



*Veterans in Business – Still Serving America*

# Verification Assistance Program 38 CFR §74.4 Review: How to Interpret the Regulations Governing Control

September 26, 2012



U.S. Department of Veterans Affairs  
Office of Small and Disadvantaged Business Utilization





# Agenda Topics

- Welcome, Introductions
- Training Objectives
- Review of 38 CFR § 74.4 - Drew Cornacchio, OGC Attorney
- Next Steps



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# Training Objectives

- Provide Verification Counselors a thorough review of 38 CFR Part 74 “Veteran-Owned Small Business Verification Guidelines.”
- Specifically, we will provide assistance on how to correctly interpret Section 74.4 of the Regulations, which governs the criteria for “control” of the small business concern.



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# 38 CFR §74.4



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# § 74.4(a) Who does CVE consider to control a Veteran-owned small business?

- Control means both the day-to-day management and long-term decision-making authority for the VOSB. Many persons share control of a concern, including each of those occupying the following positions: Officer, director, general partner, managing partner, managing member and manager.
- In addition, key employees who possess expertise or responsibilities related to the concern's primary economic activity may share significant control of the concern. CVE will consider the control potential of such key employees on a case-by-case basis.





## § 74.4(b) Who does CVE consider to control a Veteran-owned small business? (continued)

- Control is not the same as ownership, although both may reside in the same person. CVE regards control as including both the strategic policy setting exercised by boards of directors and the day-to-day management and administration of business operations.
- An applicant or participant's management and daily business operations must be conducted by one or more veterans or service-disabled veterans. Individuals managing the concern must have managerial experience of the extent and complexity needed to run the concern.





## § 74.4(b) Who does CVE consider to control a Veteran-owned small business? (continued)

- A veteran need not have the technical expertise or possess a required license to be found to control an applicant or participant if he or she can demonstrate that he or she has ultimate managerial and supervisory control over those who possess the required licenses or technical expertise.
- However, where a critical license is held by a non-veteran having an equity interest in the applicant or participant firm, the non-veteran may be found to control the firm.



## § 74.4(c)(1) Who does CVE consider to control a Veteran-owned small business? (continued)

- An applicant or participant must be controlled by one or more veterans or service-disabled veterans who possess requisite management capabilities. Owners need not work full-time but must show sustained and significant time invested in the business.
- An owner engaged in employment or management outside the applicant concern must submit a written statement supplemental to the application which demonstrates that such activities will not have a significant impact on the owner's ability to manage and control the applicant concern. Applications from joint-ventures are exempt from the requirement to submit a supplemental written statement.



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# § 74.4(c)(1) Who does CVE consider to control a Veteran-owned small business? (continued)

- Note:
  - Per § 74.4(c)(1), the applicant must demonstrate that a Veteran owner's employment or management in another entity outside the applicant concern will not interfere with his/her control of the applicant concern.
  - In particular, the applicant must provide a statement to the Center for Veterans Enterprise ("CVE") representative that is thorough and extremely detailed. The applicant should include examples of how the Veteran is able to show "sustained and significant time invested in the business," i.e., responsibility without delegating material elements of control. \*Failure to do so will result in denial.



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# § 74.4(c)(1) Who does CVE consider to control a Veteran-owned small business? (continued)

- Further Note:
  - The ability to control the applicant concern while employed by another entity will not be presumed. The burden of proof rests with the Veteran applicant.
  - In the past, the Government Accountability Office (“GAO”) specifically commented in its October 2009 report that a Veteran cannot control a business when he concurrently has a separate full-time job which operates during the same normal business hours as the applicant concern.





## § 74.4(c)(2) Who does CVE consider to control a Veteran-owned small business? (continued)

- An eligible full-time manager must hold the highest officer position (usually President or Chief Executive Officer) in the applicant or participant.



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## § 74.4(c)(3) Who does CVE consider to control a Veteran-owned small business? (continued)

- One or more veterans or service-disabled veteran owners who manage the applicant or participant must devote full-time to the business during the normal working hours of firms in the same or similar line of business. Work in a wholly-owned subsidiary of the applicant or participant may be considered to meet the requirement of full-time devotion.
- This applies only to a subsidiary owned by the VOSB itself, and not to firms in which the veteran has a mere ownership interest.



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## § 74.4(c)(4) Who does CVE consider to control a Veteran-owned small business? (continued)

- Except as provided in paragraph (f)(1) of this section, a veteran owner's unexercised right to cause a change in the management of the applicant concern does not in itself constitute veteran control, regardless of how quickly or easily the right could be exercised.



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## § 74.4(d) Who does CVE consider to control a Veteran-owned small business? (continued)

- In the case of a partnership, one or more veterans or service-disabled veterans must serve as general partners, with control over all partnership decisions. A partnership in which no veteran is a general partner will be ineligible for participation.





## § 74.4(e) Who does CVE consider to control a Veteran-owned small business? (continued)

- In the case of a limited liability company, one or more veterans or service-disabled veterans must serve as management members, with control over all decisions of the limited liability company.



## § 74.4(f) Who does CVE consider to control a Veteran-owned small business? (continued)

- One or more veterans or service-disabled veterans must control the board of directors of a corporate applicant or participant.
  - (1) CVE will deem veterans or service-disabled veterans to control the board of directors where:
    - (i) A single veteran owns 100 percent of all voting stock of an applicant or participant concern;





## § 74.4(f)(1) Who does CVE consider to control a Veteran-owned small business? (continued)

- (ii) A single veteran owns at least 51 percent of all voting stock of an applicant or participant, the individual is on the board of directors and no super majority voting requirements exist for shareholders to approve corporation actions. Where supermajority voting requirements are provided for in the concern's articles of incorporation, its by-laws, or by State law, the veteran must own at least the percent of the voting stock needed to overcome any such supermajority voting requirements; or
- (iii) No single veteran owns 51 percent of all voting stock but multiple veterans in combination do own at least 51 percent of all voting stock, each such veteran is on the board of directors, no supermajority voting requirements exist, and the veteran shareholders can demonstrate that they have made enforceable



# § 74.4(f)(1) Who does CVE consider to control a Veteran-owned small business? (continued)

- (iii) (cont'd) arrangements to permit one of them to vote the stock of all as a block without a shareholder meeting. Where the concern has supermajority voting requirements, the veteran shareholders must own at least that percentage of voting stock needed to overcome any such supermajority ownership requirements.



## § 74.4(f)(2) Who does CVE consider to control a Veteran-owned small business? (continued)

- Where an applicant or participant does not meet the requirements set forth in paragraph (f)(1) of this section, the veteran(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 veteran and one is not, the veteran vote must be weighted—worth more than one vote—in order for the concern to be eligible for VetBiz VIP Verification). Where a concern seeks to comply with this paragraph:



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## § 74.4(f)(2) Who does CVE consider to control a Veteran-owned small business? (continued)

- (i) Provisions for the establishment of a quorum cannot permit non-veteran directors to control the board of directors, directly or indirectly;
- (ii) Any executive committee of the board of directors must be controlled by veteran directors unless the executive committee can only make recommendations to and cannot independently exercise the authority of the board of directors.





## § 74.4(f)(3) Who does CVE consider to control a Veteran-owned small business? (continued)

- Non-voting, advisory, or honorary directors may be appointed without affecting veterans' or service-disabled veterans' control of the board of directors.



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## § 74.4(f)(4) Who does CVE consider to control a Veteran-owned small business? (continued)

- Arrangements regarding the structure and voting rights of the board of directors must comply with applicable state law.



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## § 74.4(g) Who does CVE consider to control a Veteran-owned small business? (continued)

- Non-veterans may be involved in the management of an applicant or participant, and may be stockholders, partners, limited liability members, officers, or directors of the applicant or participant. With the exception of a spouse or personal caregiver who represents a severely disabled veteran owner, no such non-veteran or immediate family member may:



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## § 74.4(g)(2) Who does CVE consider to control a Veteran-owned small business? (continued)

- Be a former employer or a principal of a former employer of any affiliated business of the applicant or participant, unless it is determined by the CVE that the relationship between the former employer or principal and the eligible individual or applicant concern does not give the former employer actual control or the potential to control the applicant or participant and such relationship is in the best interests of the participant firm; or



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## § 74.4(g)(3) Who does CVE consider to control a Veteran-owned small business? (continued)

- Receive compensation from the applicant or participant in any form as directors, officers or employees, including dividends, that exceeds the compensation to be received by the highest officer (usually chief executive officer or president). The highest ranking officer may elect to take a lower salary than a non-veteran only upon demonstrating that it helps the applicant or participant.





## § 74.4(h) Who does CVE consider to control a Veteran-owned small business? (continued)

- Non-veterans who transfer majority stock ownership or control of the firm to an immediate family member within 2 years prior to the application and remain involved in the firm as a stockholder, officer, director, or key employee of the firm are presumed to control the firm.
- The presumption may be rebutted by showing that the transferee has independent management experience necessary to control the operation of the firm, and indeed is participating in the management of the firm.





## § 74.4(i) Who does CVE consider to control a Veteran-owned small business? (continued)

- Non-veterans or entities may be found to control or have the power to control in any of the following circumstances, which are illustrative only and not all inclusive:
  - (1) Non-veterans control the board of directors of the applicant or participant, either directly through majority voting membership, or indirectly, where the by-laws allow non-veterans effectively to prevent a quorum or block actions proposed by the veterans or service-disabled veterans.



## § 74.4(i) Who does CVE consider to control a Veteran-owned small business? (continued)

- (2) A non-veteran or entity, having an equity interest in the applicant or participant, provides critical financial or bonding support or a critical license to the applicant or participant which directly or indirectly allows the non-veteran significantly to influence business decisions of the participant, unless an exception is authorized by the Office of Small and Disadvantaged Business Utilization.



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## § 74.4(i) Who does CVE consider to control a Veteran-owned small business? (continued)

- (3) A non-veteran or entity controls the applicant or participant or an individual veteran owner through loan arrangements. Providing a loan guaranty on commercially reasonable terms does not, by itself, give a non-veteran or entity the power to control a firm.





## **§ 74.4(i) Who does CVE consider to control a Veteran-owned small business? (continued)**

- (4) Business relationships exist with non-veterans or entities which cause such dependence that the applicant or participant cannot exercise independent business judgment without great economic risk.





# Next Steps

- Final training session in the four part series
- Verification Assessment tool for applicants
- Dedicated assistance hotline (202) 303-3285



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# Thank You!

**\*Don't forget to register at:**

**<http://www.va.gov/osdbu/veteran/vapTraining.asp>**



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