

(3) *Hedge fund* has the meaning given that term in section 13(h)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1851(h)(2)). The hedge fund must have a place of business located in the United States and be created or organized in the United States, or under the law of the United States or of any State.

(4) *Portfolio company* means any company that is owned in whole or part by a venture capital operating company, hedge fund, or private equity firm.

(5) *Private equity firm* has the meaning given the term “private equity fund” in section 13(h)(2) of the Bank Holding Company Act of 1956 (12 U.S.C. 1851(h)(2)). The private equity firm must have a place of business located in the United States and be created or organized in the United States, or under the law of the United States or of any State.

(6) *Venture capital operating company* means an entity described in § 121.103(b)(5)(i), (v), or (vi). The venture capital operating company must have a place of business located in the United States and be created or organized in the United States, or under the law of the United States or of any State.

[77 FR 76225, Dec. 27, 2012]

**§ 121.702 What size and eligibility standards are applicable to the SBIR and STTR programs?**

To be eligible for award of funding agreements in SBA’s SBIR and STTR programs, a business concern must meet the requirements below at the time of award of an SBIR or STTR Phase I or Phase II funding agreement:

(a) *Ownership and control for the SBIR program.*

(1) An SBIR awardee must:

(i) Be a concern which is more than 50% directly owned and controlled by one or more individuals (who are citizens or permanent resident aliens of the United States), other small business concerns (each of which is more than 50% directly owned and controlled by individuals who are citizens or permanent resident aliens of the United States), or any combination of these;

(ii) Be a concern which is more than 50% owned by multiple venture capital operating companies, hedge funds, private equity firms, or any combination

of these (for agencies electing to use the authority in 15 U.S.C. 638(dd)(1)); or

(iii) Be a joint venture in which each entity to the joint venture must meet the requirements set forth in paragraph (a)(1)(i) or (a)(1)(ii) of this section. A joint venture that includes one or more concerns that meet the requirements of paragraph (a)(1)(ii) of this section must comply with § 121.705(b) concerning registration and proposal requirements.

(2) No single venture capital operating company, hedge fund, or private equity firm may own more than 50% of the concern.

(3) If an Employee Stock Ownership Plan owns all or part of the concern, each stock trustee and plan member is considered an owner.

(4) If a trust owns all or part of the concern, each trustee and trust beneficiary is considered an owner.

(b) *Ownership and control for the STTR program.*

(1) An STTR awardee must:

(i) Be a concern which is more than 50% directly owned and controlled by one or more individuals (who are citizens or permanent resident aliens of the United States), other small business concerns (each of which is more than 50% directly owned and controlled by individuals who are citizens or permanent resident aliens of the United States), or any combination of these; or

(ii) Be a joint venture in which each entity to the joint venture must meet the requirements set forth in paragraph (b)(1)(i) of this section.

(2) If an Employee Stock Ownership Plan owns all or part of the concern, each stock trustee and plan member is considered an owner.

(3) If a trust owns all or part of the concern, each trustee and trust beneficiary is considered an owner.

(c) *Size and affiliation.* An SBIR or STTR awardee, together with its affiliates, must not have more than 500 employees. 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. For the purposes of the SBIR

and STTR programs, the following bases of affiliation apply:

(1) *Affiliation based on ownership.* For determining affiliation based on equity ownership, a concern is an affiliate of an individual, concern, or entity that owns or has the power to control more than 50 percent of the concern's voting equity. However, SBA may find a concern an affiliate of an individual, concern, or entity that owns or has the power to control 40% or more of the voting equity based upon the totality of circumstances. If no individual, concern, or entity is found to control, SBA will deem the Board of Directors to be in control of the concern.

(2) *Affiliation arising under stock options, convertible securities, and agreements to merge.* 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.

(i) 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.

(ii) 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.

(iii) 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.

(3) *Affiliation based on common management.* Affiliation arises where the CEO or President of a concern (or other officers, managing members, or partners who control the management of

the concern) also controls the management of one or more other concerns. Affiliation also arises where a single individual, concern, or entity that controls the board of directors of one concern also controls the board of directors or management of one or more other concerns.

(4) *Affiliation based on identity of interest.* Affiliation may arise among two or more persons (including any individual, concern or other entity) with an identity of interest. An individual, concern or entity may rebut a determination of identity of interest with evidence showing that the interests deemed to be one are in fact separate.

(i) SBA may presume an identity of interest between family members with identical or substantially identical business or economic interests (such as where the family members operate concerns in the same or similar industry in the same geographic area).

(ii) SBA may presume an identity of interest based upon economic dependence if the SBIR/STTR awardee relies upon another concern or entity for 70% or more of its receipts.

(iii) An SBIR or STTR awardee is not affiliated with a portfolio company of a venture capital operating company, hedge fund, or private equity firm, solely on the basis of one or more shared investors, though affiliation may be found for other reasons.

(5) *Affiliation based on the newly organized concern rule.* Affiliation may arise where former or current officers, directors, principal stockholders, managing members, general partners, or key employees of one concern organize a new concern in the same or related industry or field of operation, and serve as the new concern's officers, directors, principal stockholders, managing members, general partners, or key employees, and the one concern is furnishing or will furnish the new concern with contracts, financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities, whether for a fee or otherwise. A concern may rebut such an affiliation determination by demonstrating a clear line of fracture between the two concerns. A "key employee" is an employee who, because of his/her position in the concern, has a critical influence

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in or substantive control over the operations or management of the concern. A concern will be considered “new” for the purpose of this rule if it has been actively operating continuously for less than one year.

(6) *Affiliation based on joint ventures.* Concerns submitting an application as a joint venture are affiliated with each other with regard to the application. SBA will apply the joint venture affiliation exception at § 121.103(h)(3)(iii) for two firms approved to be a mentor and protégé under SBA’s 8(a) program.

(7) *Affiliation based on the ostensible subcontractor rule.* A concern and its ostensible subcontractor are treated as joint venturers, and therefore affiliates, for size determination purposes. An ostensible subcontractor is a subcontractor or subgrantee that performs primary and vital requirements of a funding agreement (*i.e.*, those requirements associated with the principal purpose of the funding agreement), or a subcontractor or subgrantee upon which the concern is unusually reliant. All aspects of the relationship between the concern and subcontractor are considered, including, but not limited to, the terms of the proposal (such as management, technical responsibilities, and the percentage of subcontracted work) and agreements between the concern and subcontractor or subgrantee (such as bonding assistance or the teaming agreement). To determine whether a subcontractor performs primary and vital requirements of a funding agreement, SBA will consider whether the concern’s proposal complies with the performance requirements of the SBIR or STTR program.

(8) *Affiliation based on license agreements.* SBA will consider whether there is a license agreement concerning a product or trademark which is critical to operation of the licensee. The license agreement will not cause the licensor to be affiliated with the licensee if the licensee has the right to profit from its efforts and bears the risk of loss. Affiliation may arise, however, through other means, such as common ownership or common management.

(9) *Exception to affiliation for portfolio companies.* If a venture capital operating company, hedge fund, or private equity firm that is determined to be af-

filiated with an awardee is a minority investor in the awardee, the awardee is not affiliated with a portfolio company of the venture capital operating company, hedge fund, or private equity firm, unless:

(i) The venture capital operating company, hedge fund, or private equity firm owns a majority of the portfolio company; or

(ii) The venture capital operating company, hedge fund, or private equity firm holds a majority of the seats of the board of directors of the portfolio company.

(10) *Totality of the circumstances.* In determining whether affiliation exists, SBA may consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation.

(d) *Calculating ownership and control.* SBA will review the small business’ equity ownership on a fully diluted basis for purposes of determining ownership, control and affiliation in the SBIR and STTR programs. This means that SBA will consider the total number of shares or equity that would be outstanding if all possible sources of conversion were exercised, including, but not limited to: Outstanding common stock or equity, outstanding preferred stock (on a converted to common basis) or equity, outstanding warrants (on an as exercised and converted to common basis), outstanding options and options reserved for future grants, and any other convertible securities on an as converted to common basis.

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### **§ 121.703 Are formal size determinations binding on parties?**

Size determinations by authorized SBA officials are formal actions based upon a specific funding agreement, and are binding upon the parties. Other SBA opinions provided to funding agreement officers or others, are only advisory, and are not binding or appealable.

### **§ 121.704 When does SBA determine the size and eligibility status of a business concern?**

(a) The size and eligibility status of a concern for the purpose of a funding