UNITED STATES OF AMERICA
SMALL BUSINESS ADMINISTRATION
OFFICE OF HEARINGS AND APPEALS
WASHINGTON, D.C.

IN THE MATTER OF:	)	
L.D.V., Inc.	)	Docket No. BDP-2006-08-21-14
Petitioner	)	

MEMORANDUM OPINION AND
ORDER DENYING MOTION FOR RECONSIDERATION

On February 12, 2007, Respondent Small Business Administration (SBA) moved for reconsideration of my decision in *Matter of L.D.V., Inc.*, SBA No. BDP-252 (2007). *See* 13 C.F.R. § 134.409(c). On March 5, 2007, Petitioner L.D.V., Inc. (Petitioner), responded to the Motion for Reconsideration (Motion).

I. Respondent SBA's Argument

In its Motion, the SBA first states, correctly, that the standard of review in an 8(a) termination case is whether the written administrative record demonstrates that SBA's termination decision was arbitrary, capricious, or contrary to law. Motion at 1 (citing Small Business Act of 1958, § 8(a)(9)(C), 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b); *Matter of Environmental Technology, Inc.*, SBA No. BDP-232 (2006)). The SBA also states that as long as the SBA's determination is reasonable, it must be upheld. Motion at 1 (citing 13 C.F.R. § 134.406(b)). SBA further notes that my review is narrow and is confined to whether the SBA's decision was based on a consideration of the relevant factors and whether the SBA made a clear error of judgment in reaching its decision. Motion at 1-2 (citing *Matter of Infotech International, Inc.*, SBA No. BDP-205 (2005) (defining clear error of judgment)).

The SBA then argues that my decision was based on a clear error of law because I concluded that the "$600,000 loan did not endow the non-disadvantaged owner with control or the power to control the Petitioner" and the "termination decision based on the loan was unreasonable and not supported by the administrative record." Motion at 3. However, the argument continues, the administrative record "demonstrates that SBA did not terminate L.D.V. solely on the basis of a $600,000 loan." *Id*. "SBA terminated L.D.V. based on the totality of circumstances as evidenced in the administrative record [which] led SBA to reasonably conclude that [Petitioner's disadvantaged owner] did not control the 8(a) firm." *Id*.[1]

[1] Counsel cites evidence from the administrative record that, he argues, warrants Petitioner's termination.

Finally, SBA argues that its termination of Petitioner from the 8(a) program was reasonable, supported by the record, and not arbitrary, capricious, or contrary to law. Motion at 8.

II. Petitioner's Argument

In its response in opposition to the Motion for Reconsideration (Response), Petitioner argues that my decision correctly concluded that the SBA's decision to terminate Petitioner was based upon an improper analysis of the law and the factual record. Thus, my decision contained no clear error of law.

III. Standard for Granting a Motion to Reconsider

I may reconsider an 8(a) decision if there is a clear showing of an error of fact or law material to the decision. 13 C.F.R. § 134.409(c).

IV. Discussion

A.

When the SBA proposes that a participant be terminated from the 8(a) program, it must notify the participant of the specific facts and reasons for the proposed termination, and provide the participant an opportunity to explain why termination is not justified. 13 C.F.R. § 124.304(b). This letter of intent to terminate (Intent Letter) cites the regulatory grounds for termination. After considering any submission by the participant, the SBA may issue a notice of termination (Termination Letter) that explains the facts and reasons for its decision. 13 C.F.R. § 124.304(d).

Here, the Intent Letter cited 13 C.F.R. § 124.303(a)(4) and (5) as the proposed grounds for termination and advised Petitioner that the SBA was concerned with $600,000 of "'Paid in Capital' which reflects ownership" and could give a non-disadvantaged individual the power to control Petitioner. Administrative Record (AR), Ex. 30, at 123. That was the only concern expressed by the SBA. *See id.* The Termination Letter stated SBA's finding, based on Petitioner's submission in response to the Intent Letter, that Petitioner had not adequately explained the circumstances surrounding "the loan or paid-in-capital of $600,000" and terminated Petitioner for violation of 13 C.F.R. § 124.303(a)(4). AR, Ex. 1, at 1-2. Then, the Termination Letter stated SBA's conclusion that a non-disadvantaged individual had the power to control Petitioner under 13 C.F.R. § 124.106(g)(2)-(4). *Id.* The SBA provided Petitioner with no other cause for termination.

Contrary to the assertion of SBA counsel, the SBA did not terminate Petitioner based on the totality of circumstances as evidenced in the administrative record; rather, the only ground cited by the SBA was that the $600,000 loan or paid-in-capital gave a non-disadvantaged individual the power to control Petitioner. In essence, counsel argues that if the administrative record demonstrates a sufficient ground for termination, regardless of what ground the SBA

actually alleged, then it is a legal error for the Administrative Law Judge to fail to sustain the termination. Therefore, I should grant the Motion. This argument is without merit for the following reasons.

B.

The Small Business Act limits the scope of review in an 8(a) appeal. *See* 15 U.S.C. § 637(a)(9)(C). It provides that before terminating an 8(a) program participant, the SBA must give the participant an opportunity for a hearing on the record in accordance with the Administrative Procedure Act, 5 U.S.C. § 551 *et seq.* 15 U.S.C. § 637(a)(9)(A), (B)(ii). The hearing, which is generally referred to as an 8(a) appeal, requires that the SBA's proposed termination action be sustained unless it is found to be arbitrary, capricious, or contrary to law. 15 U.S.C. § 637(a)(9)(C).

The SBA's regulations that implement the Small Business Act provide, in detail, how the SBA terminates an 8(a) participant. *See* 13 C.F.R. §§ 124.301-304 ("Exiting the 8(a) BD Program"). Section 124.303 lists examples of good cause for terminating a participant and § 124.304 sets forth the procedural requirements for terminating a participant. To terminate a participant, the SBA must (1) notify the participant, in writing, of "the *specific facts and reasons for SBA's findings*"; and (2) provide the participant an opportunity to "submit a written response to SBA explaining why the proposed ground(s) [for termination] should not justify termination." 13 C.F.R. § 124.304(b) (emphasis added).

Then, the SBA's Assistant Administrator responsible for 8(a) program certification and eligibility (AA/DPCE) will consider the proposed termination and any information in the participant's response to the SBA. 13 C.F.R. § 124.304(c). If the AA/DPCE believes termination is still warranted, the AA/DPCE will make a recommendation to the SBA's Associate Administrator for Business Development (AA/8(a)BD), who will decide whether to terminate the participant.[2] *Id.*

If the AA/8(a)BD decides to terminate the participant, she will send the participant a Notice of Termination, setting forth "the *specific facts and reasons for the decision*" and its right to appeal the decision. 13 C.F.R. § 124.304(d) (emphasis added).

If the participant appeals, the Administrative Law Judge hearing the appeal is limited to determining whether the SBA's "proposed action" (the termination) is arbitrary, capricious, or contrary to law. 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b).

Thus, my review is not a *de novo* review to decide whether the facts in the administrative record would support any of the potential "good cause" grounds for termination, but rather, it is to decide whether the grounds the SBA chose, as the basis for the termination being appealed, are

[2] The Small Business Act vests termination authority with the AA/8(a)BD. 15 U.S.C. § 636(j)(10)(G).

supported in the administrative record; and that the termination decision is not arbitrary, capricious, or contrary to law.

Here, the SBA argues it was error for me not to have gone beyond the SBA's stated "facts and reasons" for terminating Petitioner and not to have examined *de novo* the administrative record to determine if the record warrants termination. To have done so, however, would have been contrary to the mandate of the Small Business Act and the SBA's regulations.

C.

The Small Business Act and its implementing regulations follow the long-established principles enunciated by the Supreme Court regarding how an agency administrative determination must be reviewed. *See SEC v. Chenery Corp.*, 318 U.S. 80 (1943) (*Chenery I*). The Court noted that it could not exercise its duty of review unless it was advised of the consideration underlying the action under review, and emphasized that it must not set aside an agency action because it might have made a different determination if empowered to do so. *Chenery I*, 318 U.S. at 94. The Court then held "the orderly functioning of the process of review requires that the grounds upon which the administrative agency acted [be] clearly disclosed and adequately sustained" and "an administrative order cannot be upheld unless the grounds upon which the agency acted in exercising its powers were those upon which its actions can be sustained." *Id.* at 94-95.

When the case returned to the Supreme Court a second time for further review, the Court repeated its holding in *Chenery I. SEC v. Chenery Corp.*, 332 U.S. 194 (1947) (*Chenery II*). It made clear:

> When the case was first here, we emphasized a simple but fundamental rule of administrative law. That rule is to the effect that a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action *solely* by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action by substituting what it considers to be a more adequate or proper basis.

Chenery II, 332 U.S. at 196 (emphasis added).[3]

The Administrative Law Judge's review of the AA/8(a)BD's decision to terminate an 8(a) participant is governed by the same standard of review as a federal court's review of an administrative agency decision. *Compare* Small Business Act, § 8(a)(9)(C), 15 U.S.C. § 637(a)(9)(C) ("The Administration's proposed action . . . shall be sustained unless it is found to be arbitrary, capricious, or contrary to law."), *with* Administrative Procedure Act, § 10(e), 5

[3] The *Chenery* holdings continue to be followed. *See Gonzales v. Thomas*, 547 U.S. 183, 126 S.Ct. 1613, 1614-15 (2006) (applying them in a deportation case).

U.S.C. § 706(2)(A) ("The reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."). The Administrative Law Judge's review is therefore limited by the parameters set forth in the *Chenery* decisions and their progeny: (1) it is not *de novo*, *see* 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b); (2) it may not be founded on *post hoc* rationalizations of agency counsel; and (3) it may not be sustained on grounds not addressed by the agency because that would deny the participant adequate notice and opportunity to be heard at the agency level.

D.

The purpose of the 8(a) termination appeal procedures is to provide an 8(a) participant with (1) sufficient notice of the specific facts and reasons on which the SBA is relying to justify terminating the participant; and (2) an adequate opportunity to contest those factual allegations and reasons, before the AA/8(a)BD reaches a termination decision. This process also serves to provide the participant with another opportunity to address, in its appeal, the actual reasons on which the termination was based. This process, at the program level, reflects the fundamental due process requirements of the Fifth Amendment (no person shall be "deprived of . . . property, without due process of law"). *See generally* Richard J. Pierce, Jr., 2 Administrative Law Treatise § 9.5 (4th ed. 2002) (discussing procedural protections mandated by the due process clause of the Fifth Amendment); *see also, e.g., Sniadach v. Family Finance Corp.*, 395 U.S. 337 (1969) (requiring notice and an opportunity to be heard before garnishing wages and implying that similar procedural due process is required in informal adjudications); Henry J. Friendly, *Some Kind of Hearing*, 123 U. Pa. L. Rev. 1267, 1279-94 (1975) (seminal law review article discussing fundamental due process elements required in administrative decision-making, including notice of the proposed action and of the grounds asserted for it, the opportunity to present reasons why the proposed action should not be taken, and a written statement of reasons why the action was taken).

SBA's regulations incorporate these procedural due process rights in the 8(a) program termination procedures. *See* 13 C.F.R. § 124.304(a)-(d); *see supra* Part IV.A.

To permit the SBA to raise a new ground for the termination, i.e., the totality of circumstances as shown by the evidence in the administrative record, after the AA/8(a)BD has made her termination decision and Petitioner has filed its appeal, would deny Petitioner the opportunity to present its reasons why it should not be terminated to the SBA prior to the termination and, as to those reasons not accepted by the SBA, to me in this appeal. Accordingly, to accept the SBA's argument, Petitioner would be denied the procedural due process guarantees of adequate notice of the facts and reasons for its termination and the opportunity to address those facts and reasons.

E.

Counsel's argument that the totality of the circumstances warrants termination here, and that my failure to consider the totality of the circumstances is an error of law warranting reconsideration of *Matter of L.D.V., Inc.*, SBA No. BDP-252 (2007), is without merit. This argument, raised for the first time in this Motion, is an attempt by counsel to substitute his own rationale for Petitioner's termination for that of the AA/DPCE and the AA/8(a)BD (as stated in the Intent Letter and the Termination Letter) who are the only persons authorized by the Small Business Act to initiate and take that action. *See* 15 U.S.C. § 636(j)(10)(G); *compare* Motion at 3, *with* AR, Ex. 1 & 30. Such a substitution of judgment is impermissible. The Supreme Court, on many occasions, has held that so-called *post hoc* rationalizations by an agency's counsel may not be accepted to uphold an otherwise deficient agency determination. *See Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168-69 (1962); *Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 50 (1983). This principle has been followed in 8(a) cases. *See, e.g., Matter of Data Voice, Inc.*, SBA No. MSB-455, at 13 (1994).

Accordingly, in deciding whether the SBA's AA/8(a)BD made an error of law in her decision to terminate Petitioner, I cannot consider counsel's *post hoc* rationalization for the AA/8(a)BD's action.

F.

The SBA's determination is clear and unambiguous. It advised Petitioner that it was concerned with the implications of the $600,000 provided as "'Paid in Capital' which reflects ownership" by a non-disadvantaged individual, and whether that gave the non-disadvantaged individual control or the power to control Petitioner. AR, Ex. 30. Petitioner provided the SBA all of the documents it requested. Then, the SBA concluded that a non-disadvantaged individual "is found to have the power to control the 8(a) concern through the provision of the sizeable loan of $600,000." AR, Ex. 1.

Only after the SBA issued its Termination Letter to Petitioner and Petitioner appealed that determination, did counsel for the SBA assert that the Petitioner could have been terminated for other reasons. *See, e.g.,* Response to the Appeal at 17; Motion at 3 (the "totality of the circumstances" in the case as shown in the administrative record). Thus, counsel argues that my decision, which concluded that the SBA's determination was arbitrary, capricious, and contrary to law because the loan did not give a non-disadvantaged individual the power to control Petitioner, was legally erroneous because I did not consider these other reasons.

In its Motion, the SBA does not make a clear showing of an error of law material to the decision. Instead, it merely argues that the SBA's determination should have been sustained for other reasons. It would be inappropriate for me to address whether those reasons could justify the termination of Petitioner from the 8(a) program. Rather, I must conclude that the Motion for Reconsideration should be denied because (1) I may review the SBA determination only to

determine whether it is arbitrary, capricious, or contrary to law and counsel argues I should go beyond the SBA's determination in deciding whether Petitioner should be terminated; (2) an "arbitrary and capricious" review of the SBA's determination is limited to whether the facts and reasons for the SBA's findings and conclusion are supported in the administrative record; (3) if I accepted the argument that there are other reasons to sustain the SBA's termination decision, I would be denying Petitioner its legal right to be advised of the facts and reasons the SBA used to terminate Petitioner, as well as the opportunity to respond to those reasons, thus denying Petitioner due process of law; and (4) I cannot consider the *post hoc* rationalizations of agency counsel to sustain the SBA's determination.

V. Conclusion

For these reasons, SBA's Motion for Reconsideration is DENIED.

Date: April 13, 2007

RICHARD S. ARKOW
Administrative Law Judge