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Small and mid-sized businesses seeking ways to stabilize or improve revenue streams increasingly are marketing their goods or services to large companies or government. This type of contracting is becoming ever-more important to women- or minority-owned vendors as large companies and almost all levels of government in the U.S. emphasize or prioritize buying from these types of businesses.

Indeed, woman-owned enterprises recently received a significant boost from the Federal government. For the first time, a purchasing goal was mandated by Federal rule in late 2010 requiring agencies to fulfill at least 5% of all prime Federal contracts using woman-owned small businesses (WOSBs) and/or economically-disadvantaged woman-owned small businesses (EDWOSBs) in more than 80 industries.¹

For women- or minority-owned businesses attempting to win these often-lucrative contracts, the first step is obtaining certification of their status as a women’s business enterprise (WBE) or a minority business enterprise (MBE). That certification may be provided by a third-party certifier or, sometimes, by the WBE or MBE, itself.²

A "third-party certifier" is usually a non-profit corporation or association that issues a certificate recognized by a number of private enterprises and some governmental entities.³ "Self-certification," on the other hand, is a process undertaken by the WBE or MBE working directly with certain governmental agencies using that agency's own investigative procedures.⁴

Whether the WBE or MBE uses a third-party certifier or self-certifies, such a business is subject to the same, general scrutiny. To demonstrate it is truly a WBE or MBE and not a "front" for a male or non-minority owner, the business must provide evidence it is both owned and controlled by one or more females or minorities,⁵ as the case may be.

While proving ownership is easy (mostly), control is decidedly more complicated. Consider, for example, that control issues may prevent certification even when ownership is 100% female or minority.

Nonetheless, many professional advisors fail to inquire whether their small and mid-sized business client plan to seek such certification. And if the client raises the issue, most advisors do not fully appreciate the myriad ways that decision must alter the approach normally taken when planning a business.

Error caused by providing such business clients "one-size-fits-all" advice can be very costly to the client. Failure to appropriately consider the implications of the client's decision to seek third-party certification may well result in denial of its application. Once denied, reapplication can be made only after the expiration of one year, during which time the business is barred from competing for contracts.⁶

Worse yet, in the case of self-certifying WBEs, SBA eligibility examinations may occur after the client has been awarded government contracts.⁷ In that instance, an advisor’s failure to properly address this issue may result in loss of an existing contract.⁸ Further, "[a]ny firm found to misrepresent itself as a WOSB could be subject to criminal penalties and debarment from federal contracting."⁹

Of course, the question of initial eligibility is not the end of the enquiry for advisors. Later in the life cycle of an WBE or a MBE, good business planning requires close scrutiny of all proposed changes in the business, including but not limited to decisions impacting financing, management, or ownership.

Subtle shifts in control between women or minority business owners and male or non-minorities can result in loss of certification upon
annual renewal and, ultimately, the loss of all contracts relying upon those certifications. As mentioned above, there are many ways males or non-minorities may gain control of the WBE or MBE without actually owning it. Advisors must remain on guard against these often subtle shifts of power between the parties to transactions in these businesses or else risk harm to the WBEs and MBEs they counsel.

Women now own roughly one-third of all U.S. small businesses, according to the last census of small businesses in 2007, and minorities, approximately one in five. Clearly, issues of gender- or race-based certification can no longer be ignored—if ever they could.

Why "the usual" advice does not work for WBEs and MBEs

As a business lawyer structuring a new business, my greatest concerns include how to properly divide profits of the going concern and at the business' end, and how to protect the remaining owners if one of them should suffer a catastrophic event or commit fraud or theft. I usually accomplish all of these ends by binding the owners together as much as possible.

By that, I mean I treat all of them exactly alike in the deal, sharing control as much as possible (equally, if I can), and jiggling supermajority numbers to ensure one person cannot act unilaterally in making major decisions. This approach when dealing with a WBE or MBE co-owned by a male or non-minority, however, will destroy any chance the client's application for certification will be approved.

The question of "ownership"

The question of who owns the majority-in-interest may not always be as easy to determine as it seems. For the most part, a woman or minority holding at least 51% of the ownership of the business is sufficient to establish they are the majority owners. And, indeed, this is the minimum ownership threshold for certification.

So, how would anyone get something so straightforward so very wrong? The simple answer is, they fail to consider that the determination of who owns the business relies not solely on whether the percentage of ownership is 51% or greater, but also on whether the majority ownership is unconditional.

Surprisingly, even the basic calculation of majority ownership is not always straightforward. Consider the example of my client who wanted to gradually cede ownership of her firm to an employee stock option plan (ESOP). Her firm relied on government contracts for the bulk of its business and those contracts were awarded due to her WBE status. The plan was to begin by transferring 51% of her interest in the firm to the ESOP.

After some inquiry, however, we determined this idea was a serious nonstarter as the vast majority of her current employees were male. To grant the ESOP 51% of her ownership would have resulted in an immediate shift in the majority-in-interest from female to male. And the likelihood employee attrition would change the gender composition of her firm during her lifetime seemed slim as most employees had been there for decades and most job openings attracted almost exclusively male applicants. Gender discrimination being a bad thing, she decided it was necessary to adjust her plans to grant employees stock ownership.

Once the 51% ownership requirement is satisfied, woman or minority ownership also must be deemed "unconditional." All conditions, executory agreements, voting trusts, or other [such] arrangements all may be deemed impermissible conditions on the ownership majority-in-interest. When calculating whether the woman or minority is actually the majority, any unexercised stock option or other agreement held by the female or minority will be disregarded, but the same arrangement, "including the right to convert non-voting stock or debentures into voting stock, held by any other individual or entity will be treated as having been exercised.

Other considerations which may be
deemed to impermissibly limit the woman's or minority's unconditional ownership, include unanimous or supermajority approval requirements for sale of assets or termination of the business, requirement of entry of a judicial decree of dissolution, granting of unilateral power to any member (other than the female or minority majority), or requiring the non-majority to consent to sell, terminate, or dissolve the business. Another such limitation to unconditional ownership would be any requirement that the majority owner must find a buyer for the minority should she decide to sell or that grants the minority the right of approval of the buyer.

Even the existence of a transfer of ownership agreement between the owners that grants the right of first refusal to the minority and that limits the sale price to the amount the majority "paid for the shares initially" will result in denial. (Presumably, buy-sell agreements that grant the right of first refusal to the minority and requires that the minority either match the sale price of a bona fide offer or pay based upon the current value of the company do not represent an impermissible condition on ownership.)

Business ownership interests held in trust must be also be carefully evaluated when the business plans to seek certification. For example, "the SBA believes that a WOSB owned by a trust is considered to be directly owned by a woman if the trust is revocable and the woman is also the grantor, a trustee and the sole current beneficiary of the trust." A trust failing to meet these conditions and holding ownership of a WBE or MBE may result in imputation of ownership to a male or non-minority.

Which brings us to issues of control....

The mistake almost every client makes when considering WBE and MBE certification is believing ownership is the end of the inquiry. Many are the disappointed husbands who believed granting their wives a slim majority ownership is enough to ensure certification.

No, the control is the thing and, while various certifying agencies and entities provide advisors many examples of common ways control can become too intertwined between the woman or minority and the male or non-minority, there are few bright lines. So what might "control" really mean?

Simply put: the goal of the control requirement is to provide the woman or minority total, unfettered authority and discretion to do absolutely everything without any possibility of hindrance by a male or non-minority. This does not mean she may not delegate. It only means any authority she delegates must be hers to reclaim or otherwise exercise in her exclusive best judgment.

A short list of the ways in which a woman or minority must control the business is, well, in every way—including holding the highest officer position in the business, alone, having the right to make all decisions related to management, finances, and even whether to terminate the business and dissolve the enterprise, having a board of directors comprised of a majority of women or minorities "through actual numbers or, where permitted by state law, through weighted voting," and as the highest-ranking officer, devoting her full-time to the business concern during normal working hours. While the highest-ranking officer does not have to be the owner, to be deemed in control, the highest-ranking office must be held by another woman or minority.

Further, to become and remain certified, the woman or minority must be able to demonstrate her executive-level knowledge of all workings of the business—like a boss. She does not have to be an engineer, for example, or hold all licenses needed to run the business, but she must understand what the engineers have been directed to accomplish and exercise supervisory control over all license holders.

"However, if a man possesses the required license and has an equity interest in the concern, he may be found to control the concern."

These indicia of control can be difficult for the aforementioned husband to adjust to and that would be the point. Advisors should
carefully explain that merely tossing his wife 51% in interest and making her its operations manager or office administrator will not aid the business' efforts to obtain or maintain certification. Self-certification under these circumstances may result in criminal prosecution or civil sanctions, as mentioned earlier.

Consider a call I received recently from an employee of an electrical contractor that was being considered for the award of a big subcontract. WBE certification would cinch the deal. So we discussed why she felt her firm was certifiable.

As an initial matter, the wife owned the majority of interest in the company. She devoted her full-time effort to the business and had intimate knowledge of all of its workings. She ran the business, I was told. (Good, so far.)

Husband held the title of President, however. (Our first problem.) The death blow to any possibility of this business' certification came with the next bit of information, however. The minority male owner held the company's only electrical contractor's license, and she was unqualified to obtain one. In other words, at any moment, the male could leave the firm and the female would be unable to retain any of the firm's clients or fulfill any of the business' contracts. Because he was also an owner, it is unlikely a certifier would find that she was in control of the business.xxxi

Worse yet, issues of control may surface regardless of ownership. If the business is 100% woman- or minority-owned, we advisors must scratch the surface regarding financing before determining whether the business is certifiable. We must learn, for example, whether any financing follows "normal commercial practices and the owner retains control absent violations of the terms."xxxii Retention by a male or non-minority of any right to capriciously withdraw financing will prevent certification of the enterprise.

Further, a certified WBE or MBE can lose its certification upon renewal if the female or minority should take a step back from control.xxxiii This may happen gradually or due to a negative life event, but having a woman or minority—even a non-owner—in the business' succession plan is a definite "must" if the business relies on contracts available as a result of such certification.

Oh, and what is a minority?

The National Minority Supplier Development Council, a major third-party certifier of minority businesses, defines a racial minority as "an individual who is a U.S. citizen with at least 1/4 or 25% minimum (documentation to support claim of 25% required from applicant) of the following: Asian-Indian ..., Asian-Pacific ..., Black ..., Hispanic ..., [or] Native American ....xxxv Each term is specifically defined therein by nationality of origin.

So, let us consider the instance in which the business succession plan of a 25% minority father would grant ownership to his two, half-sibling children. In this scenario, the advisor must inquire about the minority status of the children's respective mothers. The owner or the children must be prepared to document whether each of the respective mothers is a racial minority and in sufficient quantity to ensure the children will also be 25% minority. These inquiries will determine whether an equal split between the children is feasible if the company relies on minority-ownership status as a means of obtaining business.

Final thoughts

Given all of this, modern business transactions practice demands potential WBE or MBE certification always be considered when dealing with small-, or mid-sized businesses. Once it is determined a business client will seek or has obtained such certification, the advisor must take pains to carefully evaluate any change in management, financing, or succession planning before making it, as any such change may create a potential barrier to obtaining or retaining these valuable credentials.
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3 Major third-party certifiers are the Women’s Business Enterprise National Council (WBENC), the U.S. Women’s Chamber of Commerce (USWCC), the National Women Business Owners Corporation (NWBOC), see http://www.sba.gov/content/contracting-opportunities-women-owned-small-businesses, and the National Minority Supplier Development Council (NMSDC), see http://www.mbda.gov/main/business-certification.


5 See U.S. Small Business Administration, *8(a) Business Development*, http://www.sba.gov/content/8a-business-development-0 (last visited June 16, 2012) ("The 8(a) Program offers a broad scope of assistance to firms that are owned and controlled at least 51% by socially and economically disadvantaged individuals"); U.S. Small Business Administration, *Women-Owned Small Business Federal Contract Program*, http://www.sba.gov/content/contracting-opportunities-women-owned-small-businesses (last visited June 16, 2012) ("To be eligible, a firm must be at least 51% owned and controlled by one or more women, and primarily managed by one or more women."); U.S. Women’s Chamber of Commerce (USWCC), *Certification FAQ’s*, http://www.uswcc.org/uswcc-certification-faq.aspx (last visited June 16, 2012) ("What are your standards for certification? - At least fifty-one percent ownership by a woman or women, - Proof of effective management and control of the business, - Documented evidence of contribution of capital and/or expertise, - U.S. Citizenship or Legal Resident Alien status (for FWBE certifications)"); Women’s Business Enterprise National Council (WBENC), *Certification*, http://www.wbenc.org/Certification/ (last visited June 16, 2012) ("WBENC Certification validates that the business is 51 percent owned, controlled, operated, and managed by a woman or women."); National Women Business Owners Corporation (NWBOC), *Basic Information About WBE Certification for Women-Owned Businesses*, http://www.nwbo.org/Basic_Info/index.html (last visited June 16, 2012) ("Any woman-owned business can apply for WBE Certification if the company meets the criteria of majority ownership and control of the business. By law, majority ownership means at least 51% of the business is owned by a woman or women. This is established through the legal paperwork associated with the business. Also by law, but perhaps less exact, is the concept of control of the business. A woman has control of the business if she is the final decision maker for all aspects of the business - financial, production, contracting, etc. - or she has delegated that authority to an employee manager or
another partial owner."); National Minority Supplier Development Council (NMSDC), *Minority Business Certification*, http://www.nmsdc.org/nmsdc/app/template/contentMgmt%2CContentPage.vm/contentid/1959 (last visited June 16, 2012) ("Ownership by minority individuals means the business is at least 51% owned by such individuals or, in the case of a publicly-owned business, at least 51% of the stock is owned by one or more such individuals. Further, the management and daily operations are controlled by those minority group members.").


viii See id. at § 127.404.


xi See, e.g., Women's Business Enterprise National Council, WBENC’s Standards and Procedures 14-15(March 2008) available at http://www.wbenc.org/default/Documents/Certification/Standards_Procedures_Mar08.pdf ("The woman/women owner(s) shall have the ability to perform in its area of specialty/expertise without substantial reliance upon finances and resources (e.g., equipment, automobiles, facilities, etc.) of males or non-woman business enterprises."). See also U.S. Small Business Administration, *Women-Owned Small Business (WOSB) Program: Small Entity Compliance Guide to the WOSB Program* 20 (April 2011) available at http://www.sba.gov/sites/default/files/files/WOSB%20Compliance%20Guide_April2011.pdf (last visited June 16, 2012) ("... [A]ny unexercised stock option or other agreement, including the right to convert non-voting stock or debentures into voting stock, held by any other individual or entity will be treated as having been exercised."); see id. at 23 ("Women [must] comprise the majority of voting directors through actual numbers or, where permitted by state law, through weighted voting.").


Id. (However, "[t]he pledge or encumbrance of stock or other ownership interest as collateral, including seller-financed transactions, does not affect the unconditional nature of ownership if the terms follow normal commercial practices and the owner retains control absent violations of the terms.")

See, e.g., id. at 20.

Id. See also id. at 21.

See id. at 19.

Id. at 20.

Id.

Id. at 19 (emphasis added).

See, generally, id. at 21.

See id. at 22, 23.

See id. (Having a woman or minority as "President" while the male or non-minority is "CEO," will not meet this requirement.)

See id. at 21-23.

Id. at 23.

See id. at 22.

See id. at 22.

See id. at 22.

Id. (emphasis added).

See id. at 22.

Id. at 19.
