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## SMALL BUSINESS ADMINISTRATION

13 CFR Part 125

RIN 3245-AG85

Ownership and Control of Service-Disabled Veteran-Owned Small Business Concerns

AGENCY: U.S. Small Business Administration.

ACTION: Final rule.

SUMMARY: The U.S. Small Business Administration (SBA or Agency) is amending its regulations to implement provisions of the National Defense Authorization Act for Fiscal Year 2017 (NDAA 2017). The NDAA 2017 placed the responsibility for issuing regulations relating to ownership and control for the Department of Veterans Affairs verification of Veteran-Owned (VO) and Service-Disabled Veteran-Owned (SDVO) Small Business Concerns (SBCs) with the SBA. Pursuant to NDAA 2017, SBA issues one definition of ownership and control for these concerns, which applies to the Department of Veterans Affairs in its verification and Vets First Contracting Program procurements, and all other government acquisitions which require self-certification. The legislation also provided that in certain circumstances a firm can qualify as VO or SDVO when there is a surviving spouse or an employee stock ownership plan (ESOP).

DATES: This rule is effective October 1, 2018.

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SUPPLEMENTARY INFORMATION:

[Introduction](#)

The Vets First Contracting Program within the Department of Veterans Affairs (VA) was created under the Veterans Benefits, Health Care, and Information Technology Act of 2006 (Pub. L. 109-461), 38 U.S.C. 501, 513. This contracting program was created for Veteran-Owned Small Businesses and expanded the Service-Disabled Veteran-Owned contracting program for VA procurements. Approved firms are eligible to participate in Veteran-Owned Small Business (VOSB) and Service-Disabled Veteran-Owned Small Business (SDVOSB) set-asides issued by VA. More information regarding the Vets First Contracting Program can be found on the Department of Veterans Affairs website at <https://www.va.gov/osdbu/faqs/109461.asp>.

This rule complies with the directive in the National Defense Authorization Act of 2017 (Pub. L. 114-328), section 1832, to standardize definitions for VOSBs and SDVOSBs between VA and SBA. As required by section 1832, the Secretary of Veterans Affairs will use SBA's regulations to determine ownership and control of VOSBs and SDVOSBs. The Secretary would continue to determine whether individuals are veterans or service-disabled veterans and would be responsible for verification of applicant firms. Challenges to the status of a VOSB or SDVOSB based upon issues of ownership or control would be decided by the administrative judges at the SBA's Office of Hearings and Appeals (OHA).

The VA proposed its companion rule, VA Veteran-Owned Small Business (VOSB) Verification Guidelines (RIN 2900-AP97) on January 10, 2018 (83 FR 1203)(Docket Number: VA-2018-VACO-0004). Their proposed rule sought to remove all references related to ownership and control and to add and clarify certain terms and references that are currently part of the verification process. The NDAA also provides that in certain circumstances a firm can qualify as VOSB or Service-Disabled Veteran Owned Small Business (SDVOSB) when there is

a surviving spouse or an employee stock ownership plan (ESOP). The final VA rule was issued on September 24, 2018 and is effective October 1, 2018. 83 FR 48221.

Similarly, SBA has finalized another related rule on March 30, 2018. SBA Final Rule: Rules of Practice for Protests and Appeals Regarding Eligibility for Inclusion in the U.S. Department of Veterans Affairs Center for Verification and Evaluation Database (83 FR 13626; RIN: 3245-AG87; Docket Number: SBA-2017-0007). This rule, also effective October 1, 2018, amends the rules of practice of SBA's Office of Hearings and Appeals (OHA) to implement procedures for protests of eligibility for inclusion in the Department of Veterans Affairs (VA) Center for Verification and Evaluation (CVE) database, and procedures for appeals of denials and cancellations of inclusion in the CVE database. OHA added two subparts to 13 CFR part 134: one for protests; the other for appeals. These amendments are issued in accordance with sections 1832 and 1833 of the National Defense Authorization Act for Fiscal Year 2017 (NDAA 2017).

SBA proposed this rule on January 29, 2018 (83 FR 4005; Docket Number: SBA-2018-0001). Sixty-eight comments were received, not all of which were germane to the rulemaking.

SBA received several comments related to this rulemaking as a whole. Two comments were supportive of the rule because the rule would align SBA's and VA's regulations, and would help to define elements previously addressed only outside the regulations through OHA decisions or case-by-case determinations. Six commenters opposed the proposed rule for addressing issues beyond just standardizing SBA's and VA's definitions. As explained in the section-by-section analysis, this rule codifies standards and practices that SBA has applied consistently through determinations and OHA decisions. SBA believes it benefits VOSB and SDVOSBs to have these standards and practices reflected in the regulations.

One commenter stated that SBA and VA should jointly issue regulations. SBA has consulted with VA in order to properly understand VA's positions and implement the statutory requirements in a way that is consistent with both SBA's and VA's interpretations. SBA and VA will each issue regulations effective on October 1, 2018, which will have the effect of creating a single ownership and control rule for both agencies.

#### Section-by-Section Analysis, Comments, and SBA's Responses

##### Section 125.11

In response to the NDAA 2017 changes, SBA proposed to amend the definitions in § 125.11 by incorporating language from VA's regulations and also from SBA's 8(a) Business Development (BD) program regulations. 13 CFR part 124, subpart A. SBA is defining a surviving spouse and the requirements for a surviving spouse-owned SDVO SBC to maintain program eligibility. Further, SBA is adding definitions for Daily Business Operations, Negative Control, Participant, and Unconditional Ownership. The added definitions are being adopted from SBA's 8(a) BD regulations found in part 124. SBA received two comments on the proposed definition of "Daily business operations." One comment advised that "setting of the strategic direction of the firm" is better categorized as long-term operations. SBA agrees and has deleted the reference to "setting of the strategic direction of the firm" from the definition of "daily business operations." A second comment objected to the inclusion of executive oversight, company policy, and strategic direction. SBA's deletion of strategic direction addresses this comment because, although the definition includes executive supervision and policy implementation, the definition does not address oversight or the creation of policy.

SBA received one comment on the "unconditional ownership" definition stating that it should be subject to the same conditions as extraordinary circumstances. SBA does not see a

reason to conflate ownership and control requirements, and therefore is not changing the “unconditional ownership” definition.

SBA is adding a definition for Employee Stock Ownership Plan (ESOP). This definition is adopted from section 1832(a)(6). SBA is also replacing the definitions of permanent caregiver, service-disabled veteran, and surviving spouse. SBA is adding a new definition for service-disabled veteran with a permanent and severe disability. These definitions are being updated in consultation with VA in an effort to ensure consistency across programs at both Agencies. SBA is also adding a definition for small business concerns. Concerns will need to meet all the requirements of part 121, including § 121.105(a)(1), which requires that the firm be 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.” This definition will address how to generally determine the size of a concern. VO and SDVO SBCs will still be required to meet size standards corresponding to the NAICS code assigned to each contract pursuant to §§ 125.14 and 125.15. SBA did not receive any comments on these definitions.

SBA proposed to add a definition for “extraordinary circumstances” under which a service disabled veteran owner would not have full control over a firm's decision-making process, but would not render the firm ineligible as a firm owned and controlled by one or more service disabled veterans. This definition will be used to identify discrete circumstances that SBA views as rare. The new definition will be used to allow minority equity holders to have negative control over these enumerated instances. SBA listed five limited circumstances in which a service-disabled veteran owner will not have full control over the decision making process. These five circumstances are exclusive, and SBA will not recognize any other facts or

circumstances that would allow negative control by individuals that are not service-disabled. SBA received four comments on the definition for “extraordinary circumstances.” One comment was supportive, and three comments suggested that SBA either eliminate the list, or add more protection for non-service-disabled-veteran owners. One commenter cited two SBA Office and Hearing Appeals size decisions to argue that the new rule is more restrictive than SBA’s affiliation regulations. Upon reviewing those two cases, *Size Appeal of EA Engineering, Science and Technology, Inc.*, SBA No. SIZ-4973 (2008), and *Size Appeal of Carntribe-Clement 8AJV #1, LLC*, SBA No. SIZ-5357 (2012), SBA does not agree that they govern the matter of control of an SDVO SBC by a service-disabled veteran. In *Firewatch Contracting of Florida, LLC*, SBA No. VET-137 (2008), OHA specifically stated that *EA Engineering* does not interpret the SDVO SBC regulations. The “extraordinary circumstances” definition already includes both of the powers addressed in *Carntribe-Clement*, adding a new stakeholder and dissolution. Other cases involving the SDVO SBC regulations, including *Apex Ventures, LLC*, VET-219 (2011), show that SBA’s current regulation requiring that the service-disabled veteran control “all” decisions is stricter than the proposed definition. SBA believes that current definition strikes a clear balance in favor of ensuring that SDVO SBCs are actually controlled by the service-disabled veteran. SBA has decided not to change the definition of “extraordinary circumstances.”

#### Section 125.12

SBA proposed to amend § 125.12(b), which pertains to the requirement for ownership of a partnership. SBA’s prior regulation required service-disabled veterans to own at least 51% of each type of partnership interest. Therefore, if a partnership had general partners and limited partners it was required that the service disabled veteran be both a general and limited partner. SBA is changing the requirement so that service-disabled veterans will need to own at least 51%

of the aggregate voting interest in the partnership. SBA received one comment on this change that stated that the proposed rule was inconsistent with the treatment of corporations. SBA does not find that the treatment of partnership and corporations must be identical, and therefore SBA is adopting § 125.12(b) as proposed.

SBA proposed to add coverage to § 125.12(d) to address statutory language with regard to public companies and ownership. This language does not include any equity held by an ESOP when determining ownership for a publicly owned business. SBA did not receive any comments on this change.

SBA proposed to add a new § 125.12(g) to provide clarity with regard to requirements for dividends and distributions. In general, one's right to receive benefits, compensation, and the ultimate value of one's equity should be consistent with the purported amount of equity. For example, it is not consistent with SBA's regulations for a firm to state that a service-disabled veteran owns 60 percent of the equity but records show that he or she is entitled only to a smaller amount of the firm's profit, or that the residual value of that equity is less than 60 percent if the firm is sold. SBA received two comments on § 125.12(g). One commenter argued that this new rule would be inconsistent with SBA's regulations for joint ventures which require profit distribution based on workshare. SBA does not find that the SDVO SBC regulation needs to be consistent with the joint venture regulations, which address an entirely different situation. A joint venture is not itself an SDVO SBC and is therefore treated differently. SBA does not see a benefit of treating joint ventures and SDVO SBCs as if they were the same. One commenter indicated that requiring that the service-disabled veteran be entitled to the full value of the veteran's stated equity would prevent the veteran from being able to secure commercial loans. As noted from the proposed rule, the proposed language is similar to already existing 8(a) BD

requirements. Through experience with that program, SBA has not witnessed the adverse effects predicted by this comment. The commenter presented no evidence to support the prediction, so SBA is adopting the proposed rule.

Under the new § 125.12(h), ownership decisions will be decided without regard to community property laws. This provision is similar to SBA's ownership regulations for women owned businesses. *See* 13 CFR 127.201. SBA did not receive any comments on this change.

The new § 125.12(i) allows the transfer of ownership in a SDVO SBC from a service-disabled veteran to his or her spouse upon the death of the service-disabled veteran without adversely affecting the firm's status as a SDVO SBC. SBA received two comments requesting that SBA extend survivor benefits beyond 100% service-disabled veterans. This allowance is taken from statute and can be seen in the definition of *Surviving spouse* in the proposed changes to § 125.11. As noted in the definition, the statutory provision can be found at 38 U.S.C. 101(3). SBA does not believe it has the authority to modify the definition and its application in the manner requested by the commenters. As such SBA is retaining the proposed language as is.

### Section 125.13

SBA proposed to add several new paragraphs to § 125.13 to incorporate provisions from SBA's 8(a) BD program and VA's former ownership and control regulations. SBA will continue to rely on the 8(a) program rules in part 124 for guidance in interpreting these control requirements.

SBA proposed to add language to describe how to determine if a service-disabled veteran controls the Board of Directors in § 125.13(e). This language is adopted from SBA's 8(a) BD regulations and is added to provide more clarity. In § 125.13(f), SBA added language that will require firms to provide notification of supermajority voting requirements. This regulation will

simplify the procedures for reviewing eligibility criteria related to super majority requirements. SBA did not receive any comments on these changes.

SBA proposed that § 125.13(g), (h), (i), and (j) would adopt policies and language from SBA's 8(a) BD program and VA's regulations. These provisions provide guidance on when SBA may find that a non-service-disabled veteran controls the firm. These regulations add more clarity and detail to specific issues such as quorum requirements and loan arrangements with non-service-disabled veterans. SBA received several comments on § 125.13(i). One comment recommended that SBA present the requirement as a rebuttable presumption. SBA agrees that language about a rebuttable presumption adds clarity and consistency. As such, SBA has adopted the suggestion.

SBA received three comments on the provision in § 125.13(i)(1) that a non-service-disabled veteran owner or manager not be a former employer or principal of a former employer. Specifically, the commenters mentioned that as written the requirement is not easily understood. One commenter recommended that SBA add "current" employer to the requirement because being a current employer is even more likely to lead to issues than being a former employer. SBA agrees and is adding "current." SBA also agrees that that the regulation could be clearer, and as such SBA has changed the language based on the suggestions in the comments. SBA does not believe that these changes affect the intent of the requirement.

SBA received three comments on the provision in § 125.13(i)(2) that a non-service-disabled veteran cannot receive higher compensation than the highest officer. One comment requested that SBA remove the requirement in its entirety. SBA believes this rule is necessary and has enough options for high payment of sought-after professionals to not hinder business progress. VA's regulations had a similar regulation, and SBA's 8(a) BD program currently

includes this regulation. Two commenters requested changes to the language without challenging the intent of the regulation. One of these commenters requested that SBA adopt VA's position that a non-service-disabled veteran that is the highest-compensated employee should not be an officer or a manager. The proposed language mirrors language from SBA's 8(a) BD program. SBA believes that this language has a track record of providing clarity to participants about compensation expectations, while also allowing the flexibility for firms to make business decisions that benefit the concern without harming the service-disabled veteran.

SBA received two comments on § 125.13(i)(3), relating to when an SDVO SBC is co-located with another firm. One comment suggested a revision and another suggested deletion. SBA believes the co-location regulation is necessary to address a common situation where a service-disabled veteran is not in control of the concern because of reliance on the co-located firm. Like the other elements in the control regulation, this co-location element is a rebuttable presumption, so it is still possible to find control by the service-disabled veteran if the SDVO SBC presents sufficient evidence to rebut the presumption. SBA changed the last word in the proposed regulation to clarify that the regulation will apply when the co-located firm or individual has an equity interest in the concern seeking SDVO SBC status.

SBA proposed to add rebuttable presumptions to § 125.13(k) and (l). Paragraph (k) adds a rebuttable presumption that a person not working for a firm regularly during normal working hours does not control the firm. As a rebuttable presumption, this is not a full-time devotion requirement and can be rebutted by providing evidence of control. SBA received four comments on this proposed rule. All commenters stated that this regulation was a new hindrance placed on SDVO SBCs and should not be included. The rule, however, reflects a control element that SBA and VA are already applying to current SDVO SBCs. This has always been a factor that SBA

will consider, but now it is clearly rebuttable by providing evidence of control. If a service-disabled veteran is not working during the firm's normal hours or has outside employment, SBA may presume that another individual is assuming the management role not being filled by the service-disabled veteran. This recognizes the reality of day-to-day control. SBA's regulations have always required that the day-to-day management and administration of SDVO SBC business operations must be conducted by one or more service-disabled veterans. The rebuttable presumption in paragraph (k) provides clarity on how SBA has always viewed the "day-to-day management" requirement and such is not a new requirement. Day-to-day management typically requires that an individual manage on a daily basis. In this case, if a firm does not require, and does not have an individual providing, management on a daily basis, the firm may provide that evidence to SBA to rebut the presumption.

Similarly, SBA proposed § 125.13(l) to add a rebuttable presumption regarding place of work. SBA received four comments on this proposed rule. All commenters stated that this regulation was a new hindrance placed on SDVO SBCs and should not be included. As with § 125.13(k), this is not a new policy by SBA. This is how SBA has been treating this issue already, and how SBA would treat this issue even if this paragraph was not included. A case from OHA supports SBA's position. See *In the Matter of First Capital Interiors, Inc.*, VET-2006-10-25-07 (2006). That decision makes clear that an inquiry into how an individual manages a firm remotely is reasonable, and that it is the SDVO SBC's responsibility to demonstrate that a service-disabled veteran actually controls the firm. With this regulation, SBA is attempting to address the situation where no service-disabled veteran owner lives or works near the firm's headquarters or worksites. SBA will presume that this indicates a lack of control because there is work at the headquarters and jobsites being managed and directed by individuals

that are not service-disabled veterans. All of the comments focused on the ability to work remotely in today's current environment, but this does not address SBA's main concern. As noted in SBA's proposed regulation, the main issue in these place of work instances is not remote management, but over-delegation of authority to non-service-disabled-veteran individuals who work at the office and who are at the work sites, namely, when there is evidence that individuals located at the headquarters and onsite are providing day-to-day management that should be provided by a service-disabled veteran. SBA's regulations require control over day-to-day operations, but remote observation and over-delegation do not meet this requirement. As noted in the proposed rule, this is a rebuttable presumption in which the firm may present evidence that the service-disabled has not abdicated authority to others to run the firm. Therefore, SBA is adopting the rule as proposed.

SBA is adopting § 125.13(m) and (n) as proposed. SBA did not receive comments on either subsection. The new § 125.13(m) is an exception to the control requirements in "extraordinary circumstances." As noted above, SBA has defined extraordinary circumstances to include a limited and exhaustive list of five circumstances. The rule will allow an exception to the general requirement that SDVs control long term decision making. The new § 125.13(n) is an exception to the control requirements when an individual in the reserves is recalled to active duty. SBA and VA do not think a firm owned by a service-disabled veteran should lose its status due to the necessary military commitments of its owner when serving the nation.

SBA had proposed to make technical changes to §§ 125.22 and 125.23. These technical changes along with several others have already been implemented pursuant to other rulemaking. 83 FR 13849. As such, SBA has removed the proposed changes from this final rule.

Justification for the October 1, 2018 Effective Date

The Administrative Procedure Act (APA) requires that "publication or service of a substantive rule shall be made not less than 30 days before its effective date, except \* \* \* as otherwise provided by the agency for good cause found and published with the rule." 5 U.S.C. 553(d)(3). The purpose of the APA provision delaying the effective date of a rule for 30 days after publication is to provide interested and affected members of the public sufficient time to adjust their behavior before the rule takes effect. For the reasons set forth below, SBA finds that good cause exists to make this final rule become effective on October 1, 2018, less than 30 days after it is published in the Federal Register.

As noted above, SBA and the VA have been working together to jointly implement the provisions of NDAA 2017. In doing so, SBA and the VA believe a single date on which all of the changes go into effect is the most effective path for implementation. SBA and the VA consider October 1, 2018 to be the best date for implementation of new unified rules for the programs. October 1, 2018 is the start of the new fiscal year, and is therefore the best date for separation of contract actions between different sets of regulations. Having contracts actions applying different regulations in the same fiscal year can often lead to confusion among contracting officials, and program participants. Procurements conducted in fiscal year 2018 will generally follow the old rules, while all new procurements in fiscal year 2019 will follow the new jointly developed regulations which SBA believes will lead to less confusion.

In addition to the joint effort in implementing these provisions of NDAA 2017, SBA has in a parallel rule making process implemented Sections 1932 and 1833 of NDAA 2017. These sections dealt with the transition of certain protest and appeal functions from the VA to SBA's Office of Hearing and Appeals. The final rule implementing those sections also has an implementation date of October 1, 2018. 83 FR 13626.

SBA and VA believe that a uniform transition combining the programs ownership and control requirements is extremely important. As such, SBA believes that an earlier effective date that aligns with the new fiscal year for contracting, and with the other changes implementing NDAA 2017 is the best course of action.

Compliance with Executive Orders 12866, 12988, 13132, 13771, the Paperwork Reduction Act (44 U.S.C. Ch. 35), and the Regulatory Flexibility Act (5 U.S.C. 601-612)

Executive Order 12866

OMB has determined that this rule does not constitute a “significant regulatory action” under Executive Order 12866. This rule is also not a major rule under the Congressional Review Act, 5 U.S.C. 800. This rule amends the rules concerning ownership and control of VO and SDVO SBCs. As such, the rule has no effect on the amount or dollar value of any Federal contract requirements or of any financial assistance provided through SBA or VA. Therefore, the rule is not likely to have an annual economic effect of \$100 million or more, result in a major increase in costs or prices, or have a significant adverse effect on competition or the United States economy. In addition, this rule does not create a serious inconsistency or otherwise interfere with an action taken or planned by another agency, materially alter the budgetary impact of entitlements, grants, user fees, loan programs or the rights and obligations of such recipients, nor raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

This rule is part of a joint effort by the VA and SBA to reduce the regulatory burden on the veteran business community. This rule consolidates ownership and control requirements in one regulation thus eliminating duplicate functions. Prior to the enactment of this regulation business owners had the burden of complying with both regulations. This regulation will

eliminate that burden. The single rule helps streamline the verification and certification processes which will save business owners time and money. This will also lead to less confusion.

#### Executive Order 12988

This action meets applicable standards set forth in section 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. 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 13771

This rule is not an EO 13771 regulatory action because this rule is not significant under EO 12866.

#### Paperwork Reduction Act

The SBA has determined that this rule does not impose additional reporting or recordkeeping requirements under the Paperwork Reduction Act, 44 U.S.C. Chapter 35. However, this rule does include an information collection for the VA and the OMB approval number for this collection is 2900-0675.

#### Regulatory Flexibility Act

The Regulatory Flexibility Act of 1980 (RFA), 5 U.S.C. 601-612, as amended, requires Federal agencies to consider the potential impact of regulations on small entities during

rulemaking. Small entities include small businesses, small not-for-profit organizations, and small governmental jurisdictions. Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

This rule merges SBA and VA regulations concerning ownership and control of VO and SDVO SBCs as directed by Congress. The regulation is not attempting to create new regulation, but to streamline two already existing regulations into a single regulatory framework. In SBA's determination, this rule will not have a significant economic impact on any small business.

There are approximately 21,000 firms registered as SDVO SBCs in the System for Award Management (SAM) and approximately 13,000 firms that have been certified by the VA. To a large extent SBA's and the VA's ownership and control rules were substantially similar in terms of the regulatory language, and in many instances identical. Thus, the vast majority of these firms will not be impacted by this rule. For example, this rule will not impact firms that are 100% owned and control by a service-disabled veteran. To the extent there are differences in SBA's and the VA's ownership and control rules, this rule will reduce cost and positively impact all SDVO firms, because there will be one set of criteria to measure service-disabled-veteran ownership and control throughout the Federal government. Further, SBA's current rules do not ignore ESOPs when determining ownership, which means firms that are majority owned by ESOPs are not eligible for SDVO set-asides or sole source awards. We have no data on the number of firms that this rule will be impact, but the number is very small. After consulting with industry representatives, many firms owned by ESOPs are entirely owned by the ESOP, especially those that operate in industries with employee based size standards. Those firms will still not qualify if this rule is finalized because there is still a 51% service-disabled-veteran

ownership requirement of the remaining ownership interest, not including ESOPs. However, some firms that intend to institute an ESOP may do so in way that allows the firm to qualify under this rule. With respect to surviving spouse, SBA's current rules do not recognize ownership or control by a surviving spouse. Although the VA does allow firms owned and controlled by surviving spouses to qualify under its certification program, the number of firms that qualify under the exception is extremely small. To the extent firms qualify under the surviving spouse exception the benefit will be positive, not negative. Firms that were previously not eligible to continue as SDVO firms will be able to continue for a period of time.

Therefore, the Administrator of SBA determines, under 5 U.S.C. 605(b), that this rule would not have a significant economic impact on a substantial number of small entities.

#### List of Subjects in 13 CFR Part 125

Government contracts, Government procurement, Reporting and recordkeeping requirements, Small businesses, Technical assistance, Veterans.

Accordingly, for the reasons stated in the preamble, SBA amends 13 CFR part 125 as follows:

#### PART 125 – GOVERNMENT CONTRACTING PROGRAMS

1. The authority citation for part 125 is revised to read as follows:

Authority: 15 U.S.C. 632(p), (q), 634(b)(6), 637, 644, 657(f), 657q, and 657s; 38 U.S.C. 501 and 8127.

2. Revise § 125.11 to read as follows:

#### § 125.11 What definitions are important in the Service-Disabled Veteran-Owned (SDVO) Small Business Concern (SBC) Program?

*Contracting officer* has the meaning given such term in section 27(f)(5) of the Office of Federal Procurement Policy Act (41 U.S.C. 423(f)(5)).

*Daily business operations* include, but are not limited to, the marketing, production, sales, and administrative functions of the firm, as well as the supervision of the executive team, and the implementation of policies.

*ESOP* has the meaning given the term “employee stock ownership plan” in section 4975(e)(7) of the Internal Revenue Code of 1986 (26 U.S.C. 4975(e)(7)).

*Extraordinary circumstances*, for purposes of this part, are only the following:

- (1) Adding a new equity stakeholder;
- (2) Dissolution of the company;
- (3) Sale of the company;
- (4) The merger of the company; and
- (5) Company declaring bankruptcy.

*Negative control* has the same meaning as that set forth in § 121.103(a)(3) of this chapter.

*Participant* means a veteran-owned small business concern that has verified status in the Vendor Information Pages database, available at <https://www.vip.vetbiz.gov/>.

*Permanent caregiver*, for purposes of this part, is the spouse, or an individual, 18 years of age or older, who is legally designated, in writing, to undertake responsibility for managing the well-being of the service-disabled veteran with a permanent and severe disability, as determined by Department of Veterans Affairs’ Veterans Benefits Administration, to include housing, health and safety. A permanent caregiver may, but does not need to, reside in the same household as the service-disabled veteran with a permanent and severe disability. In the case of a service-disabled veteran with a permanent and severe disability lacking legal capacity, the permanent caregiver shall be a parent, guardian, or person having legal custody. There may be no more than one permanent caregiver per service-disabled veteran with a permanent and severe disability.

(1) A permanent caregiver may be appointed, in a number of ways, including:

(i) By a court of competent jurisdiction;

(ii) By the Department of Veterans Affairs, National Caregiver Support Program, as the Primary Family Caregiver of a Veteran participating in the Program of Comprehensive Assistance for Family Caregivers (this designation is subject to the Veteran and the caregiver meeting other specific criteria as established by law and the Secretary and may be revoked if the eligibility criteria do not continue to be met); or

(iii) By a legal designation.

(2) Any appointment of a permanent caregiver must in all cases be accompanied by a written determination from the Department of Veterans Affairs that the veteran has a permanent and total service-connected disability as set forth in 38 CFR 3.340 for purposes of receiving disability compensation or a disability pension. The appointment must also delineate why the permanent caregiver is given the appointment, must include the consent of the veteran to the appointment and how the appointment would contribute to managing the veteran's well-being.

*Service-connected* has the meaning given that term in 38 U.S.C. 101(16).

*Service-disabled veteran* is a veteran who possesses either a valid disability rating letter issued by the Department of Veterans Affairs, establishing a service-connected rating between 0 and 100 percent, or a valid disability determination from the Department of Defense or is registered in the Beneficiary Identification and Records Locator Subsystem maintained by Department of Veterans Affairs' Veterans Benefits Administration as a service-disabled veteran. Reservists or members of the National Guard disabled from a disease or injury incurred or aggravated in line of duty or while in training status also qualify.

*Service-disabled veteran with a permanent and severe disability* means a veteran with a service-connected disability that has been determined by the Department of Veterans Affairs, in writing, to have a permanent and total service-connected disability as set forth in 38 CFR 3.340 for purposes of receiving disability compensation or a disability pension.

*Small business concern* means a concern that, with its affiliates, meets the size standard corresponding to the NAICS code for its primary industry, pursuant to part 121 of this chapter.

*Small business concern owned and controlled by service-disabled veterans (also known as a Service-Disabled Veteran-Owned SBC)* means any of the following:

(1) A small business concern--

(i) Not less than 51 percent of which is owned by one or more service-disabled veterans or, in the case of any publicly owned business, not less than 51 percent of the stock (not including any stock owned by an ESOP) of which is owned by one or more service-disabled veterans; and

(ii) The management and daily business operations of which are controlled by one or more service-disabled veterans or, in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran;

(2) A small business concern--

(i) Not less than 51 percent of which is owned by one or more service-disabled veterans with a disability that is rated by the Secretary of Veterans Affairs as a permanent and total disability who are unable to manage the daily business operations of such concern; or

(ii) In the case of a publicly owned business, not less than 51 percent of the stock (not including any stock owned by an ESOP) of which is owned by one or more such veterans.

*Surviving spouse* has the meaning given the term in 38 U.S.C. 101(3).

*Unconditional ownership* means ownership that is not subject to conditions precedent, conditions subsequent, executory agreements, voting trusts, restrictions on or assignments of voting rights, or other arrangements causing or potentially causing ownership benefits to go to another (other than after death of incapacity). The pledge or encumbrance of stock or other ownership interest as collateral, including seller-financed transactions, does not affect the unconditional nature of ownership if the terms follow normal commercial practices and the owner retains control absent violations of the terms.

*Veteran* has the meaning given the term in 38 U.S.C. 101(2). A Reservist or member of the National Guard called to Federal active duty or disabled from a disease or injury incurred or aggravated in line of duty or while in training status also qualify as a veteran.

*Veteran owned small business concern* means a small business concern:

(1) Not less than 51 percent of which is owned by one or more veterans or, in the case of any publicly owned business, not less than 51 percent of the stock of which is owned by one or more veterans; and

(2) The management and daily business operations of which are controlled by one or more veterans. All of the provisions of subpart B of this part apply for purposes of determining ownership and control.

3. Amend §125.12 by:

- a. Revising the introductory text;
- b. Revising the first sentence in paragraph (b);
- c. Adding a sentence at the end of paragraph (d); and
- d. Adding paragraphs (g) through (i).

The revisions and additions read as follows:

§ 125.12 Who does SBA consider to own an SDVO SBC?

Generally, a concern must be at least 51% unconditionally and directly owned by one or more service-disabled veterans. More specifically:

\* \* \* \* \*

(b) \* \* \* In the case of a concern which is a partnership, at least 51% of aggregate voting interest must be unconditionally owned by one or more service-disabled veterans. \* \* \*

\* \* \* \* \*

(d) \* \* \* In the case of a publicly owned business, not less than 51 percent of the stock (not including any stock owned by an ESOP) must be unconditionally owned by one or more veterans.

\* \* \* \* \*

(g) *Dividends and distributions.* One or more service-disabled veterans must be entitled to receive:

(1) At least 51 percent of the annual distribution of profits paid to the owners of a corporation, partnership, or limited liability company concern;

(2) 100 percent of the value of each share of stock owned by them in the event that the stock or member interest is sold; and

(3) At least 51 percent of the retained earnings of the concern and 100 percent of the unencumbered value of each share of stock or member interest owned in the event of dissolution of the corporation, partnership, or limited liability company.

(4) An eligible individual's ability to share in the profits of the concern must be commensurate with the extent of his/her ownership interest in that concern.

(h) *Community property.* Ownership will be determined without regard to community property laws.

(i) *Surviving spouse.* (1) A small business concern owned and controlled by one or more service-disabled veterans immediately prior to the death of a service-disabled veteran who was the owner of the concern, the death of whom causes the concern to be less than 51 percent owned by one or more service-disabled veterans, will continue to qualify as a small business concern owned and controlled by service-disabled veterans during the time period if:

(i) The surviving spouse of the deceased veteran acquires such veteran's ownership interest in such concern;

(ii) Such veteran had a service-connected disability (as defined in 38 U.S.C. 101(16)) rated as 100 percent disabling under the laws administered by the Secretary of Veterans Affairs or such veteran died as a result of a service-connected disability; and

(iii) For a participant, immediately prior to the death of such veteran, and during the period described in paragraph (i)(2) of this section, the small business concern is included in the database described in 38 U.S.C. 8127(f).

(2) The time period described in paragraph (i)(1)(iii) of this section is the time period beginning on the date of the veteran's death and ending on the earlier of--

(i) The date on which the surviving spouse remarries;

(ii) The date on which the surviving spouse relinquishes an ownership interest in the small business concern; or

(iii) The date that is 10 years after the date of the death of the veteran.

4. Amend §125.13 by revising paragraph (e) and adding paragraphs (f) through (n) to read as follows:

§ 125.13 Who does SBA consider to control an SDVO SBC?

\* \* \* \* \*

(e) *Control over a corporation.* One or more service-disabled veterans (or in the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran) must control the Board of Directors of the concern.

(1) SBA will deem service-disabled veteran individuals to control the Board of Directors where:

(i) A single service-disabled veteran individual owns 100% of all voting stock of an applicant or concern;

(ii) A single service-disabled veteran individual owns at least 51% of all voting stock of an applicant or concern, the individual is on the Board of Directors and no super majority voting requirements exist for shareholders to approve corporation actions. Where super majority voting requirements are provided for in the concern's articles of incorporation, its by-laws, or by state law, the service-disabled veteran individual must own at least the percent of the voting stock needed to overcome any such super majority voting requirements; or

(iii) More than one service-disabled veteran shareholder seeks to qualify the concern (i.e., no one individual owns 51%), each such individual is on the Board of Directors, together they own at least 51% of all voting stock of the concern, no super majority voting requirements exist, and the service-disabled veteran shareholders can demonstrate that they have made enforceable arrangements to permit one of them to vote the stock of all as a block without a shareholder meeting. Where the concern has super majority voting requirements, the service-disabled veteran shareholders must own at least that percentage of voting stock needed to overcome any such super majority ownership requirements. In the case of super majority ownership

requirements, the service-disabled veteran shareholders can demonstrate that they have made enforceable arrangements to permit one of them to vote the stock of all as a block without a shareholder meeting.

(2) Where an applicant or concern does not meet the requirements set forth in paragraph (e)(1) of this section, the service-disabled veteran individual(s) upon whom eligibility is based must control the Board of Directors through actual numbers of voting directors or, where permitted by state law, through weighted voting (e.g., in a concern having a two-person Board of Directors where one individual on the Board is service-disabled veteran and one is not, the service-disabled veteran vote must be weighted—worth more than one vote—in order for the concern to be eligible). Where a concern seeks to comply with this paragraph (e)(2):

(i) Provisions for the establishment of a quorum cannot permit non-service-disabled veteran Directors to control the Board of Directors, directly or indirectly; and

(ii) Any Executive Committee of Directors must be controlled by service-disabled veteran directors unless the Executive Committee can only make recommendations to and cannot independently exercise the authority of the Board of Directors.

(3) Non-voting, advisory, or honorary Directors may be appointed without affecting service-disabled veteran individuals' control of the Board of Directors.

(4) Arrangements regarding the structure and voting rights of the Board of Directors must comply with applicable state law.

(f) *Super majority requirements.* One or more service-disabled veterans must meet all super majority voting requirements. An applicant must inform the Department of Veterans Affairs, when applicable, of any super majority voting requirements provided for in its articles of incorporation, its by-laws, by state law, or otherwise. Similarly, after being verified, a

participant must inform the Department of Veterans Affairs of changes regarding super majority voting requirements.

(g) *Licenses.* A firm must obtain and keep current any and all required permits, licenses, and charters, required to operate the business.

(h) *Unexercised rights.* A service-disabled veteran owner's unexercised right to cause a change in the control or management of the applicant concern does not in itself constitute control and management, regardless of how quickly or easily the right could be exercised.

(i) *Control by non-service-disabled veterans.* Non-service-disabled veteran individuals or entities may not control the firm. There is a rebuttable presumption that non-service-disabled veteran individuals or entities control or have the power to control a firm in any of the following circumstances, which are illustrative only and not inclusive:

(1) The non-service-disabled veteran individual or entity who is involved in the management or ownership of the firm is a current or former employer or a principal of a current or former employer of any service-disabled veteran individual upon whom the firm's eligibility is based. However, a firm may provide evidence to demonstrate that the relationship does not give the non-service-disabled veteran actual control over the concern and such relationship is in the best interests of the concern.

(2) One or more non-service-disabled veterans receive compensation from the firm in any form as directors, officers or employees, including dividends, that exceeds the compensation to be received by the highest-ranking officer (usually CEO or President). The highest ranking officer may elect to take a lower amount than the total compensation and distribution of profits that are received by a non-veteran only upon demonstrating that it helps the concern.

(3) In circumstances where the concern is co-located with another firm in the same or similar line of business, and that firm or an owner, director, officer, or manager, or a direct relative of an owner, director, officer, or manager of that firm owns an equity interest in the concern.

(4) In circumstances where the concern shares employees, resources, equipment, or any type of services, whether by oral or written agreement with another firm in the same or similar line of business, and that firm or an owner, director, officer, or manager, or a direct relative of an owner, director, officer, or manager of that firm owns an equity interest in the concern.

(5) A non-service-disabled veteran individual or entity, having an equity interest in the concern, provides critical financial or bonding support.

(6) In circumstances where a critical license is held by a non-service-disabled individual, or other entity, the non-service-disabled individual or entity may be found to control the firm. A critical license is considered any license that would normally be required of firms operating in the same field or industry, regardless of whether a specific license is required on a specific contract.

(7) Business relationships exist with non-service-disabled veteran individuals or entities which cause such dependence that the applicant or concern cannot exercise independent business judgment without great economic risk.

(j) *Critical financing.* A non-service-disabled veteran individual or entity may be found to control the concern through loan arrangements with the concern or the service-disabled veteran(s). Providing a loan or a loan guaranty on commercially reasonable terms does not, by itself, give a non-service-disabled veteran individual or entity the power to control a firm, but

when taken into consideration with other factors may be used to find that a non-service-disabled firm or individual controls the concern.

(k) *Normal business hours.* There is a rebuttable presumption that a service-disabled veteran does not control the firm when the service-disabled veteran is not able to work for the firm during the normal working hours that businesses in that industry normally work. This may include, but is not limited to, other full-time or part-time employment, being a full-time or part-time student, or any other activity or obligation that prevents the service-disabled veteran from actively working for the firm during normal business operating hours.

(l) *Close proximity.* There is rebuttable presumption that a service-disabled veteran does not control the firm if that individual is not located within a reasonable commute to firm's headquarters and/or job-sites locations, regardless of the firm's industry. The service-disabled veteran's ability to answer emails, communicate by telephone, or to communicate at a distance by other technological means, while delegating the responsibility of managing the concern to others is not by itself a reasonable rebuttal.

(m) *Exception for "extraordinary circumstances."* SBA will not find that a lack of control exists where a service-disabled veteran does not have the unilateral power and authority to make decisions in "extraordinary circumstances." The only circumstances in which this exception applies are those articulated in the definition.

(n) *Exception for active duty.* Notwithstanding the provisions of this section requiring a service-disabled veteran to control the daily business operations and long-term strategic planning of a concern, where a service-disabled veteran individual upon whom eligibility is based is a reserve component member in the United States military who has been called to active duty, the concern may elect to designate in writing one or more individuals to control the concern on

behalf of the service-disabled veteran during the period of active duty. The concern will not be considered ineligible based on the absence of the service-disabled veteran during the period of active duty. The concern must keep records evidencing the active duty and the written designation of control, and provide those documents to VA, and if requested to SBA.

Dated: September 21, 2018.

**Linda E. McMahon,**

*Administrator.*

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