

WHEN WILL THE SBA GIVE “PRESENT EFFECT” TO STOCK SALES OR AGREEMENTS TO MERGE?

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In a recent case at the Small Business Administration (“SBA”) Office of Hearings and Appeals, (“OHA”), the OHA clearly explained when “present effect” will be given to stock options, convertible securities and agreements to merge. This is important because such agreements deal with the power to control a concern, and hence impact affiliation of companies.

Telecommunications Support Services, Inc., SBA No. SIZ-5953, August 17, 2018.

The case involves a letter of intent (“LOI”) dated May 12, 2017 under which Acorn Growth Companies, LLC entered into with CIS Secure Computing, Inc. In the size protest, the issue was whether the LOI constituted an “agreement in principle” that was given present effect by the area SBA office, and which therefore found the two companies to be affiliated for size purposes.

The “present effect rule” is stated in 13 CFR § 121.103(d), as follows:

Affiliation arising under stock options, convertible securities, and agreements to merge. (1) In determining size, SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.

(2) Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered “agreements in principle” and are thus not given present effect.

(3) Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.

(4) An individual, concern or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so. SBA will not give present effect to individuals', concerns' or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.

OHA included in the decision on this size appeal the following distinguishing characteristics of agreements which *should* be given present effect, and those which *should not* be given present effect:

GIVE PRESENT EFFECT TO AN AGREEMENT (i.e. it is an agreement in principle):

1. Consider the substance of the full document itself, not captions or partial quotations.
2. There is tangible evidence that agreement in principle has been reached
3. The agreement includes a specific price
4. The agreement includes important terms
5. The agreement results in expeditious purchase of one concern by another

DO NOT GIVE PRESENT EFFECT TO AN AGREEMENT (it is not an agreement in principle):

1. The agreement describes itself as non-binding
2. The agreement sets forth only general terms for the purchase—is really is an opportunity for the buyer to evaluate an opportunity
3. The agreement has a range of prices rather than a set price, or bases a price only upon the condition that seller must meet certain financial conditions
4. Is conditioned on an extensive due diligence examination of a great deal of financial information prior to any deal being closed
5. Is non-binding, except for provisions dealing with the negotiations themselves
6. The Agreement allows either party to withdraw from the agreement

Takeaway: Examine the indicia of “present effect” or “no present effect” when reaching these types of agreements, to determine if SBA will give present effect, and how this could impact on a size determination or size protest.

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