

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

IN THE MATTER OF:

Office Design Group, Inc.,

Petitioner

SBA No. BDP-355

Decided: June 3, 2010

APPEARANCES

J. Russell Smith, Chief Executive Officer, Office Design Group, Irvine, California.

Meagan K. Geurzon, Office of General Counsel, Small Business Administration,
Washington, D.C.

DECISION

I. Introduction and Jurisdiction

On January 13, 2010, Office Design Group, Inc. (Petitioner) appealed a Small Business Administration (SBA) determination denying Petitioner entry into the 8(a) Business Development (BD) program. SBA found Petitioner ineligible for the 8(a) BD program because Petitioner could not provide sufficient documentation: (1) to establish that J. Russell Smith, the disadvantaged owner upon whom Petitioner's eligibility is based, holds the highest officer position in the firm; or (2) to demonstrate compliance with the requirements governing the participation of non-disadvantaged individuals. Petitioner claims the SBA's decision is arbitrary and capricious. I find the SBA considered all of the facts presented by Petitioner, correctly applied the law to those facts, and reached a reasonable decision. Thus, the SBA's decision was not arbitrary, capricious, or contrary to law, and the appeal must be denied.

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

II. Issue

Whether the action of the SBA denying Petitioner admission into the 8(a) BD program is arbitrary, capricious, or contrary to law. 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b).

III. Background

A. Facts

On September 17, 2009, SBA issued a letter to Mr. Smith informing him that Petitioner's request for admission to the 8(a) BD program was denied. Administrative Record (AR), Ex. 7. The SBA cited seven reasons for the denial: (1) Mr. Smith did not own fifty-one percent of the firm; (2) Mr. Smith did not hold the highest officer position; (3) Mr. Smith did not control the firm; (4) Petitioner did not comply with the requirements governing the participation of non-disadvantaged individuals and entities; (5) Petitioner did not have potential to successfully meet the business development objectives of the 8(a) BD program; (6) SBA could not determine if Petitioner and its principals satisfy SBA's good character requirement; and (7) SBA could not determine whether Petitioner was operating as a broker. *Id.*

On October 15, 2009, Petitioner requested SBA reconsider its initial decline and addressed the reasons for SBA's decline in detail. AR, Ex. 4.

On December 4, 2009, SBA declined Petitioner's application for the 8(a) BD program. AR, Ex. 1. SBA notified Petitioner that, following a review of its application and supporting documentation, Petitioner was unable to establish that Mr. Smith holds the highest officer position in the firm or to demonstrate compliance with the requirements governing the participation of non-disadvantaged individuals. *Id.*

B. Appeal

On January 13, 2010, Petitioner appealed SBA's decline. Petitioner argues it has addressed SBA's concerns regarding who holds the highest officer title in the company and the opportunity for a non-disadvantaged individual, Therese Smith, to exercise negative control over the company.

First, Petitioner explains that titles have nothing to do with who controls Petitioner. Petitioner argues Mrs. Smith holds the title of president to assist in the sales effort. Petitioner states it held a special board meeting to amend the bylaws to give Mr. Smith the title of Chief Executive Officer (CEO). Petitioner asserts Mr. Smith is the CEO and the final authority on matters regarding Petitioner.

Petitioner argues it is impossible to address SBA's concerns about a non-disadvantaged individual exercising negative control. Petitioner states Mr. and Mrs. Smith run Petitioner together. Petitioner states there is a division of responsibilities, but those responsibilities often overlap. Petitioner disputes SBA's reliance on the fact Mrs. Smith receives a salary from Petitioner and Mr. Smith does not receive a salary. Petitioner states Mr. Smith is not receiving a salary because Petitioner cannot afford it. Petitioner states the lack of salary does not indicate Mr. Smith does not work for Petitioner. Petitioner encourages SBA to check with every government agency with whom Petitioner is registered. Petitioner states Mr. Smith is the main contact and in most cases the only contact with the federal government.

Petitioner argues that it has satisfied SBA's concerns regarding the highest officer title and influence from a non-disadvantaged individual and for SBA to hold otherwise is capricious and arbitrary.

C. SBA's Answer

On March 15, 2010, SBA filed its answer and a copy of the administrative record.

SBA argues Mr. Smith does not hold Petitioner's highest officer position. SBA states in July of 2009 Petitioner's board of directors held a meeting and changed Mr. Smith's title from secretary to CEO. The SBA does not dispute that Mr. Smith is Petitioner's CEO, but notes Petitioner's corporate by-laws were not amended to reflect the creation of the CEO position or to modify the president's duties. SBA reviewed Petitioner's corporate by-laws which only account for a president, a vice president, a secretary, and a treasurer. SBA states the meeting minutes from the July 1, 2009 and the October 9, 2009 board of directors meetings do not reflect that the directors agreed that the CEO position would be considered a higher position than the president. Thus, SBA argues Mrs. Smith remains the president and highest officer of the company.

Additionally, SBA asserts Petitioner did not comply with the regulations governing the participation of a non-disadvantaged owner. Specifically, SBA asserts Petitioner has not complied with 13 C.F.R. § 124.106(e) because Mrs. Smith has the power to control Petitioner. SBA states Mrs. Smith, the non-disadvantaged owner of Petitioner, actively participates in the business as president, is the highest compensated officer, and is the only owner and manager with any background in Petitioner's industry. Additionally, SBA notes, according to Petitioner's bylaws, the president is the highest position in the firm and Petitioner pays Mrs. Smith \$26,400 annually where Mr. Smith does not receive a salary. SBA states Petitioner's explanation that it is not in a position to pay Mr. Smith a salary does not explain why Mrs. Smith, Mr. Smith's spouse, receives a salary when Mr. Smith does not.

SBA argues Mrs. Smith's compensation is a reflection of her control over the company which is supported by her experience in interior design. SBA states Mrs. Smith has an associate's degree in interior design technology and marketing management and professional experience as an interior designer, manager, and sales associate at three different interior design firms. SBA notes Mr. Smith's professional experience prior to Petitioner was not in interior design, but as an executive and sales manager at a waste water treatment company, an executive at a sanitation supply company, and an executive at a chemical engineering firm. SBA stresses that Mrs. Smith is the only officer and manager with interior design experience and SBA asserts Mr. Smith is dependent on Mrs. Smith's industry knowledge.

SBA states 13 C.F.R. § 124.106(a)(2) is clear that a disadvantaged individual must control the day-to-day operations of the 8(a) BD applicant, including holding the highest officer position in the firm, and 13 C.F.R. § 124.106(e) limits participation by non-disadvantaged owners. SBA states Petitioner neither provided sufficient evidence to demonstrate that Mr. Smith controls the Petitioner nor sufficient evidence to overcome SBA's determination that a non-disadvantaged individual may exercise negative control over Petitioner.

IV. Discussion

A. Standard of Review.

The SBA's determination must be sustained unless a review of the written administrative record demonstrates the SBA acted arbitrarily, capriciously, or contrary to law in concluding that Mr. Smith does not hold the highest officer position and that Petitioner is not in compliance with the requirements governing the participation of non-disadvantaged individuals. 13 C.F.R. § 134.406(b).

My review of the administrative record is narrow and does not permit me to substitute my own judgment for that of the SBA. I must examine whether the SBA considered all of the facts presented as well as the laws and regulations that guide the decision-making process. Then, I must determine whether the SBA made a clear error of judgment in its decision before I can find the SBA acted arbitrarily, capriciously, or contrary to law. *See Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

A clear error of judgment can be found if the SBA (1) fails to properly apply the law and regulations to the facts of the case; (2) fails to consider an important aspect of the problem; (3) offers an explanation for its determination that runs contrary to the evidence; or (4) provides an implausible explanation that is more than a difference between my views and those of the SBA. In sum, the SBA must articulate a reasonable explanation for its action, including a rational connection between the facts found and its determination. *Id.* As long as the SBA's determination is reasonable, it must be upheld on appeal. 13 C.F.R. § 134.406(b).

B. Preliminary Matters

Petitioner attached a copy of the minutes from Petitioner's December 18, 2009 board of directors' meeting to its appeal. In its answer, SBA objected to Petitioner's new evidence. Petitioner's new evidence was not in existence at the time SBA issued its determination on December 4, 2009 and, accordingly, is not a part of the administrative record. In accordance with 13 C.F.R. §§ 134.406 and 134.407, this proceeding will be decided solely on a review of the written administrative record and the minutes of Petitioner's December 18, 2009 board of directors' meeting will not be considered.

C. Failure to Achieve 8(a) BD Program Eligibility

To be eligible to participate in the 8(a) BD program, a concern must meet all 8(a) BD eligibility criteria. 13 C.F.R. §§ 124.101-124.108. These criteria include a requirement that disadvantaged individuals own, manage, and control the concern. 13 C.F.R. § 124.101.

One characteristic of disadvantaged control is that the concern's disadvantaged full-time manager holds the highest officer position. 13 C.F.R. § 124.106(a)(2). Another is that non-disadvantaged individuals involved in the management of an applicant may not exercise actual control or have the power to control the applicant and cannot receive compensation from the applicant that is greater than the compensation received by the disadvantaged highest ranking officer. 13 C.F.R. § 124.106(e). Although 13 C.F.R. § 124.106(e)(3) allows a disadvantaged

highest ranking officer to elect to take a lower salary than a non-disadvantaged individual, the regulation requires the applicant to demonstrate that the compensation arrangement helps the concern. *Id.* Absent such a showing, such excessive compensation creates a presumption that the non-disadvantaged individual impermissibly controls the concern. *Matter of Oak Hill Rehabilitation Specialists, Inc.*, SBA No. BDP-154, at 5 (2001); 13 C.F.R. § 124.106(e)(3).

On appeal, Petitioner acknowledges that Mrs. Smith is Petitioner's president, but argues that titles have nothing to do with who controls Petitioner. Petitioner indicates it held a special interim board of directors meeting, amended the bylaws, and gave Mr. Smith, the disadvantaged individual upon whom eligibility is based, the title of CEO.

I have reviewed the minutes from Petitioner's special interim board meetings and Petitioner's bylaws. The minutes of Petitioner's July 1, 2009 board meeting changed Mr. Smith's title to CEO and retained Mrs. Smith's title as president. AR Ex. 14 at 22. The minutes of Petitioner's October 9, 2009 board meeting are clear that the sole intent of the meeting was to establish that Mr. Smith is the CEO and chairman of the corporation. *Id.* at 20. Petitioner's bylaws discuss the duties of the president, vice president, secretary, and treasurer. AR, Ex. 16 at 59. Petitioner's bylaws identify the president as exercising a general supervision over the affairs of the corporation. *Id.* Petitioner's bylaws do not acknowledge the position of CEO. AR Ex. 16 at 61-66. SBA relies on business organization documentation to ensure that the officer position held by the disadvantaged full-time manager is authorized to manage the day-to-day management of the firm. *See* 8(a) BD Standard Operating Procedure 80 05 3A Ch. 2D § 7(b)(4). Accordingly, based on the information Petitioner provided it, SBA's decision that the disadvantaged individual does not hold Petitioner's highest officer position was not arbitrary, capricious, or contrary to law.

With respect to SBA's determination regarding the participation of non-disadvantaged individuals and the potential for negative control, Petitioner concedes that Mrs. Smith's compensation from Petitioner exceeds Mr. Smith's, who does not receive a salary from Petitioner. The regulation, 13 C.F.R. § 124.106(e)(3), allows a disadvantaged officer to take a lower salary than a non-disadvantaged individual upon demonstrating that it helps the concern. Petitioner provides no evidence that the greater compensation paid to Mrs. Smith helps Petitioner. Petitioner states Mr. Smith is not receiving a salary because Petitioner cannot afford to pay Mr. Smith at this time, but Petitioner's justification does not explain why Petitioner can and is paying Mrs. Smith, the non-disadvantaged individual. In sum, Petitioner acknowledges the facts on which the SBA based its determination and has failed to show how Mrs. Smith's excessive compensation helps Petitioner.

Based on the evidence before it at the time of its determination, the SBA reasonably concluded that Mrs. Smith, a non-disadvantaged individual, received greater compensation than Mr. Smith, the disadvantaged individual upon whom eligibility is based, and Petitioner failed to demonstrate that the compensation arrangement helps Petitioner. Accordingly, because Petitioner failed to demonstrate that excessive compensation was in Petitioner's best interest, the SBA reasonably concluded that Petitioner is not in compliance with the 8(a) BD regulation regarding the involvement of non-disadvantaged individuals. 13 C.F.R. § 124.106(e).

Thus, the SBA's determination that Petitioner does not meet the eligibility requirements for the 8(a) BD program is reasonable and not arbitrary, capricious, or contrary to law.

V. Conclusion

The Small Business Administration's determination denying Petitioner entry into the 8(a) BD program is not arbitrary, capricious, or contrary to law. 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b).

Subject to 13 C.F.R. § 134.409(c), this is the final decision of the Small Business Administration and is binding on the parties. 15 U.S.C. § 637(a)(9)(D); 13 C.F.R. § 134.408(a).

BRENDA P. MURRAY
Administrative Law Judge