



Determining Board Governance and Control

Issue:

This brief discusses the verification requirement concerning control of boards of directors.

(For purposes of this brief, the regulations when referring to Service-Disabled Veterans applies equally to Veterans; applicant refers to the business entity applying for verification; and participant refers to a business entity that has already been verified.)

The Regulations:

13 CFR § 125.11 provides:

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.

13 CFR § 125.13(a) provides that “[c]ontrol by one or more service-disabled veterans means that both the long-term decisions making and the day-to-day management and administration of the business operations must be conducted 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).”

According to **13 CFR § 125.13(e)**, “[o]ne 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 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 a 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.”

13 CFR § 125.11 states that “[n]egative control has the same meaning as that set forth in §121.103(a)(3) of this chapter," that is, “[n]egative control includes, but is not limited to, instances where a minority shareholder has the ability, under the concern's chapter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.”

What This Means:

Subpart B as referred to in 13 CFR § 125.11 is saying that anywhere in the regulations where the term Service-Disabled Veteran is used, it is equally applicable to Veterans for purposes of determining eligibility.

The regulatory language in 13 CFR § 125.13(e)(1) does not require any additional interpretation in determining when Veterans are deemed to control the Board of Directors. If one or more Veterans fulfill the individual requirements as outlined in 13 CFR § 125.13(e)(1), Veterans are deemed to control the Board of Directors.

Single Veteran owns 100% of all voting stock.

If a single Veteran owns 100% of all voting stock of an applicant, the Veteran is deemed to control the Board of Directors as provided in 13 CFR § 125.13(e)(1)(i).

Single Veteran owns at least 51% of all voting stock but less than 100%.

(1) No single Veteran owns at least 51% of all voting stock but less than 100% (2) the Veteran is on the Board of Directors (3) no super majority voting requirements exist for shareholders to approve corporate actions (4) where super majority voting requirements are

provided for in the applicant's business documents or by state law, the Veteran must own at least the percent of the voting stock needed to overcome the super majority voting requirements.

Thus, a Veteran is deemed to control the Board of Directors, if the corporation's business documents fulfill the requirements of 13 CFR § 125.13(e)(1)(ii).

Two or more Veterans own at least 51% of all voting stock but no one Veteran alone owns at least 51%.

(1) No one Veteran owns 51% of all voting stock but together two or more Veterans own at least 51% of all voting stock (2) each Veteran is on the Board of Directors (3) no super majority voting requirements exist (4) the 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 and (5) where there are super majority voting requirements, the Veteran shareholders must own at least that percentage of voting stock needed to overcome any such super majority ownership requirements. (6) However, in the case of super majority ownership requirements, the 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.

Thus, Veterans are deemed to control the Board of Directors, if the corporation's business documents fulfill the requirements of 13 CFR § 125.13(e)(1)(iii).

Veteran(s) do not qualify under 13 CFR § 125.13(e)(1)

Where an applicant or concern does not meet the requirements set forth in paragraph (e)(1) of this section, Veterans 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.

Thus, Veterans are deemed to control the Board of Directors, if the corporation's business documents don't qualify under 13 CFR § 125.13(e)(1) but fulfill the requirements of 13 CFR § 125.13(e)(2).

Examples of Lack of Control under 13 CFR § 125.13(e)(2):

Lack of Quorum

- There are four directors—two Veterans and two non-Veterans. According to the company by-laws, the Board of Directors manages the corporation. A quorum for board meetings consists of a majority of directors, in this case, three of the four directors. Since Veterans are unable to establish a quorum without one of the two non-Veterans, non-Veterans would be found to control the Board of Directors.
- There are two directors—one Veteran and one non-Veteran. According to the company by-laws, the majority of the directors constitute a quorum for a board of directors meeting. In this case, both the Veteran and non-Veteran directors must be present to establish a quorum. Consequently, the non-Veteran director can exert negative control by being unavailable to establish a quorum. Therefore, the Veteran does not control the Board of Directors as required by the regulations.

Negative Control by Failing to Vote

- According to the company by-laws, the Board of Directors manages the corporation. A quorum for board meetings consists of the majority of directors—and the act of a majority of directors present at a meeting constitutes board action. With a two-person board of directors (i.e., one Veteran and the other non-Veteran), the

non-Veteran director can exert negative control by abstaining from the vote and consequently, preventing board action. Therefore, the Veteran has not demonstrated full control of the Board of Directors as required by the regulations.

- According to the company by-laws, a majority of directors is required to establish a quorum. The corporation has three directors (i.e., one Veteran and two non-Veterans). Since a majority of directors is required to establish a quorum and there are two non-Veteran directors, the non-Veteran directors have the power to establish a quorum or transact business without the presence of the Veteran. The two non-Veterans may also prevent board action initiated by the Veteran. In this case, the Veteran has not demonstrated control as required by the regulations.

Lack of Weighted Voting

- The company by-laws state that the business of a corporation shall be managed by its Board of Directors. In the case where there are only two directors—one Veteran and one non-Veteran—and there is no provision for weighted voting, the firm fails to meet the requirements of the regulations as the non-Veteran director can block corporate action. Thus, the Veteran has not demonstrated control of the Board of Directors as required by the regulations.
- Article II, Section 1 of the company by-laws states that “...all corporate powers shall be exercised by or under the direction of, and the business and affairs of the corporation shall be managed under the direction of, the Board of Directors.” Article II, Sections 6 and 7 state that a quorum will be a majority of the directors and that the vote of a majority of the directors present when a quorum is established will be the act of the board of directors. The Articles of Incorporation list the Veteran and the non-

Veteran owners as directors of the company. There is no provision for weighted voting giving the Veteran director a majority vote for the transaction of business. Therefore, the business fails to meet the requirements of the regulations as the non-Veteran director can exercise control by blocking corporate action. Thus, the Veteran has not demonstrated full control of the Board of Directors as required by the regulations.

Example of Control under 13 CFR § 125.13(e)(2):

Actual numbers

- The company by-laws state that the business of a corporation shall be managed by its Board of Directors. In the case where there are three voting directors—two Veterans and one non-Veteran, the firm meets the actual numbers requirement of the regulations as the Board of Directors is comprised of more Veteran voting Directors than non-Veteran voting Directors, two Veterans to one non-Veteran. Thus, the Veterans have demonstrated control of the Board of Directors as required by the regulations.

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