

AN OVERVIEW ON AFFILIATION

Why is Affiliation an Important Issue?

SBA determines whether an entity qualifies as a small business concern by counting its receipts, employees, or other measures including those of all its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit. 13 C.F.R. § 121.103(a)(6).

Where Do I Find SBA's Affiliation Rules?

SBA's rules on affiliation are found at 13 C.F.R. § 121.103. The regulations are available online at www.sba.gov/size. You may also contact any of the points of contact at the bottom of this document to receive a copy of the rules.

For Which Government Programs Does Affiliation Apply?

SBA's affiliation rules apply to the following government contracting or business development programs:

- small business set asides;
- Small Business Innovation Research (SBIR) program;
- Small Business Technology Transfer (STTR) program;
- Certificate of Competency (COC) program;
- Historically Underutilized Business Zone (HUBZone) program;
- Women-Owned Small Business (WOSB) and Economically Disadvantaged Women-Owned Small Business (EDWOSB) programs;
- Service-Disabled Veteran-Owned Small Business program;
- small disadvantaged business price evaluation adjustment and participation program;
- small business subcontracting;
- 8(a) Business Development program; and
- 7(j) management and technical assistance program.

SBA considers the receipts or employees (or other measure) of an applicant's or participant's affiliates in determining size for purposes of participating in the above programs, or receiving an award or preference as a result of status as a small business.

The affiliation principles also apply to small business loan programs. A number of government agencies, including the Food and Drug Administration and the Department of Veterans Affairs, operate programs for which small business status is a requirement for eligibility. The affiliation principles apply to these programs as well.

What are the General Principles of Affiliation?

Generally, affiliation exists when one business controls or has the power to control another or when a third party (or parties) controls or has the power to control both businesses. Control may arise through ownership, management, or other relationships or interactions between the parties.

Control may be affirmative or negative. Negative control includes instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

SBA commonly receives questions about whether a business concern is affiliated with its investors. The following are some of the affiliation rules that may apply when a business concern receives an investment, such as from a venture capital company, hedge fund, or private equity firm.

1. Stock ownership (13 C.F.R. § 121.103(c))

Control of 50% or more of voting stock. A person¹ is an affiliate of a concern if the person owns or controls, or has the power to control, 50% or more of the concern's voting stock.

Example: Company A is the majority owner of Companies B, C and D (54.5%, 81%, and 60% respectively). Company A has the power to control Companies B, C and D. The companies are all affiliated. The receipts and/or number of employees of all four companies will be aggregated in determining the size of any one of them.

Control of less than 50% voting stock, but large compared to others. A business concern also is affiliated with a person who owns and controls, or has the power to control, a block of voting stock that is large compared to all other outstanding blocks of stock.

Example 1: Company A owns 40 percent of the voting stock of Company B and the next largest share is 2 percent. Company A controls Company B due to the fact it owns the largest block of voting stock compared to all other outstanding blocks of voting stock. Company A and Company B are affiliates. In addition, all other companies controlled by Company A will be considered affiliates of Company B.

Example 2: Two individuals each own blocks of shares of Company A. One individual owns 46.67% of the business and the other owns 33.333%. The

¹ The term "person" used throughout this document and the regulations includes an individual, entity, or business concern. § 121.103(c)(1).

individual that owns 46.67% of the stock owns the largest single block, which is large compared to any other block, and therefore has the power to control the concern. This individual also controls Company B. There is affiliation between Company A and Company B.

Control of less than 50% voting stock by multiple minority owners. If two or more persons each owns or controls (or has the power to control) less than 50% of a concern's voting stock and (i) the minority holdings are all approximately equal in size and (ii) all of the minority holdings taken together are large compared to any other stock holdings, affiliation is presumed to exist with each of those persons. A presumed affiliate may rebut the presumption by showing that it does not have control or the power to control.

Example: Investor X, Investor Y, and Company A each own 23% of Company B. No other stockholder owns more than 5% of Company B. All three persons will be presumed to control Company B. Each presumed affiliate may attempt to rebut the presumption by showing that its control or power to control does not exist. If the presumption is not overcome, then Company A and Investors X and Y will all be considered affiliates of Company B. In addition, all companies controlled by Company A and Investors X and Y are affiliates of Company B.

Voting stock is widely held. When a concern's voting stock is widely held and no single block of stock is large as compared with all other stock holdings, the business concern's Board of Directors and Chief Executive Officer (CEO) or President are deemed to have the power to control the concern unless evidence is provided to show otherwise.

Example: In a widely held corporation where no one stockholder has a block of voting stock sufficient to give it control or the power to control the concern, control instead rests in the Board of Directors and the CEO or President. This means that any business controlled by the Board or by the CEO or President is an affiliate of the business concern in question, unless the Board and CEO or President can rebut this presumption.

2. Stock options, convertible securities, and agreements to merge (13 C.F.R. § 121.103(d))

SBA treats stock options, convertible securities, and agreements to merge as though the rights granted have been actually exercised. SBA gives present effect to an agreement to merge (including an agreement in principle) or to sell stock. If these rights have been granted and they confer the power to control, affiliation exists.

Example 1: If Company A holds an option to purchase a controlling interest in Company B, the situation is treated as though Company A had exercised its rights and had become owner of the controlling interests in Company B. Company A

and B are affiliates. In addition, all companies controlled by Company A will be considered affiliates of Company B.

Example 2: Company A and Company B are in discussion about a merger between the two of them. Both companies' representatives have met several times over the past two months. There is neither a formal nor informal agreement to merge. Unless the two companies have an agreement in principle, SBA will not find affiliation between the two companies based on these open and continuing discussions of merger alone.

3. Common management (13 C.F.R. § 121.103(e))

If one or more officers, directors, managing members, or general partners who control a business concern control the Board of Directors and/or the management of another business concern, the concerns are affiliates.

Example 1: Controlling members of Company A's Board of Directors occupy three out of five positions in Company B's Board of Directors. The two concerns are affiliated. In addition, all concerns controlled by Company A will be considered affiliates of Company B.

Example 2: A controlling member of Company A's Board of Directors has veto rights over the majority decisions of Company B's Board of Directors. By possessing such negative control, Company A has control of the Board of Directors of Company B and the two concerns are affiliated. In addition, all companies controlled by Company A will be considered affiliates of Company B.

4. Identity of interest between individuals or businesses, including family members (13 C.F.R. § 121.103(f))

Individuals or firms that have identical (or substantially identical) business or economic interests may be treated as one party unless they can demonstrate otherwise. Family members, persons with common investments, or firms that are economically dependent through contractual (or other) relationships, are among those treated this way. However, individuals or firms may seek to demonstrate that no affiliation exists by providing evidence establishing that apparently identical interests are, in fact, separate. Patterns of subcontracting, commingling of staff and/or facilities, and other veiled attempts to disguise the true nature of the relationship may evidence an identity of interest.

Example 1: Several officers of Company A are also officers of Company B. The two companies are in the same line of work and extensively subcontract with each other. The interrelationship between the two companies results in them acting as one, and therefore, the two are considered affiliates.

Example 2: Company A and B share office space and equipment in the same location and also share key employees. In addition, Company A has sent a substantial amount of business to Company B for each of the last three years. All this, taken together, is an indication that the two companies have combined their resources to each other's benefit, and therefore, are likely to be affiliated

Example 3: When three of four members of a concern's Board of Directors have multiple investments in common with each other outside the concern, they may be viewed as sharing an identity of interest. The three directors would be deemed to control the Board and to therefore also control the business. Each outside business that these three directors control would be an affiliate of the business concern in question.

Example 4: A husband and wife founded an accounting firm in 1974. In 2008, their daughter opened an office supply store using her own funds and a bank loan. Her parents purchase supplies from the daughter's store, and sales to her parents represent 10% of the daughter's revenues. There are no other business interactions between the daughter and her parents. If there are no other indicia of affiliation, SBA would find the business dealings to be minimal and the presumed affiliation due to family relationships is rebuttable.

5. Contractual relationships or economic dependency (13 C.F.R § 121.103(a),(f) and (g))

A concern that is economically dependent upon another person will probably be found to be affiliated with the concern(s) on which it is dependent.

Example 1: Company A performs subcontracts for Company B, and Company B accounts for 90% of Company A's revenues. Company A's existence depends on work from Company B, and the two are deemed affiliates.

Example 2: Company A provides significant loans to Company B and guarantees other loans to Company B. Company B's over reliance of dependence on Company A's financial support (both direct and indirect) results in their affiliation.

Example 3: A loan between two businesses is not an arm's-length transaction and the terms and conditions of the loan demonstrate financial dependence by one business on the other. The two are deemed affiliates.

Example 4: Company A obtained a patent for a product it developed. It licenses the use of the product to Company B, and makes it available for other companies to obtain a license. No affiliation exists between Company A and Company B based solely on the licensing agreement.

6. Newly Organized Concerns (13 C.F.R § 121.103(g))

A new concern that is organized by the former officers, directors, principal stockholders, managing members, or key employees of another concern may be affiliated with the older concern if the older concern furnishes the new concern with contracts, financial or technical assistance, indemnification, or other facilities. The affiliation may be rebutted by showing that there is a clear line of fracture between the two businesses.

Example: The former chief executive officer of Company A organizes Company B. Company B receives subcontracts from Company A. Company B is affiliated with Company A, unless it can establish that there is a clear line of fracture between the two companies.

CONCLUSION

The above is an overview of some basic principles of affiliation as set forth in SBA's regulations and decisions from SBA's Office of Hearings and Appeals (see <http://www.sba.gov/oha>). You should review all applicable regulations carefully before certifying a business's size status. For further information or questions, please contact the SBA Area Office of Government Contracting responsible for the area in which the company is located. Below is a listing of Area Offices and the geographical areas they serve.

Note: This overview has no legal effect and does not create any legal rights. Compliance with the guidance set forth in this document does not establish compliance with the SBA's regulations or establish a presumption or inference of compliance. The legal requirements that apply are governed by SBA's size regulations, which control if there is any inconsistency between the rule and the information in this guidance.

Contacts

SBA's Office of Government Contracting has six offices, each covering separate geographic areas.
Below are the office addresses and telephone numbers.

<p style="text-align: center;">Area I</p> <p>Janette Fasano, Area Director Office of Government Contracting Boston Area Office U.S. Small Business Administration 10 Causeway Street Room 265 Boston, MA 02222-1093 Tel: (617) 565-5622 Fax: (617) 565- 8186</p> <p>CT, ME, MA, NH, NJ, NY, RI, VT, PR, USVI</p>	<p style="text-align: center;">Area IV</p> <p>Pamela J. Beavers, Area Director Office of Government Contracting Chicago Area Office U.S. Small Business Administration 500 West Madison Street Suite 1250 Chicago, IL 60661-2511 Tel: (312) 353-7674 Fax: (202) 741-6840</p> <p>IL, IN, IA, KS, MI, MN, MO, NB, ND, OH, SD, WI</p>
<p style="text-align: center;">Area II</p> <p>David W. Loines, Area Director Office of Government Contracting Philadelphia Area Office U.S. Small Business Administration Parkview Tower 1150 First Avenue Suite 1001 King of Prussia, PA 19406 Tel: (610) 382-3190 Fax: (202) 481-1531</p> <p>DE, MD, PA, VA, WV, Washington, DC Metropolitan Area</p>	<p style="text-align: center;">Area V</p> <p>Robert C. Taylor, Area Director Office of Government Contracting Dallas Area Office U.S. Small Business Administration 4300 Amon Carter Boulevard Suite 116 Fort Worth, TX 76155 Tel: (817) 684-5303 Fax: (202) 481-5247</p> <p>AR, CO, LA, NM, OK, TX</p>
<p style="text-align: center;">Area III</p> <p>Mitchell Morand, Area Director Office of Government Contracting Atlanta Area Office U.S. Small Business Administration 233 Peachtree Street, NE Suite 1805 Atlanta, GA 30309 Tel: (404) 331-7587 Fax: (404) 331-2956</p> <p>AL, FL, GA, KY, MS, NC, SC, TN</p>	<p style="text-align: center;">Area VI</p> <p>James Gambardella, Area Director Office of Government Contracting San Francisco Area Office U.S. Small Business Administration 455 Market Street 6th Floor San Francisco, CA 94105 Tel: (415) 744-8429 Fax: (415) 744-0314</p> <p>AK, AZ, CA, HI, ID, MT, NV, OR, UT, WA, WY, GU</p>