

AFFILIATION: COMMON OWNERSHIP IS DIFFERENT FROM COMMON MANAGEMENT

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Under the Size Regulations of the Small Business Administration (“SBA”), when there is affiliation between two or more businesses, the resources of all affiliates are counted in determining if the business is “small” or “not small.” A recent case at the SBA Office of Hearings and Appeals (“OHA”) demonstrates clearly two different kinds of situations where affiliation may be found—one arising from common ownership and the other arising from common management. *Hardwire, LLC*, SBA No. SIZ-5983 (Feb. 8, 2019).

It is helpful to review the pertinent regulations in order to understand the case. Here are the key sections on affiliation arising from common ownership and arising from common management.

§ 121.103 How does SBA determine affiliation?

(a) *General Principles of Affiliation.*

- (1) Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists.
- (2) SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists.
- (3) Control may be affirmative or negative. Negative control includes, but is not limited to, 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.
- (4) Affiliation may be found where an individual, concern, or entity exercises control indirectly through a third party.
- (5) In determining whether affiliation exists, SBA will consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation.

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(c) *Affiliation based on stock ownership.*

- (1) A [person](#) (including any individual, concern or other entity) that owns, or has the power to control, 50 percent or more of a concern's voting stock, or a block of voting stock which is large compared to other outstanding blocks of voting stock, controls or has the power to control the concern.

...

(e) *Affiliation based on common management.* Affiliation arises where one or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns.

In *Hardwire*, the protester argued that two companies (Central Lake Armor Express, Inc. or CLAE, and Steel Connect) were affiliated under common management, 13 C.F.R. § 121.103(e). One person, Jim Henderson was the CEO of three companies, CLAE, Steel Connect and its subsidiary, Modus Link. OHA noted that affiliation through common management does not require total control of a concern, just critical influence or the ability to exercise substantive control over the concern's operations. Furthermore, persons in senior leadership positions, such as the CEO and COO, are presumed to exercise substantive control over a firm's operations, absent significant evidence to the contrary.

When the protest was considered by the Area Office of SBA, that office concluded that there could be no affiliation through common management when the concerns in question had different ownership. OHA rejected this legal conclusion, noting that the common management regulation does not require common ownership in order to find affiliation—they are two separate regulations, and either one can give rise to affiliation.

OHA concluded that Mr. Henderson clearly had critical influence or substantive control over Praesidium since he was its CEO (Praesidium was a parent company that controlled CLAE), and that he was also CEO of Steel Connect, and therefore had critical influence or substantive control over Steel Connect. Both Steel Connect and CLAE were affiliated under Mr. Henderson's common management, and their resources had to be added together in determining their size.

The takeaway. Common management is different from common ownership under the SBA rules. In order to ensure that a small business is small, you must ensure that neither methods of affiliation apply, otherwise the resources of both companies will be counted together in determining size.

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