

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

IN THE MATTER OF:

QC Management, Inc.

Petitioner

SBA No. BDP-346

Decided: March 31, 2010

REMAND ORDER

For the reasons discussed below, both the letter of intent to graduate from the 8(a) Business Development (BD) program and the notice of early graduation that the Small Business Administration (SBA) issued to QC Management, Inc. (Petitioner) are legally deficient. Thus, I am remanding this matter to SBA. 13 C.F.R. § 134.406(e). SBA is ordered to conduct a complete review to determine whether Petitioner's owner continues to be impaired in his ability to compete in the free enterprise system due to diminished capital and credit opportunities. 13 C.F.R. § 124.104. If SBA determines that early graduation is appropriate, SBA is ordered to file and serve Petitioner with a new letter of intent to graduate Petitioner early from the 8(a) BD program explaining why Petitioner's owner is no longer impaired in his ability to access capital and credit opportunities.

I. Background

On February 26, 2009, SBA sent Petitioner a letter notifying Petitioner of its intent to graduate Petitioner from the 8(a) BD program prior to the expiration of Petitioner's program term. SBA stated Petitioner's disadvantaged owner, upon whom eligibility is based, is no longer economically disadvantaged because his two-year average adjusted gross income (AGI) indicates he is no longer economically disadvantaged. SBA determined Petitioner's owner's two-year average AGI is greater than \$200,000 and places him within the top percentiles of all United States taxpayers.

On March 23, 2009, Petitioner disagreed with SBA's conclusion and requested reconsideration. Petitioner objected to SBA's methodology and asserted SBA failed to follow the provisions of the Small Business Act of 1958, § 8(a), as amended, 15 U.S.C. § 637(a). Additionally, Petitioner asserted that SBA failed to articulate a reasonable explanation for its action, including a rational connection between the facts found and SBA's determination.

On June 10, 2009, SBA graduated Petitioner early from the 8(a) BD program. SBA noted Petitioner's response did not overcome the reasons cited for early graduation and found Petitioner's disadvantaged owner, upon whom eligibility is based, is no longer economically disadvantaged under 13 C.F.R. § 124.302(a)(2) and § 124.104(c). SBA reiterated that SBA has compared 8(a) BD participant's owner's income to all individual taxpayers for many years and that the Office of Hearings and Appeals (OHA) has found this comparison to be a reasonable

basis to find that an individual participating in the 8(a) BD program is not economically disadvantaged.

SBA rebutted Petitioner's allegations that SBA failed to distinguish between initial and continuing eligibility by stating that the only difference between initial and continuing eligibility concerns net worth which is not the basis of SBA's determination to graduate Petitioner early. In response to Petitioner's assertion that individuals with \$200,000 are not within the top 2% of taxpayers, SBA noted it is not bound by a fixed percentage and that it is reasonable to conclude that individuals with an AGI of \$200,000 are not economically disadvantaged. Additionally, SBA stated Petitioner's owner's income is within the top 1% of all taxpayers. SBA also dismissed Petitioner's owner's claim that distributions reported on Internal Revenue Service (IRS) Schedule K-1 were used to pay down his mortgage to obtain bonding for Petitioner; SBA reasoned a bonding firm generally looks at the financial strength of the business and would not require individuals to take funds out of the business.

On July 30, 2009, Petitioner appealed SBA's early graduation decision to OHA. Petitioner argues SBA's decision to graduate Petitioner early is arbitrary, capricious, and contrary to law because SBA relied on an internal policy defining substantial personal income which has never been adopted by formal rulemaking. Petitioner asserts SBA's failure to define substantial personal income under 13 C.F.R. § 124.112(c)(2) through formal rulemaking circumvents the notice and comment procedures required by the Administrative Procedure Act (APA), 5 U.S.C. § 553. To support its argument, Petitioner cites *Owner-Operator Independent Drivers Association, Inc. v. Federal Motor Carrier Safety Administration*, 494 F.3d 188 (D.C. Cir. 2007) and *Chamber of Commerce of United States v. Securities Exchange Commission*, 443 F.3d 890, 909 (D.C. Cir. 2006).

Additionally, Petitioner argues the SBA's decision to graduate Petitioner early from the 8(a) BD program is incomplete and inconsistent with SBA's regulations and fails to consider that Petitioner's owner used K-1 distributions to pay down his personal mortgage in order to obtain bonding for Petitioner. Petitioner asserts SBA's determination: is based on "excessive" income, where the regulation speaks to "substantial" income; states income for SBA purposes is not always the same as for IRS purposes, but provides no explanation; assumes Petitioner's owner's personal income for 2006 and 2007 places him the top percentiles of taxpayers based on a comparison with 2006 IRS tax statistics; does not compare Petitioner's owner's personal income against similar small businesses; and admits SBA is not bound by a fixed percentage, yet disqualifies Petitioner's owner for being in the top 2% of taxpayers.

## II. Motion to Dismiss or for Summary Decision

### A. SBA's Motion

On September 28, 2009, SBA moved to dismiss for lack of jurisdiction or, in the alternative, for summary decision.

SBA argues OHA's jurisdiction is limited to whether SBA's determination is arbitrary, capricious, or contrary to law and does not include whether SBA's methodology violates the rulemaking requirements of the APA. Additionally, SBA asserts Petitioner's appeal does not state any facts that refute SBA's grounds for graduation and SBA is entitled to a decision in its favor as a matter of law.

SBA states OHA has repeatedly found SBA's methodology for determining economic disadvantage, comparing an individual's personal income with all other taxpayers, to be reasonable. SBA asserts it compared Petitioner's average personal income for 2006 and 2007 to IRS statistics for 2006. SBA states based on IRS statistics Petitioner's owner is just below the top 1% of taxpayers for 2006 and it was reasonable for SBA to conclude Petitioner's owner was no longer economically disadvantaged. SBA cites *Matter of Zin Technologies, Inc.*, SBA No. SDBA-170, at 7 (2006), to support SBA's contention that it is not bound to a fixed percentage when defining economic disadvantage. In response to Petitioner's assertion that SBA did not measure Petitioner's owner's income against similar small businesses, SBA cites *Matter of Autek Systems Corporation*, SBA No. MSB-417, *after remand*, SBA No. MSB-420 (1992), *aff'd sub nom. Autek Systems Corp. v. U.S.*, 835 F. Supp. 13, 15 (D.D.C. 1993), *aff'd*, 43 F.3d 712 (D.C. Cir. 1994) (per curiam) (unpublished opinion), and argues SBA is not required to compare a socially disadvantaged owner's financial condition to the financial condition of nonsocially disadvantaged owners in similar businesses.

SBA asserts Petitioner does not deny Petitioner's owner's personal income places him in the top percentiles of individual taxpayers. Accordingly, SBA argues OHA should grant SBA's motion for summary judgment because SBA acted reasonably in graduating Petitioner from the 8(a) BD program early and Petitioner fails to assert any evidence to support Petitioner's contention that SBA acted unreasonably in graduating Petitioner.

#### B. Petitioner's Response to SBA's Motion

On October 19, 2009, Petitioner responded to SBA's motion to dismiss or for summary decision. Petitioner argues SBA's assertion that OHA does not have authority to determine whether SBA's methodology violates the rulemaking requirements of the APA is contrary to 13 C.F.R. § 134.406(b). Petitioner asserts OHA clearly has jurisdiction to review errors of law, in addition to errors of fact, and Petitioner argues SBA has violated its obligations under the APA by failing to use its rulemaking authority to define substantial personal income. Moreover, Petitioner states its appeal does cite facts that, if proven true, would warrant reversal, specifically that SBA's failure to define substantial personal income violates the APA and that SBA's findings are incomplete and inconsistent with SBA regulations.

### III. Discussion

#### A. Jurisdiction

The Small Business Act and SBA regulations limit the jurisdiction of an administrative law judge to hear appeals in SBA 8(a) BD program determinations. 15 U.S.C. § 637(a)(9)(E)(i); 13 C.F.R. § 134.405(a). I am required to decline jurisdiction when the "appeal does not, on its face, allege facts that, if proven to be true, would warrant reversal or modification of the

determination.” 13 C.F.R. § 134.405(a)(1). Petitioner argues SBA’s decision to graduate Petitioner is arbitrary, capricious, and contrary to law because SBA relied on an internal policy defining substantial personal income and the determination is incomplete and inconsistent with SBA regulations. Petitioner’s allegations, if true, would warrant reversal or modification of the determination. Accordingly, I accept jurisdiction of this appeal. The SBA’s motion to dismiss for lack of jurisdiction is DENIED.

### B. Summary Decision

Summary decision is also inappropriate. Petitioner’s appeal raises genuine issues of law and fact and survives summary decision. Accordingly, SBA’s motion for summary decision is DENIED. 13 C.F.R. §§ 134.212(a), 134.408(a).

### C. Remand

When the SBA proposes that a participant be graduated from the 8(a) BD program prior to the expiration of the participant’s program term, SBA must notify the participant of the specific facts and reasons for the proposed early graduation in writing and provide the participant an opportunity to explain why early graduation is unjustified. 13 C.F.R. § 124.304(b). This letter of intent to graduate early (Intent Letter) issued by the SBA cites the regulatory grounds for early graduation. After considering any submission by the participant, the SBA may issue a notice of early graduation (Graduation Letter) that explains the facts and reasons for SBA’s decision. 13 C.F.R. § 124.304(d).

Here, the Intent Letter cited 13 C.F.R. § 124.302(a)(2) as the proposed grounds for graduation and advised Petitioner’s owner that his average two-year income indicates he is no longer economically disadvantaged. The Graduation Letter stated SBA’s finding that Petitioner had not overcome the reasons cited for early graduation. The reasons SBA cited for graduating Petitioner early from the 8(a) BD program are: “One or more of the disadvantaged owners upon whom the Participant’s eligibility is based are no longer economically disadvantaged, 13 C.F.R. § 124.302(a)(2) and 13 C.F.R. § 124.104(c).” Letter from Joseph P. Loddo, Associate Administrator, Office of Business Development, to Mr. Quynh Ngo, President, QC Management, Inc. (June 10, 2009).

SBA’s Intent Letter and Graduation Letter are legally deficient and conflict with the regulations cited as a basis for early graduation. SBA’s Intent Letter and Graduation Letter frame the issue around the amount of Petitioner’s owner’s income, but, in accordance with 13 C.F.R. § 124.104, the legal inquiry in determining whether an individual is economically disadvantaged is whether the individual’s ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities. OHA case law has approved SBA’s examination of an owner’s personal income in evaluating economic disadvantage. However, the Intent Letter and Graduation Letter do not explain how Petitioner’s owner’s income renders Petitioner ineligible based on the regulatory definition of economic disadvantage.

Section 124.302(a) states “SBA may graduate a firm from the 8(a) BD program prior to the expiration of its Program Term where SBA determines” the firm has successfully completed the 8(a) BD program or, under § 124.302(a)(2), “One or more of the disadvantaged owners upon whom the Participant’s eligibility is based are no longer economically disadvantaged.” Section 124.104(a) defines an economically disadvantaged individual as a socially disadvantaged individual “whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same or similar line of business who are not socially disadvantaged.” Section 124.104(c) reiterates that the focus of determining economic disadvantage is “diminished capital and credit opportunities”:

(c) *Factors to be considered.* In considering diminished capital and credit opportunities, SBA will examine factors relating to the personal financial condition of any individual claiming disadvantaged status, including personal income for the past two years (including bonuses and the value of company stock given in lieu of cash), personal net worth, and the fair market value of all assets, whether encumbered or not. SBA will also consider the financial condition of the applicant compared to the financial profiles of small businesses in the same primary industry classification, or, if not available, in similar lines of business, which are not owned and controlled by socially and economically disadvantaged individuals in evaluating the individual’s access to credit and capital. The financial profiles that SBA compares include total assets, net sales, pre tax profit, sales/working capital ratio, and net worth.

*Id.*

Notwithstanding the regulations emphasis on diminished capital and credit opportunities, the Intent Letter and Graduation Letter do not indicate how Petitioner’s owner has overcome diminished access to capital and credit opportunities since Petitioner was admitted into the 8(a) BD program and the Graduation Letter does not address the persuasive facts that SBA relied on in evaluating Petitioner’s response regarding Petitioner’s inability to secure bonding. The Intent Letter and Graduation Letter are required to set forth the specific facts and reasons for SBA’s findings. 13 C.F.R. § 124.304(b), (d).

Accordingly, I am remanding this matter to allow SBA to review whether Petitioner’s owner continues to be impaired due to diminished capital and credit opportunities and, if appropriate, SBA may issue a new Intent Letter that cites the relevant regulatory provision, states the facts relied upon, and informs Petitioner of SBA’s analysis.

#### IV. Conclusion

The case is REMANDED to the SBA for further consideration of Petitioner’s continued eligibility for the 8(a) BD program that is consistent with this Remand Order. 13 C.F.R. § 134.406(e). 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 no later than 45 days from the date of this Remand Order. The new letter of intent to graduate early should

provide Petitioner with the rights required by 13 C.F.R. § 124.304 and articulate the specific regulations, facts, and reasons SBA is relying on to justify graduating Petitioner prior to the expiration of its 8(a) BD program term.

---

BRENDA P. MURRAY  
Administrative Law Judge