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CLIENT ALERT

U.S. Court of Federal Claims Rejects Department of Veterans Affairs' Interpretation of Unconditional Ownership for SDVOSBs

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In a February 6, 2013 client alert regarding new developments for service-disabled veteran-owned small businesses (“SDVOSBs”), we discussed the U.S. Court of Federal Claims’ (“COFC”) recent decision in KWV, Inc. v. United States and the U.S. Government Accountability Office’s (“GAO”) recent report on the Department of Veterans Affairs’ (“VA”) verification process for SDVOSBs. Yesterday, the COFC issued another ruling that impacts the issues discussed in last week’s client alert and will have important ramifications for veteran ownership in SDVOSBs. The case, Miles Construction, LLC v. United States, No. 12-597C (Fed. Cl. 2013), is detailed below.

Similar to the KWV decision, Miles Construction involved a firm that had been verified as an SDVOSB by the VA’s Center for Veterans Enterprise (“CVE”), only to have that decision contradicted a few months later by the VA’s Office of Small and Disadvantaged Business Utilization (“OSDBU”) in response to a post-award protest. As in KWV, the COFC in Miles Construction overturned the OSDBU’s post-award protest decision and reinstated the CVE’s verification of the SDVOSB.

More importantly, the COFC ruled in Miles Construction on the issue of transfer restrictions placed on veteran ownership in an SDVOSB. Transfer restrictions have been one of the most common reasons for denial of SDVOSBs. The VA’s position has been that, under its rule that requires a veteran to have unconditional ownership of an SDVOSB, transfer restrictions (such as a right of first refusal) are impermissible because they constitute a condition on ownership. The VA’s interpretation is similar to several rulings by the SBA’s Office of Hearings and Appeals (“OHA”). As a result, to use the VA’s or SBA’s SDVOSB programs, veteran owners have had to strip all transfer restrictions from their shareholder and operating agreements.

Based on Miles Construction, firms looking to participate in the VA’s Veterans First Program should no longer need to remove all transfer restrictions from their governing documents. The recent GAO report we discussed in the February 6th client alert revealed that the VA was considering a change to its regulations in mid-2014 that would permit transfer restrictions on the veteran’s ownership. The Miles Construction decision indicates that no rule change is needed because the judge found that the current VA rules do not prohibit transfer restrictions that are a “normal commercial practice.” At issue in Miles Construction was a traditional right of first refusal transfer restriction found in many operating and shareholder

agreements. The COFC found that such a provision should be permitted because it “is not presently executory, is a standard provision used in normal commercial dealings, and does not burden the veteran’s ownership interest unless he or she chooses to sell some of his or her stake.”

While Miles Construction also discussed several OHA decisions on transfer restrictions, the court did not overrule OHA’s conclusions. The judge based his decision on the text of the operative VA rule, which he found to be materially different from the text in the operative SBA rule. Nevertheless, the analysis in Miles Construction suggests that OHA should reconsider its previous rulings on certain types of transfer restrictions placed on veteran ownership. If OHA does not revisit its conclusions, SDVOSBs would be placed in a difficult position because they could only utilize normal commercial transfer restrictions if they plan to operate exclusively within the VA’s Veterans First Program.

If you have questions about Miles Construction and what the ruling means for you, please contact Jon Williams or Grant Madden at (202) 857-1000. Mr. Williams may also be reached at jwilliams@pilieromazza.com, and Mr. Madden’s email address is gmadden@pilieromazza.com.