

**United States Small Business Administration
Office of Hearings and Appeals**

IN THE MATTER OF:

Peniel Solutions, LLC,

Petitioner

SBA No. BDP-336

Decided: December 23, 2009

APPEARANCES

Peter B. Ford, Theodore B. Watson and Associates, LLC, Denver, Colorado, for Petitioner.

Karen H. Holzen, Office of General Counsel, Small Business Administration, Washington, D.C.

DECISION AND REMAND ORDER

I. Introduction and Jurisdiction

On May 12, 2009, the Respondent Small Business Administration (SBA) graduated Peniel Solutions, LLC (Petitioner) from the 8(a) Business Development (8(a) BD) program because the SBA determined that Veronise McGriff, the disadvantaged owner upon whom Petitioner's eligibility is based, is no longer economically disadvantaged. Petitioner appealed the determination on June 24, 2009.

There is jurisdiction to decide this appeal. *See* Small Business Act, § 8(a)(9)(A), (B)(ii); 13 C.F.R. § 134.102(j)(1). The appeal is timely. *See* 13 C.F.R. § 134.202(a)(1).

I find the SBA made mistakes of fact in determining whether to graduate Petitioner early from the 8(a) BD program. I also find the administrative record is insufficiently complete to decide whether the SBA determination is arbitrary, capricious, or contrary to law because it does not show the evidence the SBA relied upon for its conclusion. Thus, the case must be remanded to the SBA for a new determination.

II. Issue

Whether the SBA's graduation of Petitioner from the 8(a) BD program is arbitrary, capricious, or contrary to law. *See* Small Business Act, § 8(a)(9)(C), 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b).

III. Background

On June 5, 2008, the SBA advised Petitioner that its owner, Veronise McGriff, is no longer economically disadvantaged because her two-year average Adjusted Gross Income (AGI) is in the top 2.65% of U.S. taxpayers, which is \$200,000 and above.¹ Administrative Record (AR), Ex. E, Letter of Intent to Graduate Early (Intent Letter). Specifically, SBA stated, based on the information Petitioner submitted, Ms. McGriff's AGI was \$313,357 in 2007 and \$160,499 in 2006, resulting in a two-year average AGI of \$236,928. SBA noted, in accordance with SBA policy and the Office of Hearings and Appeals (OHA) case law, Ms. McGriff's two-year average AGI is excessive because it places her in the top percentile of all taxpayers. *Id.*

On June 23, 2008, Ms. McGriff responded on behalf of Petitioner and stated she believed SBA's calculations erroneously included S corporation taxes she paid. AR, Ex. D. Ms. McGriff cited the statute and SBA Standard Operating Procedure 80-05-3, Ch. 2D, § 5(b)(2) (July 24, 2004) (SOP) to support excluding S corporation taxes paid from her AGI. *Id.* Ms. McGriff stated when S corporation taxes are deducted her average two-year income is \$135,336² and is below the \$200,000 threshold. *Id.* Ms. McGriff also attached a table with the amounts used for her calculation, including what the amount represents, where it appears on her tax form, how much is attributed to her, and how much is attributed to her husband. *Id.*

After considering Petitioner's response, the SBA concluded Petitioner had not overcome the proposed ground for early graduation. AR, Ex. A, Notice of Early Graduation Letter (Graduation Letter). On May 12, 2009, SBA graduated Petitioner early from the 8(a) BD program based on the determination that Petitioner's owner is no longer economically disadvantaged because Ms. McGriff's average two-year income is greater than \$200,000. *Id.* The Graduation Letter stated Petitioner failed to explain or provide any documentation supporting Ms. McGriff's calculation. *Id.* SBA stated there is no evidence that amounts were left in the corporation or that Ms. McGriff's income was taxed at 35% and there is no justification for subtracting state taxes to determine Ms. McGriff's federal AGI. *Id.*

IV. Discussion

A. Standard for Remand

An Administrative Law Judge may remand a case to the SBA for further consideration if he or she determines that "due to the absence in the written administrative record of the reasons upon which the determination was based, the administrative record is insufficiently complete to decide whether the determination is arbitrary, capricious, or contrary to law." 13 C.F.R. § 134.406(e). The Administrative Law Judge may also remand a case for further determination

¹ SBA states this is based on 2005 data, the most recent Internal Revenue Service information available.

² In Petitioner's appeal, Petitioner acknowledges the first page of its response erroneously states Ms. McGriff's two-year average AGI is \$125,336. Petitioner affirms that the amount is actually \$135,336, as it appears in the table of calculations included with her response. AR, Ex. D, at 3.

“where it is clearly apparent from the record that SBA made an erroneous factual finding . . . or a mistake of law” *Id.*

B. Errors Requiring Remand and
Deficiencies in the Administrative Record

First, it is clearly apparent from the administrative record that the SBA made mistakes of fact. The SBA concedes its original analysis of Ms. McGriff’s two-year average AGI includes errors, such as erroneously deducting corporate taxes for 2007, mistakenly attributing Ms. McGriff’s pension funds to her spouse, and overestimating Petitioner’s 2006 S corporation taxes. SBA Response, 3 n.2, 10 n.8. The SBA asserts the errors were discovered before the final determination to graduate Petitioner was made, but there is nothing in the administrative record or the Graduation Letter to support that assertion. The only calculations in the administrative record predate the Intent Letter, AR, Ex. G, H, and SBA acknowledges the amounts used for the Intent Letter calculation were incorrect.

Second, the administrative record is insufficiently complete for me to decide whether the SBA determination is arbitrary, capricious, or contrary to law. In the Intent Letter, SBA states the reason for the proposed early graduation is because Ms. McGriff’s two-year average AGI, \$236,968, exceeds \$200,000 and places her in the top percentile of all taxpayers. AR, Ex. E, Intent Letter, at 2. Petitioner exercised its opportunity to respond to the Intent Letter and provided an explicit calculation to dispute SBA’s assessment that Ms. McGriff’s two-year average AGI exceeded \$200,000. AR, Ex. D. SBA rejected Petitioner’s calculation due to a lack of supporting documentation.³

In fact, Petitioner’s response quoted SBA SOP 80-05-3, Ch. 2D, § 5(b)(2), “How Does the BOS Determine if an Individual is Economically Disadvantaged?” to explain why Ms. McGriff thought her deductions were valid. AR, Ex. D. Petitioner did not submit documentation, but it was not required to do so. There is nothing in the administrative record that indicates Petitioner should not be considered credible; Petitioner had been eligible for the 8(a) program and was apparently acting in good faith as a participant. In such circumstances, the SBA has to provide a clear explanation of why it intends to graduate Petitioner so that Petitioner has an opportunity, if possible, to preserve its status. Although SBA did not accept Petitioner’s calculation, the SBA did not explain why it found the merits of Petitioner’s position invalid or inconsistent with other evidence in the administrative record. Moreover, the administrative record does not include the SBA’s calculation for Ms. McGriff’s two-year average AGI or explain why her two-year average AGI exceeds \$200,000. Thus, it is impossible for me to evaluate the SBA’s basis for graduating Petitioner early or to decide if the SBA erred in calculating Ms. McGriff’s two-year average AGI.

Third, the Intent Letter and the Graduation Letter are defective because they do not provide Petitioner with sufficient information to permit it to formulate an appeal that addresses

³ Petitioner filed supporting evidence with its appeal but that evidence, not being in the written administrative record that was before the SBA when it issued the Graduation Letter, is inadmissible here. Appeal; 13 C.F.R. §§ 134.406(a), 134.407.

the concerns of the SBA. The letters do not state which amounts the SBA relied upon in calculating Ms. McGriff's AGI for 2006 and 2007 to conclude early graduation was appropriate. In the Graduation Letter, SBA simply states Petitioner is no longer eligible because Ms. McGriff's two-year average AGI is greater than \$200,000.

Additionally, SBA's assertion that it is SBA's practice to deduct federal S corporate taxes, but not state S corporate taxes is problematic given the text of the SOP. The SOP states, "SBA excludes any portion of an individual's income used to pay S Corporation taxes from his or her adjusted gross income in determining economic disadvantage." SOP 80-05-3, Ch. 2D, § 5(b)(2). The SOP does not make a distinction between federal and state taxes.

Accordingly, it is apparent that the SBA made mistakes of fact in deciding whether to graduate Petitioner early from the 8(a) BD program. Additionally, the administrative record, by failing to explain and disclose the calculation demonstrating Petitioner's owner's two-year average AGI exceeded \$200,000, is an insufficiently complete record on which to decide whether the SBA's determination is arbitrary, capricious, or contrary to law. The case must be remanded to the SBA to issue a new determination correcting its mistakes and to provide a sufficiently complete administrative record to permit a review of the evidence. *See* 13 C.F.R. § 134.406(e).

V. Conclusion

The case is REMANDED to the SBA for further consideration and a new determination of Petitioner's continued eligibility for the 8(a) BD program that is consistent with this Decision and Remand Order. *See* 13 C.F.R. § 134.406(e).

The SBA is ORDERED to consider all of the evidence submitted by Petitioner to the SBA, including evidence submitted during the pendency of this appeal. If the SBA determines that early graduation is appropriate, the SBA is FURTHER ORDERED to file and serve Petitioner with a new letter of intent to graduate early (new intent letter) no later than 30 days from the date of this Decision and Remand Order. The new intent letter should provide Petitioner with the rights required by 13 C.F.R. § 124.304.

BRENDA P. MURRAY
Administrative Law Judge