the retirement account is legitimate.

(iii) Income received from an applicant or Participant that is an S corporation, limited liability company (LLC) or partnership will be excluded from an individual's 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. Losses from the S corporation, LLC or partnership, however, are losses to the company only, not losses to the individual, and cannot be used to reduce an individual's net worth.

* * * * *

(3) *Personal income for the past three years.* (i) If an individual's adjusted gross income averaged over the three years preceding submission of the 8(a) application exceeds $250,000, 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 three preceding years exceeds $350,000. 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.

(ii) Income received from an applicant or Participant that is an S corporation, LLC or partnership will be excluded from an individual's income 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. Losses from the S corporation, LLC or partnership, however, are losses to the company only, not losses to the individual, and cannot be used to reduce an individual's personal 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 $4 million for an applicant concern and $6 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.

■ 16. 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.

* * * * *

■ 17. Amend § 124.106 by revising paragraph (a)(2), and paragraph (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) * * *

(2) A disadvantaged full-time manager must hold the highest officer position (usually President or Chief Executive Officer) in the applicant or Participant and be physically located in the United States.

* * * * *

(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).

■ 18. Amend § 124.108 by revising paragraph (a)(1) and removing paragraph (f) to read as follows:

§ 124.108 What other eligibility requirements apply for individuals or businesses?

(a) * * *

(1) If during the processing of an application, adverse information is obtained from the applicant or a credible source regarding possible criminal conduct by the applicant or any of its principals, SBA will suspend further processing of the application and refer it to SBA's Office of Inspector General (OIG) for review. If SBA does not hear back from OIG within 45 days, SBA will coordinate with OIG a suitable date to recommence the processing of the application. The AA/BD will consider any findings of the OIG when evaluating the application.

* * * * *

■ 19. Amend § 124.109 by revising paragraphs (b) introductory text, (c)(3)(i), (c)(3)(ii), (c)(4)(i) introductory text, (c)(4)(i)(B), 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) program?

* * * * *

(b) *Tribal eligibility.* In order to qualify a concern which it owns and controls for participation in the 8(a) BD program, an Indian Tribe must establish its own economic disadvantaged status under paragraph (b)(2) of this section. Once an Indian Tribe establishes that it is economically disadvantaged in connection with the application for one Tribally-owned firm, it need not reestablish such status in order to have other businesses that it owns certified for 8(a) BD program participation, unless specifically requested to do so by the AA/BD. An Indian Tribe may request to meet with SBA prior to submitting an application for 8(a) BD participation for its first applicant firm to better understand what SBA requires for it to establish economic disadvantage. Each Tribally-owned concern seeking to be certified for 8(a) BD participation must comply with the

provisions of paragraph (c) of this section.

* * * * *

(c) * * *

(3) * * *

(i) For corporate entities, a Tribe must unconditionally own at least 51 percent of the voting stock and at least 51 percent of the aggregate of all classes of stock. For non-corporate entities, a Tribe must unconditionally own at least a 51 percent interest.

(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) sole source contract that is a follow-on contract to an 8(a) contract that was performed immediately previously by another Participant (or former Participant) owned by the same Tribe. For purposes of this paragraph, the same primary NAICS code means the six digit NAICS code having the same corresponding size standard.

* * * * *

(4) * * *

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

* * * * *

(B) Management may be provided by non-Tribal members if the concern can demonstrate that the Tribe can hire and fire those individuals, that it will retain control of all management decisions common to boards of directors, including strategic planning, budget approval, and the employment and compensation of officers, and that a written management development plan exists which shows how Tribal members will develop managerial skills sufficient to manage the concern or similar Tribally-owned concerns in the future.

* * * * *

(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 (individual or consolidated) for each of the two previous tax years showing operating revenues in the primary industry in which 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.

* * * * *

■ 20. Amend § 124.110 as follows:

■ a. Redesignate paragraphs (c), (d) and (e) as paragraphs (e), (f) and (g), respectively;

■ b. Add new paragraphs (c) and (d);

■ c. Add two new sentences to the end of newly designated paragraph (e); and

■ d. Revise newly designated paragraph (g).

§ 124.110 Do Native Hawaiian Organizations have any special rules for applying to the 8(a) BD program?

* * * * *

(c) An NHO must establish that it is economically disadvantaged and that its business activities will principally benefit Native Hawaiians.

(1) To determine whether an NHO is economically disadvantaged, SBA considers the individual economic status of the NHO's members. The majority of an NHO's members must qualify as economically disadvantaged under § 124.104. For the first 8(a) applicant owned by a particular NHO, individual NHO members must meet the same initial eligibility economic disadvantage thresholds as individually-owned 8(a) applicants. For any additional 8(a) applicant owned by the NHO, individual NHO members must meet the economic disadvantage thresholds for continued 8(a) eligibility. If the NHO has no members, then a majority of the members of the board of directors must qualify as economically disadvantaged. If there are members and a board of directors, only a majority of the members must be economically disadvantaged.

(2) An NHO should describe any activities that it has done to benefit Native Hawaiians at the time its NHO-owned firm applies to the 8(a) BD program. In addition, the NHO must include statements in its bylaws or operating agreements identifying the benefits Native Hawaiians will receive from the NHO. The NHO must have a detailed plan that shows how revenue earned by the NHO will principally benefit Native Hawaiians. As part of an annual review conducted for an NHO-owned Participant, SBA will review how the NHO is fulfilling its obligation to principally benefit Native Hawaiians.

(d) An NHO must control the applicant or Participant firm. To establish that it is controlled by an NHO, an applicant or Participant must demonstrate that the NHO controls its board of directors. An individual responsible for the day-to-day management of an NHO-owned firm need not establish personal social and economic disadvantage.

(e) * * * In addition, once an applicant is admitted to the 8(a) BD program, it may not receive an 8(a) sole source contract that is a follow-on contract to an 8(a) contract performed by another Participant (or former Participant that has left the program within two years of the date of application) owned by the Native Hawaiian Organization for a period of two years from the date of admission to the program. For purposes of this paragraph, the same primary NAICS code means the six digit NAICS code having the same corresponding size standard.

* * * * *

(g) An applicant concern owned by a NHO must possess reasonable prospects for success in competing in the private sector if admitted to the 8(a) BD program. An applicant concern owned by a NHO may establish potential for success by demonstrating that:

(1) It has been in business for at least two years, as evidenced by income tax returns (individual or consolidated) 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

(2) 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

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

■ 21. Amend § 124.111 by adding two new sentences to the end of paragraph (d) and by revising paragraph (f) to read as follows:

§ 124.111 Do Community Development Corporations (CDCs) have any special rules for applying to the 8(a) BD program?

* * * * *

(d) * * * In addition, once an applicant is admitted to the 8(a) BD program, it may not receive an 8(a) sole source contract that is a follow-on contract to an 8(a) contract performed by another Participant (or former Participant that has left the program within two years of the date of application) owned by the CDC for a period of two years from the date of admission to the program. For purposes of this paragraph, the same primary NAICS code means the six digit NAICS code having the same corresponding size standard.

* * * * *

(f) An applicant concern owned by a CDC must possess reasonable prospects for success in competing in the private sector if admitted to the 8(a) BD program. An applicant concern owned by a CDC may establish potential for success by demonstrating that:

(1) It has been in business for at least two years, as evidenced by income tax returns (individual or consolidated) 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

(2) 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

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

* * * * *

■ 22. Amend § 124.112 as follows:

■ a. Redesignate paragraphs (b)(7) and (b)(8) as paragraphs (b)(9) and (b)(10), respectively, and add new paragraphs (b)(7) and (b)(8);

■ b. Revise paragraphs (d)(1), (d)(2) introductory text, and (d)(3); and

■ c. Add new paragraphs (d)(5), (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) * * *

(7) A listing of any fees paid to agents or representatives to assist the Participant in obtaining or seeking to obtain a Federal contract;

(8) A report for each 8(a) contract performed during the year explaining how the performance of work requirements are being met for the contract, including any 8(a) contracts performed as a joint venture;

* * * * *

(d) * * *

(1) The term withdrawal includes, but is not limited to, the following: Cash dividends; distributions in excess of amounts needed to pay S Corporation, LLC or partnership 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. Although officers' salaries are generally not considered withdrawals for purposes of this paragraph, SBA will count those salaries as withdrawals where SBA believes that a firm is attempting to circumvent the excessive withdrawal limitations though the payment of officers' salaries. SBA will look at the totality of the circumstances in determining whether to include any specific amount as a withdrawal under this paragraph.

(2) If SBA determines that funds or assets have been excessively withdrawn from the Participant for the personal benefit of one or more owners or managers, or any person or entity affiliated with such owners or managers, and such withdrawal was detrimental to the achievement of the targets, objectives, and goals contained in the Participant's business plan, SBA may:

* * *

(3) Withdrawals are excessive if in the aggregate during any fiscal year of the Participant they exceed (i) $250,000 for firms with sales up to $1,000,000; (ii) $300,000 for firms with sales between $1,000,000 and $2,000,000; and (iii) $400,000 for firms with sales exceeding $2,000,000.

* * * * *

(5) The excessive withdrawal analysis does not apply to Participants owned by Tribes, ANCs, NHOs, or CDCs where a withdrawal is made for the benefit of the Tribe, ANC, NHO, CDC or the native or shareholder community. It does, however, apply to withdrawals from a firm owned by a Tribe, ANC, NHO, or CDC that do not benefit the relevant entity or community. Thus, if funds or assets are withdrawn from an entity-owned Participant for the benefit of a non-disadvantaged manager or owner that exceed the withdrawal thresholds, SBA may find that withdrawal to be excessive. For example, a $1,000,000 payout to a non-disadvantaged manager would be deemed an excessive withdrawal.

(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 where the Participant can demonstrate that the majority of its total revenues during a three-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, objectives and goals 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. A firm that has not met the targets, objectives and goals set forth in its business plan at the end of its nine-year term in the 8(a) BD program will not be considered to have graduated from the 8(a) BD program, but rather to have merely completed its program term.

■ 23. 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 (*http://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.

■ 24. 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, copies of signed Federal personal and

business tax returns, individual and business bank statements, and personal history statements. An applicant must also submit a signed 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.

■ 25. Amend § 124.204 as follows:
■ a. Revise paragraph (a);
■ b. Redesignate paragraphs (c), (d) (e) and (f) as paragraphs (d), (e), (f) and (g);
■ c. Add a new paragraph (c); and
■ d. Revise newly designated paragraph (d).

§ 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. 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.

(d) An applicant must be eligible as of the date the AA/BD issues a decision. The decision will be based on the facts set forth in the application, any information received in response to SBA's request for clarification made pursuant to paragraph (b) of this section, and any changed circumstances since the date of application.

* * * * *

■ 26. Amend § 124.205 by revising paragraphs (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 DPCE unit 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, whether or not available at the time of initial application, 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.

* * * * *

■ 27. 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 or voluntary early graduation;

(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.

■ 28. Amend § 124.302 as follows:
■ a. Revise the section heading;
■ b. Revise paragraphs (a) introductory text, and (a)(1);
■ c. Remove paragraph (d);
■ d. Redesignate paragraph (c) as paragraph (d); and

3. Add 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, as adjusted during the program, for three successive program years unless the firm is able to demonstrate that it has taken steps to change its industry focus to another NAICS code that is contained in the goals, targets and objectives of its business plan.

* * * * *

■ 29. 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. * * *

(13) Excessive withdrawals that are detrimental to the achievement of the targets, objectives, and goals contained in the Participant's business plan, including transfers of funds or other business assets from the concern for the personal benefit of any of its owners or managers, or any person or entity affiliated with the owners or managers (*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). * * *

■ 30. 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;

(ii) The statutory or regulatory authority that qualifies the firm for SDB status; and

(iii) Where applicable, 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 the section, the procuring activity contracting officer may protest the SDB status of the firm to SBA pursuant to § 124.1010 where questions regarding the firm's SDB status remain.

■ 31. Amend § 124.305 by revising the first sentence of paragraph (a), 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 § 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) is 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.

(5) *Effect of suspension.* Once a suspension is issued pursuant to this section, a Participant cannot receive any additional 8(a) BD program assistance, including new 8(a) contract awards, for as long as the Participant is suspended. This includes any procurement requirements that the firm has self-marketed and those that have been accepted into the 8(a) BD program on behalf of the suspended concern. However, the suspended Participant must complete any previously awarded 8(a) contracts.

* * * * *

§ 124.403 [Amended]

■ 32. Amend § 124.403 by removing paragraph (d).

■ 33. 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. * * *

* * * * *

■ 34. 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) and the nonmanufacturer rule, if applicable, (*see* § 121.406(b)) 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.

* * * * *

■ 35. Amend § 124.504 as follows:

■ a. Revise the heading and the first sentence of paragraph (a);

■ b. Remove paragraph (d); and
■ c. Redesignate paragraph (e) as paragraph (d), and revise 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, service disabled veteran-owned small business, or women-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, service disabled veteran-owned small business, or women-owned small business 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 (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 paragraph (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 paragraph (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 also 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, SDVO small business, or WOSB set-aside.

(4) 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 does not apply to orders offered to and accepted for the 8(a) BD program pursuant to § 124.503(h).

■ 36. 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 $6,500,000 for contracts assigned manufacturing NAICS codes and $4,000,000 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 $3.8 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 $4.2 million.

* * * * *

(b) *Exemption from competitive thresholds for Participants owned by Indian Tribes, ANCs and NHOs.* (1) A Participant concern owned and controlled by an Indian Tribe or an ANC may be awarded a sole source 8(a) contract 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) A Participant concern owned and controlled by an NHO may be awarded a sole source Department of Defense (DoD) 8(a) contract 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 DoD contracts, 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 it meets the requirements of § 124.513.

* * * * *

■ 37. Amend § 124.507 as follows:
■ a. Redesignate paragraphs (b)(2)(iii) and (b)(2)(iv) as paragraphs (b)(2)(iv) and (b)(2)(v), respectively;
■ b. Add new paragraphs (b)(2)(iii), (c)(2)(i), (c)(2)(ii) and (c)(2)(iii); and
■ c. Add an example to paragraph (d)(1) to read as follows:

§ 124.507 What procedures apply to competitive procurements?

* * * * *

(b) * * *

(2) * * *

(iii) In compliance with the continued eligibility reporting requirements set forth in § 124.112(b);

* * * * *

(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) The effective date of a bona fide place of business is the date that the evidence (paperwork) shows that the business in fact regularly maintained its business at the new geographic location.

(iv) 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.

(d) * * *

(1) * * *

Example to paragraph (d)(1). The program term for 8(a) Participant X is scheduled to expire on December 19. A solicitation for a competitive 8(a) procurement specifies that initial offers are due on December 15. The procuring activity amends the solicitation to extend the date for the receipt of offers to January 5. X submits its offer on January 5 and is selected as the apparent successful offeror. X is eligible for award because it was an eligible 8(a) Participant on the initial date set forth in the solicitation for the receipt of offers.

* * * * *

■ 38. Amend § 124.509 by adding a new sentence at the end of paragraph (a)(1), and by adding two new sentences after the first sentence of paragraph (e)(1) to read as follows:

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

(a) * * *

(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.

* * * * *

(e) * * *

(1) * * * A firm receiving a waiver will be able to self market its capabilities and receive one or more sole source 8(a) contracts during the next program year. At its next annual review, SBA will reevaluate the firm's circumstances and determine whether the waiver should be extended an additional program year. * * *

* * * * *

■ 39. Amend § 124.510 by revising paragraph (b) to read as follows:

§ 124.510 What percentage of work must a Participant perform on an 8(a) contract?

* * * * *

(b) A Participant must certify in its offer that it will meet the applicable performance of work requirement. Compliance with the requirement will be determined as of the date of contract award, so that a Participant may revise its initial offer to clarify or otherwise come into compliance with the performance of work requirements. The procuring agency contracting officer must be satisfied that the Participant will meet the applicable performance of work requirement at time of award.

* * * * *

■ 40. 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 the SBA servicing district office of all modifications and options exercised within 15 business days of their occurrence, or by another date agreed upon by SBA.

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

■ 41. Amend § 124.513 as follows:

■ a. Revise paragraph (c)(2);

■ b. Redesignate paragraphs (c)(3) through (c)(11) as (c)(4) through (c)(12),

■ c. Adding a new paragraph (c)(3);

■ d. Revise newly designated paragraphs (c)(4) and (c)(7);

■ e. Remove the phrase "the managing venturer" from newly designated paragraphs (c)(9) and (c)(10) and add in its place the phrase "the 8(a) Participant managing venturer";

■ f. Revise paragraphs (d) and (e); and

■ g. Add a new paragraph (i) to read as follows:

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

* * * * *

(c) * * *

(2) Designating an 8(a) Participant as the managing venturer of the joint venture. In an unpopulated joint venture or a joint venture populated only with administrative personnel, the joint venture must designate an employee of the 8(a) managing venturer as the project manager responsible for performance of the contract. In a joint venture populated with individuals intended to perform any contracts awarded to the joint venture, the joint venture must otherwise demonstrate that performance of the contract is controlled by the 8(a) managing venturer;

(3) Stating that with respect to a separate legal entity joint venture the 8(a) Participant(s) must own at least 51% of the joint venture entity;

(4) 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), or in the case of a separate legal entity joint venture commensurate with their ownership interests in the joint venture;

* * * * *

(7) 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.* (1) 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. For an unpopulated joint venture or a joint venture populated only with one or more administrative personnel, 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. For a joint venture populated with individuals intended to perform contracts awarded to the joint venture, each 8(a) Participant to the joint venture must demonstrate what it will gain from performance of the contract and how such performance will assist in its business development.

(2)(i) In an unpopulated joint venture, where both the 8(a) and non-8(a) partners are technically subcontractors, the amount of work done by the partners will be aggregated and the work done by the 8(a) partner(s) must be at least 40% of the total done by all partners. In determining the amount of work done by a non-8(a) partner, all work done by the non-8(a) partner and any of its affiliates at any subcontracting tier will be counted.

(ii) In a populated joint venture, a non-8(a) joint venture partner, or any of

its affiliates, may not act as a subcontractor to the joint venture awardee, or to any other subcontractor of the joint venture, unless the AA/BD determines that other potential subcontractors are not available, or the joint venture is populated only with administrative personnel.

(A) If a non-8(a) joint venture partner seeks to do more work, the additional work must generally be done through the joint venture, which would require the 8(a) partner(s) to the joint venture to also do additional work to meet the 40% requirement set forth in paragraph (d)(1) of this section.

(B) If a joint venture is populated only with administrative personnel, the joint venture may subcontract performance to a non-8(a) joint venture partner provided it also subcontracts work to the 8(a) partner(s) in an amount sufficient to meet the 40% requirement. The amount of work done by the partners will be aggregated and the work done by the 8(a) partner(s) must be at least 40% of the total done by all partners. In determining the amount of work done by a non-8(a) partner, all work done by the non-8(a) partner and any of its affiliates at any subcontracting tier will be counted.

(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) After approving the structure of the joint venture in connection with the first contract, SBA will review only the addendums relating to performance of work on successive contracts.

(ii) SBA must approve the addendums prior to the award of any successive 8(a) contract to the joint venture.

* * * * *

(i) *Performance of work reports.* An 8(a) Participant to a joint venture must describe how it is meeting or has met the applicable performance of work requirements for each 8(a) contract it performs as a joint venture.

(1) As part of its annual review, the 8(a) Participant(s) to the joint venture must explain for each 8(a) contract performed during the year how the performance of work requirements are being met for the contract.

(2) 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.

■ 42. Amend § 124.519 by revising paragraph (a), by removing paragraph (c), by redesignating paragraphs (d), (e) and (f) as paragraphs (c), (d) and (e), respectively, and by revising newly designated paragraph (e) 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.

* * * * *

(e) 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.

■ 43. Amend § 124.520 as follows:
■ a. Revise the heading;
■ b. Revise paragraph (a);
■ c. Revise paragraph (b) introductory text;
■ d. Revise paragraphs (b)(1)(i) and (iv), (b)(2), and (b)(3);
■ e. Revise paragraphs (c)(1) and (c)(3);
■ f. Add new paragraphs (c)(4) and (c)(5);
■ g. Revise paragraph (d)(1);
■ h. Revise paragraph (e)(1), and the second sentence of (e)(2);
■ i. Redesignate paragraph (f) as paragraph (g) and add new paragraph (f);
■ j. Redesignate newly designated paragraphs (g)(2) and (g)(3) as paragraphs (g)(3) and (g)(4);
■ k. Add a new paragraph (g)(2); and
■ l. Add a new paragraph (h) to 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. This assistance may include technical and/or management assistance; financial assistance in the form of equity investments and/or loans; subcontracts; and/or assistance in performing prime contracts with the Government through joint venture arrangements. Mentors are encouraged to provide assistance relating to the performance of non-8(a) contracts so that protégé firms may more fully develop their capabilities. 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) *Mentors.* Any concern or non-profit entity that demonstrates a commitment and the ability to assist developing 8(a) Participants may act as a mentor and receive benefits as set forth in this section. This includes businesses that have graduated from the 8(a) BD program, firms that are in the transitional stage of program participation, other small businesses, and large businesses.

(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 or non-profit entity to mentor more than one protégé at a time where it 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) * * *

(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 six months remaining in its program term.

(d) * * *

(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 in order for the joint venture to 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).

(iii) Once a protégé 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). Leaving the 8(a) BD program, or terminating the mentor/protégé relationship while a protégé firm is still in the program, does not, however, affect contracts previously awarded to a joint venture between the protégé and its mentor. In such a case, the joint venture continues to qualify as small for previously awarded contracts and is obligated to continue performance on those contracts.

* * * * *

(e) * * *

(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 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 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 60 calendar days 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 terminate its mentor/protégé agreement;

(ii) 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; and

(iii) SBA may 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 in order to encourage the mentor to comply with its mentor/protégé agreement. Where a protégé firm is able to independently complete performance of any such contract, SBA may also authorize a substitution of the protégé firm for the joint venture.

(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).

■ 44. 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 or seeking to obtain a Federal contract. The listing must indicate the amount of compensation paid and a description of the activities performed for such compensation.

* * * * *

■ 45. Amend § 124.602 as follows:
■ a. Revise paragraph (a) introductory text;
■ b. Redesignate paragraphs (a)(1) and (a)(2) as paragraphs (a)(3) and (a)(4), respectively;
■ c. Add new paragraph (a)(1) and (a)(2);
■ d. Revise paragraphs (b) and (c); and
■ e. Add new paragraph (g) to read as follows:

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

(a) Except as set forth in paragraph (a)(1) of this section, 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.

(1) Participants with gross annual receipts of more than $10,000,000 which are owned by a Tribe, ANC, NHO, or CDC may elect to submit unaudited financial statements within 120 days after the close of the concern's fiscal year, provided the following additional documents are submitted simultaneously:

(i) Audited annual financial statements for the parent company owner of the Participant, prepared by a licensed independent public accountant, for the equivalent fiscal year;

(ii) Certification from the Participant's Chief Executive Officer and Chief Financial Officer (or comparable positions) that each individual has read the unaudited financial statements, affirms that the statements do not contain any material misstatements, and certifying that the statements fairly represent the Participant's financial condition and result of operations.

(2) In the first year that a Participant's gross receipts exceed $10,000,000, a Participant may provide an audited balance sheet, with the income and cash flow statements receiving the level of service required for the previous year (review or none, depending on sales the year before the audit is required). * * *

(b)(1) 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.

(2) The servicing SBA District Director may waive the requirement for reviewed financial statements for good cause shown by the Participant.

(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.

* * * * *

(g) Participants owned by Tribes, ANCs, NHOs and CDCs may submit consolidated financial statements prepared by the parent entity that include schedules for each 8(a) Participant instead of separate audited financial statements for each individual 8(a) Participant. If one Participant must submit an audited financial statement, then the consolidated statement and the schedules for each 8(a) Participant must be audited.

■ 46. Add a new § 124.604 to read as follows:

§ 124.604 Report of benefits for firms owned by Tribes, ANCs, NHOs and CDCs.

As part of its annual review submission, each Participant owned by a Tribe, ANC, NHO or CDC must submit to SBA information showing how the Tribe, ANC, NHO or CDC has provided benefits to the Tribal or native members and/or the Tribal, native or other community due to the Tribe's/ANC's/NHO's/CDC's participation in the 8(a) BD program through one or more firms. This data includes information relating to funding cultural programs, employment assistance, jobs, scholarships, internships, subsistence activities, and other services provided by the Tribe, ANC, NHO or CDC to the affected community.

■ 47. 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.

■ 48. Revise § 124.1009 to read as follows:

§ 124.1009 Who decides disadvantaged status protests?

In response to a protest challenging the disadvantaged status of a concern, the SBA's AA/BD, or designee, will determine whether the concern is disadvantaged.

Dated: February 1, 2011.

Karen G. Mills,

Administrator.

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