This presentation has been prepared for information purposes and general guidance only and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice.

No representation or warranty (express or implied) is made as to the accuracy or completeness of the information contained in this publication, and CohnReznick LLP, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

This presentation and its content are the property of CohnReznick LLP and are protected by applicable copyright laws. Any unauthorized use of the information herein will be considered a violation of CohnReznick LLP’s intellectual property rights. Unless stated otherwise herein, no part of this presentation may be copied, distributed, or published, in whole or in part, without the prior written agreement of CohnReznick LLP.
AGENDA

- Teaming Arrangement Fundamentals
- Teaming Arrangements in Small Business Procurements
- Why It Is Really Important to Follow the SBA’s Rules
- Attorneys’ Roles
- Top Ten Clauses
- When the Teaming Arrangement Goes South
OVERVIEW OF FAR RULES ON TEAMING ARRANGEMENTS

• The Government will recognize the integrity and validity of contractor team arrangements; provided, the arrangements are identified and company relationships are fully disclosed in an offer or, for arrangements entered into after submission of an offer, before the arrangement becomes effective. (FAR 9.603)

• “Contractor team arrangement,” as used in this subpart, means an arrangement in which—
  • Two or more companies form a partnership or joint venture to act as a potential prime contractor
  • A potential prime contractor agrees with one or more other companies to have them act as its subcontractors under a specified Government contract or acquisition program
TEAMING ARRANGEMENTS
FUNDAMENTALS

• Teaming arrangements cover both:
  • Joint Ventures, and
  • Teaming Agreements

• When do federal contractors form teams?
  • (A) When a contractor:
    • (1) Needs outside
      • Strengths/capabilities/qualifications
      • Expertise
      • Staffing
      • Financial/bonding capability, and
    • (2) Needs a firm commitment, locked-in via a JV or teaming agreement, with the outside provider
TEAMING ARRANGEMENTS
FUNDAMENTALS (CONTINUED)

• When do federal contractors form teams? (cont.)
  • (B) In a small business procurement, when a large business concern (LBC)
    • (1) Wants to participate with small business concern (SBC) prime in a portion of a contract
      (typically because LBC is otherwise ineligible), and
    • (2) LBC wants to lock-in its subcontractor status/pricing should government award prime
      contract to its SBC prime

• Alternative to teaming: regular prime-subcontractor relationship

• When **not** to team in a small business procurement?
  • When the purpose is for the SBC to serve as a front for an LBC!!!
AN EFFECTIVE TEAMING RELATIONSHIP — IT’S NOT JUST THE LAW AND REGULATIONS

• First principles
  • The goals when contracting with the federal government:
    • To deliver the best product or service to the government;
    • At the lowest realistic price; and
    • At the maximum profit
  • Teaming decision should be framed by these goals
AN EFFECTIVE TEAMING RELATIONSHIP (CONTINUED)

• Three business model approaches
  • (1) Be the prime contractor (with or without subcontractors)
    • Simply proposing to use subcontractors does not require teaming arrangements with the subcontractors
  • (2) Team with another party in a formal commitment/teaming arrangement
    • (a) Joint venture (JV)/partnership as the prime contractor
    • (b) Prime contractor enters into teaming agreement with a major subcontractor
      • Prime-subcontractor structure
      • Prime-subcontractor involves a teaming agreement, separate from the subcontract
SO YOU NEED TO TEAM —

• How to decide which approach — JV or teaming agreement?
  • Corporate/management advantages/disadvantages of each approach
  • When a small business procurement — limitations of SBA rules and “affiliation” principles
  • Nature of the procurement and requirements of the government
  • FAR Part 9 — contractor responsibility factors
  • Strengths and capabilities of the parties
WHAT IS A JV?

- A corporate entity separate from its members, or a partnership
- JV is the offeror/bidder to government
- Contractual privity will be between JV and government
- Can be populated or unpopulated (pass-through entity)
- JV members can be subcontractors
- JV is not a quick way to assemble a team without addressing scope of work issues
WHAT IS A TEAMING AGREEMENT?

- Agreement between prospective prime contractor and subcontractor to work cooperatively on proposal
- Usually includes outline of terms of a subcontract to be issued if government awards prime contract to prime
- Designed to lock-in parties, set out pricing and scope of work
- Binding contract? Depends on terms and jurisdiction
JV VERSUS TEAMING AGREEMENT

• Benefits of JV:
  • The corporation/JV can be set in place and cover multiple RFPs and contracts
  • The management, control and profit/loss distribution issues usually get addressed up front
  • Tax savings may result
  • Can avoid the high cost structure of the parent corporations — important if price is a major source selection criterion
  • JV B&P costs allowable
JV VERSUS TEAMING AGREEMENT (CONTINUED)

• Drawbacks of a JV:
  • A partner in a JV possesses liability for the obligations of the JV (if a partnership)
  • Management issues or partner disagreements may be difficult to mitigate
  • A JV may lock a contractor into a relationship with the other company for a longer period of time than the contractor intended
  • Contractors use it (wrongly) to avoid scope of work issues until prime contract award
 JV VERSUS TEAMING AGREEMENT (CONTINUED)

• Benefits of teaming agreement approach
  • Less expensive to set-up
    • No corporate filings
    • No tax implications
  • Less of a commitment by the prime to the sub (if you are the prime)

• Drawbacks to teaming agreement approach
  • Requires well-drafted agreement to make it legally binding
  • Usually not enforceable until performance starts
  • Potential conflicts between teaming agreement and the subcontract
  • Structure less useful to management of project and resolution of disputes
  • Less of a commitment by the prime to the sub (if you are the sub)
  • Subcontractor’s B&P costs not allowable
OVERVIEW OF SBA RULES ON JVS AND TEAMING AGREEMENTS

• JV
  • Separate legal entity (as envisioned by FAR rules)
  • 3/2 rule for JVs
  • Venturers are always considered affiliated for size purposes
  • Some teaming agreements are treated as de facto JVs for affiliation purposes
    • Usually bad outcome for affiliation purposes
    • But if size standard is met, provides flexibility for Performance of Work requirement
• Teaming agreements
  • Prime-subcontractor structure
    • Teaming agreement separate from subcontract
    • Teaming agreement typically requires award of subcontract if prime contract awarded
  • Team members presumed **not** affiliated by SBA (13 C.F.R. § 125.6) unless:
    • Common control or management;
    • Identical or substantially identical business or economic interests; OR
    • A violation of the “Ostensible Subcontractor Rule”
  • If an exception is found, treated as a *de facto* JV and affiliation results
WHEN DOES SBA TREAT TEAMING AGREEMENTS AS A JV? (CONTINUED)

• Three exceptions — If SBA makes any of the following findings, the teaming agreement’s participants are affiliated (13 CFR 121.103):
  • Common control or management,
  • Identical or substantially identical business or economic interests, OR
  • A violation of the “Ostensible Subcontractor Rule”
WHEN DOES SBA TREAT TEAMING AGREEMENTS AS A JV? (CONTINUED)

- According to 13 CFR 121.103, an “ostensible subcontractor” finding applies when:
  - The prime contractor is “unusually reliant upon” the subcontractor to perform a contract’s requirements, OR
  - The subcontractor “performs primary and vital requirements” of the contract
WHEN DOES SBA TREAT TEAMING AGREEMENTS AS A JV? (CONTINUED)

- Factors the SBA considers in its “totality of the circumstances” analysis
  - The submitted proposal — management of the contract, technical responsibilities of the parties, percentage of the work subcontracted, etc.
  - The terms of the prime-sub agreement, especially the amount of bonding assistance provided
  - Whether the subcontractor is an incumbent contractor that has become ineligible to compete for the follow-on contract due to its increased size
  - This obviously gives the appearance of a teaming arrangement based mainly on the qualifying SBC prime’s ability to meet the contract’s size requirements
SIZE STANDARDS AND JV AFFILIATION RULES

- Size standards — receipts or employees
- Normal affiliation rule — combine all affiliated joint venturers (and *de facto* JV team members) for size standard counting purposes
- Relaxed affiliation rules for “certain procurements”
  - Each venturer/member must still be within size standard
  - But, don’t combine all affiliated venturers/members
SIZE STANDARDS AND JV AFFILIATION RULES (CONTINUED)

• What are the “certain procurements”?
  • Bundled contracts, of any contract value
  • Receipts size standard — procurement exceeds ½ of the size standard
  • Employee size standard — procurement exceeds $10 million
• Special rules for 8(a)s, SDVOBs and mentor-protégé
• Key takeaway
  • If the venturers/team members can’t fit within the size standard using the above affiliation rules, then a JV can’t be used
  • Carefully draft teaming agreements to avoid de facto JV status
TEAMING ARRANGEMENTS AND SIZE PROTESTS

• Teaming arrangements can be challenged in size protests
  • Must be filed five (5) business days from notice of apparent successful offeror
  • More information is better
  • Fast process
  • Akin to COC process
  • Regional SBA office decision appealable to SBA
  • Coordinated with GAO protest
PERFORMANCE OF WORK REQUIREMENTS—FAR 52.219-14

• Specifies percent of work that must be performed by small business prime
• The JV/offeror/prime must meet the percentage
• Encompasses all subcontracting — including 1099 employees
• One exception:
  • If relaxed affiliation rules apply (i.e., certain procurements and all team members meet standard), then percentage is determined by the team as a whole
  • Usually considered contract administration — not protestable
ROLE OF THE ATTORNEYS

• Helping the parties putting the deal together
  • Consistent with FAR and SBA rules
  • With an understanding of the benefits/drawbacks to JVs versus teaming agreements
  • Getting the best deal for the respective client
• Drafting an agreement that:
  • Reflects roles and expectations of the team members
  • Considers the dynamics of the teaming relationship
  • Fosters trust between the teaming members
TOP TEN CLAUSES TO COVER IN TEAMING AGREEMENT

• Designation of a Prime Contractor and a Subcontractor
• Purpose and Scope of the Agreement
• Incorporation by Reference of a Non-Disclosure Agreement
• Protection/Allocation of Technical Data/Inventions/Patents
• Division of Responsibilities Between the Prime Contractor and the Subcontractor, and Definition of the Relationship of the Parties (i.e., neither party shall have the right to bind the other)
TOP TEN CLAUSES TO COVER IN TEAMING AGREEMENT (CONTINUED)

- Duration of the Agreement and Termination Provisions
- Limitation of Liability
- No Assignment Without Consent
- Exclusivity/Noncompetition
- If a Commercial Item Subcontractor, Requirement that the Resulting Subcontract will be a FAR Part 12 Commercial Item Subcontract
WHY IT IS IMPORTANT — REALLY IMPORTANT — TO FOLLOW THE SBA’S RULES AND REGULATIONS

• Size protests
• Suspension/debarment
• And worse: GTSI
  • In 2008, a joint venture company MultiMaxArray (MMA) awarded a $165M DHS IDIQ IT 100% SB set-aside contract
  • Unsuccessful SB bidder, Wildflower Int’l, filed a size protest alleging MMA was a front company for subcontractor, GTSI:
    “GTSI apparently designs the systems necessary to satisfy a FirstSource delivery order, selects the computer hardware and software configurations, negotiates pricing with the vendors, prepares the MultiMaxArray proposal and then performs all of the necessary services to install, maintain and provide technical support and training for the DHS user.”
WHY IT IS IMPORTANT — REALLY IMPORTANT — TO FOLLOW THE SBA’S RULES AND REGULATIONS (CONTINUED)

• MMA lost the protest, the contract was terminated, and SBA began a fraud investigation

• SBA suspended GTSI, barring the company from participating in any Federal contractual action (prime, sub, grant, etc.) because:
  • GTS obtained multiple e-mail addresses from MMA so it would appear MMA was the entity conducting business with the government
  • GTSI placed MMA’s letterhead on invoices it submitted to DHS to make it appear as though they came from MMA
WHY IT IS IMPORTANT — REALLY IMPORTANT — TO FOLLOW THE SBA’S RULES AND REGULATIONS (CONTINUED)

• GTSI stock, trading at $7.25 right before announcement, went to $3.55
• SBA lifted the suspension based on the following conditions being met
  • The resignation of GTSI’s CEO and general counsel
  • The suspension of three other senior executives for up to 3 years
  • GTSI immediately ceasing work as a subcontractor to SBC primes
  • GTSI no longer taking part in the mentor-protégé program and in SBC joint ventures
  • An SBA-approved monitor reporting on GTSI’s compliance
WHEN THE TEAMING ARRANGEMENT GOES SOUTH

• Primary issue: delivery to the government under the prime contract
  • Accomplish that and the rest is just money
• Get help from attorneys to find solutions short of litigation
• The bad prime contract result
  • Government terminates prime contract, reprocures and small business prime loses follow-on work
  • Adverse past performance report
  • Termination for default
  • Excess reprocurement costs
WHEN THE TEAMING ARRANGEMENT GOES SOUTH (CONTINUED)

• The bad legal result
  • Breach of contract actions
  • Tort claims
  • False Claims Act claims
• When the government plays a role in the mess — the Nightvision case
• How to avoid the worst case result
  • Don’t team unless really needed
  • Use an approach that reflects the real relationship of the parties
  • Review the prime contract to see if it backstops the teaming agreement
  • Have a Plan B for performance
ACCOUNTING CONSIDERATIONS

• Role of the Accountants
• Potential Impacts
• Teaming Arrangements vs. Joint Ventures
• Overview of Accounting for Joint Ventures
• Variable Interest Entities (VIEs)
• Hypothetical Examples
ROLE OF THE ACCOUNTANTS

• To help identify potential impacts to the Company
  • Financial statement impact
  • Loan covenant impact
  • Tax impact

• Key is early involvement to help identify and mitigate potential impacts.
POTENTIAL IMPACTS

- Increased financial statement disclosure
- Equity method of accounting
- Consolidation
- Loan covenant issues
- Increase in audit fees due to consolidation
- Evaluation of other alternatives
  - Qualified or “Except for” report by accountant or auditor
  - Consideration of OCBOA
TEAMING ARRANGEMENTS VERSUS JOINT VENTURES

• Teaming Arrangements
  • Less potential impact
  • Possible additional financial statement disclosure

• Joint Ventures
  • Most potential impact
  • Record investment in joint venture (cost, equity, consolidation, proportionate consolidation)
  • Additional financial statement disclosure (may be extensive)
OVERVIEW OF ACCOUNTING FOR JOINT VENTURES

• General Rules
  • Less than 20% ownership: Cost (less impairment, if any) or Fair Value Method
  • 20% to 50% ownership: Equity Method
  • Greater than 50% ownership: Consolidate
  • Proportionate Consolidation allowed for certain industries (Construction or Extractive Industry)
• Variable Interest Entity (VIE) rules may also apply
The guidance on variable interest entities found in Accounting Standards Codification (ASC) section 810 Consolidations may apply and may change the consolidation conclusions reach under the general rules.

- ASC 810 is principles based – no bright line tests
- Scope exceptions exist for ASC 810 that may be applicable to joint ventures in certain cases
VARIABLE INTEREST ENTITIES (VIES)

- The reporting entity must consolidate if:
  - The reporting entity has one or more variable interests in the other entity, and
  - The other entity is a variable interest entity (VIE), and
  - The reporting entity determines it is the primary beneficiary of the VIE (i.e. it has a controlling financial interest in the VIE through means other than majority ownership)
Variable Interest:

- What is it?
  - A pathway through which the reporting entity is exposed to the financial variability (i.e. upsides, downsides) of another entity. The pathway can be explicit or implicit.

- Examples
  - Equity interests
  - Loans
  - Guarantees
  - Leases (if terms are above or below market)
  - Implicit variable interests
VARIABLE INTEREST ENTITIES (CONTINUED)

Variable Interest Entity (VIE):

• An entity is considered a VIE if it has:
  • Insufficient equity (can’t stand on its own), OR
  • Equity investors that lack any of the following characteristics of a controlling financial interest:
    • Power to direct activities on the entity
    • The obligation to absorb expected losses
    • The right to receive the entity’s residual returns
Primary Beneficiary of VIE

• What is it?
  • “An enterprise or individual that has a variable interest, or interests, in the VIE and has a controlling financial interest in that VIE.”

• Controlling Financial Interest
  • The power to direct the activities of a VIE that most significantly impact the entity’s economic performance, and
  • The obligation to absorb losses that may be significant to the VIE or the right to receive returns that may be significant to the VIE
Primary Beneficiary of VIE (continued)

• Cannot be more than one primary beneficiary

• In certain circumstances, there may be no primary beneficiary (i.e. power is shared between multiple unrelated parties with no one party controlling)
When Consolidation Is Required . . .

- Balance sheet must segregate assets of the VIE that can only be used to settle obligations of the VIE
- Balance sheet must segregate liabilities of the VIE for which creditors do not have recourse to the general credit of the primary beneficiary
- Significant disclosures are generally required (including disclosures of judgments made)
VARIABLE INTEREST ENTITIES (CONTINUED)

When Consolidation is NOT Required (i.e. the Investee is a VIE but the Reporting Entity is not the Primary Beneficiary) . . .

• Significant disclosures are generally required (including disclosures of judgments made)
HYPOTHETICAL EXAMPLE #1

Background Information for Hypothetical Examples:

- Your company (Company A) and an unrelated entity (Company B) form a joint venture (A-B LLC, or “the LLC”) for the purpose of securing and performing a specific $15 million government contract
- Company A will hold a 40% ownership interest in the LLC and Company B will hold a 60% ownership interest. The LLC’s profits and losses, capital contributions and distributions, will be split in accordance with the ownership percentages
HYPOTHETICAL EXAMPLE #1 (CONTINUED)

- Initial capital contributions to the LLC consist of $4,000 from Company A and $6,000 from Company B
- A separate bank account will be established for the LLC and all checks drawn on the account will require two signatures, one from an authorized Company A representative and one from an authorized Company B representative
- Company A will maintain the LLC’s books and records
The LLC Operating Agreement specifies that a Management Committee comprised of 2 representatives from Company A and 3 representatives from Company B will have management oversight and governance over the LLC’s operations. Each representative on the Management Committee will have one vote and a simple majority vote will rule.
HYPOTHETICAL EXAMPLE #1 (CONTINUED)

- The LLC’s Operating Agreement also specifies that a senior executive from Company B will be temporarily assigned to the LLC as Project Executive. The Project Executive will have responsibility for directing all significant activities related to the LLC’s $15 million government contract, including negotiating contract and change order terms, selecting vendors, and managing the LLC’s workforce. The Project Executive serves at the discretion of the LLC’s Management Committee and reports to the Management Committee monthly.
HYPOTHETICAL EXAMPLE #1 (CONTINUED)

- Based on these hypothetical facts and circumstances, which party (or parties) should consolidate the LLC's accounts into its financial statements?

  a). Company A
  b). Company B
  c). Neither
  d). Both
HYPOTHETICAL EXAMPLE #2

Assume the same facts and circumstances as in hypothetical example #1, except that instead of specifying a senior executive from Company B as Project Executive, the LLC’s Operating Agreement specifies that a senior executive from Company A will serve as the Project Executive for the LLC. Does this change your answer as to which party should consolidate the accounts of the LLC into its financial statements?
HYPOTHETICAL EXAMPLE #3

Assume the same facts and circumstances as in hypothetical example #2, adding the following consideration:

- Company B does not possess the expertise needed to direct the LLC’s activities related to the $15 million government contract, whereas Company A does have such expertise.

- The LLC’s Operating Agreement specifies that the Project Executive from Company A cannot be removed without the unanimous consent of the Management Committee.

Does this change your answer as to which party should consolidate the LLC?
GovCon360 keeps you abreast of the ever-changing regulatory environment that is Government contracting. From reference materials, like searchable pdf copies of the FAR and DCAM, to our past Lunch and Learn seminar slide decks and thought pieces on industry matters, we’ve got it covered. Subscribe to our RSS feed to receive short alerts on recent industry changes. It’s always been our job to help our clients maintain a competitive advantage by staying ahead of the curve. This website is an extension of the services we’ve been providing for over 35 years by putting useful resources and up-to-date information at your fingertips.