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## SMALL BUSINESS ADMINISTRATION

### 13 CFR Part 107

#### Small Business Investment Companies

**AGENCY:** Small Business Administration.

**ACTION:** Final rule.

**SUMMARY:** This final rule implements a provision of Public Law 106-9, enacted April 5, 1999, under which certain types of consideration paid to a small business investment company (SBIC) by a small business are excluded from "cost of money" limitations.

**DATES:** This final rule is effective December 18, 2000.

**FOR FURTHER INFORMATION CONTACT:** Leonard W. Fagan, Investment Division, at (202) 205-7583.

**SUPPLEMENTARY INFORMATION:** On June 20, 2000, SBA published a proposed rule to implement a provision of Public Law 106-9, enacted April 5, 1999, that amended section 308(i)(2) of the Small Business Investment Act of 1958. See 65 FR 38223. This amendment provided that certain types of consideration paid to an SBIC by a small business are excluded from the regulatory limitations on "Cost of Money" established by the Small Business Administration (SBA). The amendment excluded from these Cost of Money limits any consideration consisting of "contingent obligations" granting the SBIC an interest in the "equity or increased future revenue" of the small business.

SBA received no comments on the proposed rule during the 30-day public comment period and is finalizing the proposed rule without change. The final rule contains the following provisions:

Revised § 107.855(g)(12) allows the exclusion of royalty payments for all SBIC financings. Previously, this exclusion applied only to "LMI Investments" as defined in § 107.50. To qualify for the exclusion, the royalty must be based on improvement in the

performance of the small business after the date of the financing. The royalty could be expressed, for example, as a percentage of any increase in an underlying unit of measurement (*e.g.*, revenues or sales) after the date of the financing. The royalty can be based on an increase in more than one unit of measurement; for example, a royalty could provide for payment to the SBIC if either the revenue or the profits of the small business increased.

If an SBIC makes an investment through a holding company or an investment vehicle, as permitted under § 107.720(b), SBA will evaluate performance improvements by looking through the holding company or investment vehicle to the performance of the operating business itself.

Also with respect to royalty payments, the definition of a Debt Security in § 107.815(a) is revised to include a loan with a right to receive royalties that are excluded from the Cost of Money. As a result, a financing of this type will be subject to the lower Cost of Money ceiling applicable to Debt Securities, rather than the higher ceiling applicable to Loans with no upside potential.

This rule also adds § 107.855(g)(13), which excludes from Cost of Money any gains realized by an SBIC from the disposition of Equity Securities issued by a small business. This provision has been added as a clarification, since SBA's longstanding practice has been to exclude such gains from the Cost of Money limits. For example, if an SBIC receives warrants that qualify as Equity Securities, or converts debt to an Equity Security, any gains realized on the disposition of these interests do not count against the Cost of Money ceiling.

Finally, § 107.855(i) has been removed. This paragraph allowed an SBIC that was lending to a small business to receive a one-time "bonus" at the end of the loan term, contingent upon one or more factors reflecting the performance of the business during the loan period. Such bonus payments were excluded from the Cost of Money. The revision of § 107.855(g)(12), which provides a broader exclusion of contingent payments from the Cost of Money, renders the bonus provision redundant.

#### Compliance With Executive Orders, 12866, 12988, and 13132, the Regulatory Flexibility Act (5 U.S.C. 601, *et seq.*), and the Paperwork Reduction Act (44 U.S.C. Ch. 35).

This final rule does not constitute a "significant" regulatory action within the meaning of section 3(f) of Executive Order 12866 and thus, was not reviewed by the Office of Management and Budget (OMB).

Under the Regulatory Flexibility Act, 5 U.S.C. 601, *et seq.*, SBA has determined that this final rule will not have a significant economic impact on a substantial number of small entities. The purpose of the final rule is to implement a provision of Public Law 106-9 allowing small business investment companies (SBICs) to realize contingent payments, such as royalties, from small businesses without being subject to regulatory limits on the amount of consideration received. Interest and other non-contingent payments made to SBICs by small businesses will continue to be subject to the existing Cost of Money regulations. This provision is expected to be attractive primarily to SBICs considering investments in small businesses that are seeking to grow, but whose owners do not want to give substantial equity interests to outside investors. In such cases, the SBIC can participate in the growth of the business by collecting a royalty rather than through an ownership interest.

Based on recent statistics for the SBIC program, the circumstances that this final rule addresses do not appear to apply to most small businesses currently receiving SBIC financing. In fiscal year 1999, SBICs provided financing to 1,983 different small businesses. In approximately two-thirds of all the financings closed during that year, the SBIC obtained an actual or potential equity interest in the small business; even if the proposed rule had been in place, it is unlikely that these transactions would have included royalty provisions. The remaining one-third of SBIC financings typically consist of loans to very small businesses with low growth potential, which are unlikely to have the ability to make royalty payments under any circumstances. Thus, it is unlikely that this final rule will affect a substantial number of small entities. The final rule is expected to expand financing

opportunities for certain small businesses wishing to grow while remaining closely held, rather than make SBIC financing more expensive for small businesses currently being served by the program.

For purposes of Executive Order 12988, SBA has determined that this final rule is drafted, to the extent practicable, in accordance with the standards set forth in section 3 of that Order.

For purposes of Executive Order 13132, SBA has determined that this final rule has no federalism implications.

For purposes of the Paperwork Reduction Act, 44 U.S.C. Ch. 35, SBA certifies that this final rule contains no new reporting or recordkeeping requirements.

**List of Subjects in 13 CFR Part 107**

Investment companies, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

For the reasons set forth above, SBA is amending 13 CFR part 107 as follows:

**PART 107—SMALL BUSINESS INVESTMENT COMPANIES**

1. The authority citation for part 107 continues to read as follows:

**Authority:** 15 U.S.C. 681 *et seq.*, 683, 687(c), 687b, 687d, 687g and 687m.

2. In § 107.815, revise the first sentence of paragraph (a) to read as follows:

**§ 107.815 Financings in the form of Debt Securities.**

\* \* \* \* \*

(a) *Definitions.* Debt Securities are instruments evidencing a loan with an option or any other right to acquire Equity Securities in a Small Business or its Affiliates, or a loan which by its terms is convertible into an equity position, or a loan with a right to receive royalties that are excluded from the Cost of Money pursuant to § 107.855(g)(12). \* \* \*

\* \* \* \* \*

3. In § 107.855, revise paragraph (g)(12), add paragraph (g)(13) and remove paragraph (i) to read as follows:

**§ 107.855 Interest rate ceiling and limitations on fees charged to Small Businesses (“Cost of Money”).**

\* \* \* \* \*

(g) \* \* \*  
(12) Royalty payments based on improvement in the performance of the Small Business after the date of the Financing.

(13) Gains realized on the disposition of Equity Securities issued by the Small Business.

\* \* \* \* \*

Dated: November 3, 2000.  
**Aida Alvarez,**  
*Administrator.*  
[FR Doc. 00-29522 Filed 11-16-00; 8:45 am]  
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**SMALL BUSINESS ADMINISTRATION**

**13 CFR Part 121**

**Small Business Size Standards; Health Care**

**AGENCY:** Small Business Administration.  
**ACTION:** Final rule.

**SUMMARY:** The Small Business Administration is adopting new size standards for 19 Health Care industries and retaining the existing \$5 million size standard for the remaining 11 Health Care industries. The North American Industry Classification System classifies Health Care industries under Subsector 621, Ambulatory Health Care Services; Subsector 622, Hospitals; and Subsector 623, Nursing and Residential Care Facilities. These revisions are made to more appropriately define the size of businesses in these industries that SBA believes should be eligible for Federal small business assistance programs.

**DATES:** This final rule is effective on December 18, 2000.

**FOR FURTHER INFORMATION CONTACT:** Gary M. Jackson, Assistant Administrator for Size Standards, (202) 205-6618.

**SUPPLEMENTARY INFORMATION:** On May 4, 1999, the Small Business Administration (SBA) proposed revisions to 11 size standards for the Health Care industries (64 FR 23798). At that time, SBA size standards were established for industries defined by the

Standard Industrial Classification (SIC) System. Effective October 1, 2000, SBA established its size standards based on industries defined by the new North American Industry Classification System (NAICS), and no longer uses the SIC System (65 FR 30836, dated May 15, 2000). Accordingly, the changes to the Health Care size standards adopted in this final rule pertain to the NAICS industries.

The NAICS makes several noteworthy changes to the Health Care industries listed in the SIC System. First, the NAICS changes the terminology of the health related industries to “Health Care” from “Health Services” under the SIC System. Second, the NAICS establishes a Sector (equivalent to a Division in the SIC System) titled “Health Care and Social Assistance.” Health Services was a Major Group under the Services Division with 19 industries. The Health Care industries are grouped into three Subsectors (equivalent to a Major Group in the SIC System). Third, the number of Health Care industries increases to 30 NAICS industries from 19 Health Services SIC industries.

SBA has decided to adopt the proposed revisions of May 4, 1999 to the Health Care size standards. Most SIC Health Services industries correspond to a NAICS industry. However, there are some Health Services industries, or activities within an industry, that are combined with other SIC industries to form a new Health Care NAICS industry. In these cases, SBA has followed the guidelines it used to establish NAICS size standards. These guidelines are described in the proposed rule of October 22, 1999 (64 FR 57188) and the final rule of May 15, 2000 (65 FR 30836). In most cases, the NAICS size standard is the same as or higher than the size standard SBA had proposed for the SIC industry. Two activities in one Health Services industry, however, were reclassified into industries outside of the Health Care with a size standard lower than proposed for their SIC industries. The following table lists the proposed size standards by SIC industry and adopted size standards corresponding to the NAICS industries.

SIC code	SIC industry	Proposed size standard (millions of dollars)	NAICS code	NAICS industry	Adopted size standard (millions of dollars)
8011 .....	Offices and Clinics of Doctors of Medicine.	\$7.5			
	Surgical and Emergency Centers .....		621493	Freestanding Ambulatory Surgical and Emergency Centers.	\$7.5