Cite as: *Matter of The Desa Group, Inc.*, SBA No. BDPT-543 (2015)

United States Small Business Administration
Office of Hearings and Appeals

IN THE MATTER OF: The Desa Group, Inc. Petitioner	SBA No. BDPT-543 Decided: February 5, 2015

DECISION

On September 18, 2014, The Desa Group, Inc., ("Petitioner" or "TDG") appealed a determination by the Small Business Administration terminating Petitioner's participation in the 8(a) Business Development Program ("8(a) BD Program"). See 13 C.F.R, parts 124 and 134. On November 14, 2014, the SBA filed an *Answer* and a certified Administrative Record in response to the *Appeal Petition*. This case is now before this Court pursuant 13 C.F.R. §§ 124.206(a) and 134.102(j)(l) to determine whether the SBA's decision was arbitrary, capricious. or contrary to law.[1]

I. Procedural History

Petitioner was admitted into the 8(a) BD Program on September 30, 2010, based on the socially and economically disadvantaged status of its owner, Ms. Dionne Fleshman. On October 11, 2012, the SBA received a tip that Ms. Fleshman did not actually work full-time at Petitioner, as is required by SBA regulations. Rather, the tip alleged that Ms. Fleshman worked for DESA Inc. ("DESA" or "DI"), a company owned by her mother, Ms. Diane Sumpter. DESA graduated from the 8(a) BD Program in 1997. The SBA initiated an investigation into Petitioner based on the tip.

On February 14, 2013, the SBA's South Carolina District Office notified Petitioner that it intended to terminate Petitioner's involvement in the 8(a) Program because Petitioner had allegedly violated several SBA regulations both before and after it was admitted into the Program. Petitioner responded to the Intent to Terminate Letter ("Letter of intent") on March 19, 2013. The SBA issued a Notice of Termination ("Termination Letter") on July 31, 2013. The *Appeal Petition* followed relatively soon thereafter. The proceeding was transferred to this Court on September 19, 2014.

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[1] Pursuant to an Interagency Agreement in effect beginning October 1, 2012, Administrative Law Judges of the U.S. Department of Housing and Urban Development are authorized to hear cases for the U.S. Small Business Administration.

On December 4, 2014. Petitioner filed an *Objection to the Administrative Record*, citing the omission of several documents. Both parties successfully sought to supplement the Administrative Record with additional information. The matter is now ripe for decision.

II. Applicable Law

A. Participation in the 8(a) BD Program

The 8(a) BD Program was developed to help eligible small businesses compete in the American economy. 13 C.F.R. § 124.1. To be eligible. a business must be able to demonstrate potential for success and be owned and controlled by one or more socially and economically disadvantaged individuals who are of good character and are United States citizens. 13 C.F.R. § 124.101. Once admitted into the Program, a firm remains a participant for nine years, but may be graduated or terminated from the Program prior to term completion if circumstances warrant. Termination is warranted if the company fails to maintain its eligibility; i.e., if it is no longer owned by a disadvantaged individual or the individual is no longer determined to be of good character. A company may also be terminated for good cause. as illustrated at 13 C.F.R. § 124.303(a). A "material breach of any terms and conditions of the 8(a) BD Program Participation Agreement" constitutes good cause for terminating a company's participation in the Program. 13 C.F.R. § 124.303(a)(19). Prior to termination, the SBA must first notify the participant in writing of its intent, state "the specific facts and reasons for SBA's findings," and allow the participant 30 days to respond to the allegations. 13 C.F.R. § 124.304(b).

B. Standard of Review

The SBA's decision to terminate a participant's enrollment in the 8(a) BD Program can only be overturned if the reviewing court concludes - after considering the entire administrative record - that the determination was arbitrary, capricious, or contrary to law. 5 U.S.C. § 706(A)(2); 13 C.F.R. § 134.402, 134.406(a)-(b):. The reviewing court's task is to decide whether the agency reached a reasonable conclusion in light of the facts available in the administrative record. It does not ask whether the conclusion was the best one, or even a correct one. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29 (1983); *Griffis v. Delta Familv-Care Disability*, 723 F.2d 822, 825 (11th Cir. 1984) ("This court's judicial role is limited to determining whether the [agency's] interpretation was made rationally and in good faith - not whether it was right."); *Ace Technical*, SBA No. SDBA-178. p. 3 (2008) ("[Examination] is not a *de novo* review of the administrative record to decide whether the SBA's ultimate conclusions are correct."). Any reasonable conclusion must be upheld, even if it differs from the conclusion the reviewing court would have reached. *State Farm*, 463 U.S. at 42-43; *Citizens to Preserve Overton Park. Inc. v. Volpe*, 401 U.S. 402, 416 (1971); 13 C.F.R. § 134.406(b). If there are multiple grounds cited for the SBA's decision, and at least one of the grounds is reasonable, the decision cannot be found to be arbitrary, capricious, or contrary to law. *NAMO, LLC*, SBA No. BDP-458 (2012); *Alabasi*, SBA No. BDP-368 (2010); *Garza Telecomms., Inc.*, SBA No. MSB-620 (1998).

An agency's conclusion is unreasonable, and thus arbitrary and capricious, if it constitutes a "clear error of judgment." *State Farm*, 463 U.S. at 43; *Southern Aire Contracting. Inc*., SBA No. BDP-505 (2012); *StrategyGen Co*., SBA No. BDP-427, p. 5 (2012). Such error occurs if the agency (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 decision that runs counter to the evidence; or, (4) offers an explanation that is so implausible that it cannot be ascribed to a mere difference in view between the agency and the Court. *Southern Aire*, SBA No. BDP-505.

III. Discussion

The SBA has an affirmative responsibility under the Small Business Act to ensure that only eligible business concerns are admitted into - and remain in - the 8(a) BD Program. This ensures that public funds are properly administered, and that the benefits of the 8(a) BD Program are limited to those small businesses owned, controlled, and managed by socially and economically disadvantaged individuals. The SBA's Letter of Intent identified nine alleged violations of 13 C.F.R. § 124.303(a) and included multiple detailed explanations for each allegation. Petitioner fully addressed each allegation in its response. After considering Petitioner's responses, the SBA's Termination Letter confirmed the vast majority of the allegations. The Court must determine whether that decision was reasonable.

A. Alleged Violation of 13 C.F.R. § 124.303(a)(1)- Submission of False Information in the 8(a) BP Program Application

First, the SBA alleged that Ms. Fleshman made numerous false statements before and after Petitioner's admission to the 8(a) BD Program.[2] SBA Form 912 asks whether an applicant owner has ever been arrested or charged with a crime other than a minor traffic violation. Ms. Fleshman responded in the negative. In fact, she was charged with bouncing a check in 1991; a misdemeanor. When confronted with this discrepancy, Ms. Fleshman stated that she was unaware that the incident constituted a criminal charge because she was not arrested and resolved the issue by paying the check at the courthouse. Afterwards, court personnel told her that "the matter was over and that there was nothing more for me to do." Petitioner thus argues that her response on the application does not constitute a false statement under 13 C.F.R. § 124.303(a)(1) because its omission was an honest mistake.

The SBA determined that her explanation was of no weight because it "does not overcome the fact that a criminal offense occurred and was not reported. "[3] The SBA's

[2] The Termination Letter also cited Petitioner for falsely claiming to share no common employees with DESA. Petitioner hired Ms. Camille Shaw, a DESA employee, approximately eight months after Petitioner was admitted into the 8(a) BD Program. The SBA initially determined that this represented a "quick contradiction," and indicated a pre-existing intent to share employees. The SBA abandoned this argument in its *Answer*.

[3] Petitioner takes issue with the SBA's conclusion that "a criminal offense occurred," noting that an offense technically does not "occur" until there is a conviction. Petitioner is correct in this regard. Ms. Fleshman was charged with a criminal offense, but it was never

Answer cites *Garcia Enterprises*, SBA No. BDP-217 (2005), for the proposition that there is "no regulatory requirement that the false statement be made knowingly. . . . It is not a defense to a termination action that a false statement was inadvertently made." *See also, Clemens Bros*., SBA No. BDP-200 (2003).

Section 124.303(a)(1) states that good cause for termination exists if the applicant submits false information in its Program application. It is silent as to whether the submission must be deliberately false. The SBA therefore appears to have a legitimate basis for its belief that any false statement - no matter the circumstances - warrants termination pursuant to Section 124.303(a)(1). However, according to Section 124.108(a)(5), termination proceedings should be initiated only if the SBA learns that "false information has been *knowingly submitted*" by the applicant. 13 C.F.R. § 124.108(a)(5) (emphasis added). The policy rationale for including an intentionality element should be self-evident. A deliberate lie is compelling evidence of poor character and integrity on the part of the applicant, making him or her unsuitable for the 8(a) BD Program. By comparison, a mistake shows little more than simple carelessness.

Moreover, the SBA's reliance on *Garcia Enterprises* is misplaced. The authoritative force of that decision is severely undercut, if not overruled outright, by more recent SBA precedent confirming the existence of a reasonable mistake exception. In the most analogous such case, *Puente One Construction Group, Inc*., SBA No. BDP-318 (2009),[4] the applicant owner answered "no" to the criminal history question despite having a misdemeanor conviction in his past. The court found that "[I]f Mr. Puente mistakenly and honestly believed the application question only requested an affirmative response if the arrest involved a felony AND his mistaken belief was reasonable, then Petitioner would not have violated 13 C.F.R. § 124.303(a)(1). To be reasonable, the mistake must have been based on information, or lack thereof, which would indicate to a reasonable person that the question only pertained to felonies." Id. At p. 2 (emphasis in original). The court then found that there was no mistake because the question asked about *any* arrests or charges, making it unlikely that a reasonable person would believe the question related only to felonies. *See also, H Squared Industries, Inc*., SBA No. BDP-349 (2010) (owner's assertion that she forgot about $100,000 SBA loan 25 years earlier was unreasonable); *K.S. Constr. Co., Inc.*, SBA No. BDP-401 (2011) (owner's assertion that an application question included a time element was unreasonable).

The more recent case law therefore holds that an honest and reasonable mistake is a valid defense to an alleged violation of 13 C.F.R. § 124.303(a)(1). Here, Ms. Fleshman disputes that she was ever arrested and maintains that she had no further interactions with the judicial system

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prosecuted. Regardless, the question asks whether Ms. Fleshman was ever charged with or convicted of an offense. She has acknowledged that she was charged with bouncing the check.

[4] The author of the *Garcia Enterprises* decision, Administrative Law Judge Richard S. Arkow, remarked in that decision that it seemed "odd" that the knowing element was missing from Section 124.303(a)(1) but present in Section 124.108(a)(5). Despite his reservations, he based the *Garcia* decision on the plain language of Section 124.303(a)(1). It is therefore particularly notable that, five years later, Judge Arkow also authored *Puente*. which explicitly lays out the test for the reasonable mistake exception.

after paying the amount of the bounced check. She also states that a background check did not reveal any criminal history under her name. The SBA, apparently deeming Ms. Fleshman's explanation to be irrelevant, did not consider whether a reasonable person in such a scenario would believe the bounced check constituted a criminal offense. It therefore failed to consider a necessary aspect of the analysis.

The SBA also ruled that Petitioner falsely certified how much of its income in 2010 came from contracts with DESA. In an e-mail sent to the SBA on September 24. 2010 ("September 2010 e-mail"), Ms. Fleshman stated that Petitioner earned slightly less than 25% of its 2010 income from DESA. A submission in 2012 showed that Petitioner actually earned 39.9% of its 2010 income from DESA. The SBA determined that Ms. Fleshman deliberately understated the income in the September 2010 e-mail to make it appear that Petitioner was not financially dependent on her mother's company. As a result, the SBA concluded that Petitioner had made a false statement in its application materials, in violation of 13 C.F.R. § 124.303(a)(1).

In response, Petitioner argued that the 25% figure reflected an estimate of the company's earnings as of June 30, 2010, and was accurate when she sent the September 2010 e-mail. The 39.9% figure represented the revenue percentage for all of 2010. Petitioner thus asserts that (1) it could not know in September what the total amounts would be for the year, and thus could not have intended to mislead; and (2) a statement that is accurate at the time it is made cannot be a "false" statement.

The SBA considered Petitioner's arguments but noted that Petitioner never identified the 25% figure as an estimate, which could have alleviated any confusion. Nevertheless, Ms. Fleshman was responding to an e-mail from SBA investigator Solomon Wheeler, dated September 16, 2010, which asked her to "provide a copy of The Desa Group's latest interim financial statements that include an income statement and balance sheet. (June Year to Date 2010)." (emphasis in original.) She specifically stated in the September 2010 e-mail that the attached figures were "June Year to Date 2010,"and described them as the "latest" financial statements. In short, the SBA asked for and received a snapshot of Petitioner's finances, so it had no reason to believe the figures represented a final yearly tally.

Moreover, the SBA does not contend that the 25% figure was actually false when it was made. Rather, it argues that the figure was deliberately misleading because Ms. Fleshman knew that DESA's actual contribution to Petitioner's revenues would be significantly higher by year's end. This argument implies that an accurate statement can be misleading and thus constitute a "false statement" under Section 124.303(a)(1)- The *SBA's Answer* offered no discussion on this legal question. Even assuming, *arguendo*, that the theory holds, it still requires some showing that Ms. Fleshman was aware, as of September 2010. that the revenues attributable to DESA were destined to rise. Only then could her September statement be construed as deliberately deceptive. The SBA does not cite any evidence indicating Ms. Fleshman's knowledge at the relevant time. The Termination Letter merely states that the SBA "believes" the 25% figure was not a good faith estimate and "believes" that it was offered for deceptive purposes. Belief that a statement is deceptive does not establish that it was deceptively made. With no evidence of deceptive intent, the SBA's conclusion is simply guesswork. As such, it is arbitrary.

B. Alleged Violations of 13 C.F.R. §§ 124.303(a)(3) - Failure to Maintain Full-Time Day-to-Day Management and Control by Disadvantaged Individual

The Termination Letter also concluded that Petitioner was overly reliant on DESA. thereby giving DESA and Ms. Sumpter the power to control Petitioner. Beyond the mere possibility of control, it is also immediately apparent that the SBA believes that Ms. Sumpter actually pulls the strings at Petitioner, making Ms. Fleshman a mere figurehead. The Termination Letter stated repeatedly that “SBA does not believe TDG's and DI's real working relationship and intentions . . . were properly disclosed.” The SBA cited eleven grounds for its decision. These examples confirm an extensive business relationship between Petitioner and DESA. They do not, however, present any direct evidence that Ms. Fleshman has ceded control of her company to her mother. The SBA therefore bases its conclusion almost entirely on circumstantial evidence, of which there is a significant amount. There is nothing inherently inappropriate about the SBA's reliance on circumstantial evidence, but it must still offer a rational connection between the evidence and the inferences drawn to reach its conclusions.

The majority of the SBA's conclusions regarding Petitioner's management and control lack the necessary connection between the facts cited and the conclusion. In many instances the Termination Letter identified a real or perceived business connection between Petitioner and DESA, then made a conclusory statement that the connection was indicative of shared management, improper reliance, or lack of full-time dedication to Petitioner. It rarely attempted to explain how the evidence supported the conclusion. Rather, the SBA simply assumes that because the two companies had connections, Ms. Sumpter must be actively involved in the management of Petitioner, and Ms. Fleshman must, therefore, not be managing Petitioner on a full-time basis. Piling inferences on inferences, SBA concludes that Petitioner must also therefore have changed its ownership or management structure without obtaining the required prior approval from SBA. These inferences are simply not supported by a preponderance of the evidence.

For example, the Termination Letter noted, among other things, that both companies are present on each other's Linkedln and Facebook social media profiles and both companies referenced each other, or their employees, on their own websites. The SBA thus determined that Petitioner “is connected to DI and gives the appearance that DI also manages [Petitioner].”

The evidence only supports the first half of the conclusion. Connections are bilateral by definition. The fact that a connection exists between the companies offers no insight into who controls whom. The SBA points to nothing in either company's Linkedln or Facebook profiles that indicates a power structure. The exercise of control could run in either direction, or not at all. The SBA's conclusion is arbitrary because it infers a control dynamic that is not supported by the evidence.

The SBA also cites Ms. Fleshman's presence on DESA's web site as evidence that she does not manage Petitioner full-time. At one time, the “About DESA” section of DESA's web site listed Ms. Fleshman as a “leader” of the company. The SBA determined that this “gives the appearance that you are devoted full time to DI and not your own company, TDG. Thus, it gives the impression that other contracts are not being fully managed by TDG/you.”

"Leader" is neither a job title nor a job description. The SBA does not hazard a guess as to what a DESA "leader" does. Instead, it assumes that, whatever a "leader" is, it must require Ms. Fleshman's full-time attention. There is no information on the web site or anywhere in the record describing the role or duties of the position. The SBA therefore cannot draw any informed conclusion about the time investment necessary to perform those duties. As a result, the SBA also cannot draw any conclusions about the impact of Ms. Fleshman's leadership role on her ability to manage her own company. It is speculative to say that being a "leader" at DESA renders Ms. Fleshman incapable of devoting her full attention to Petitioner.

DESA has also appeared on Petitioner's web site.[5] The SBA identified "numerous references to DI accomplishments" on Petitioner's web site, including a story celebrating the achievements of Michelle Moshinskie, a DESA employee. The Termination Letter stated that these references were "an indication that TDG relies on DI's accomplishments for obtaining work" are "are indicative of you not maintaining management and control over TDG and being reliant on DI."

Again, the references to DESA's accomplishments are evidence only that the two companies are connected. They say nothing about who runs the company. There is no evidence in the record that the references were made in order to help Petitioner obtain work. The SBA pulls the necessary motivation out of thin air. The conclusion is therefore arbitrary.

As further evidence of Ms. Fleshman's inability to manage Petitioner on a full-time basis, the Termination Letter noted that Petitioner earned between $7,000 and $10,000 from DESA between 2010 and 2012. It then concluded that those payment amounts "make it unfeasible for you to be working full-time to cover TDG's other contract performance obligations."

The SBA's conclusion is again based on inaccurate or unsupported assumptions. It presumes that Ms. Fleshman is an employee of DESA and that she spends so much time working on matters on behalf of DESA that she cannot also oversee her own company's affairs. It characterized the earnings as "your increased salary at DI." This is contrary to the evidence. Her personal tax records establish that Ms. Fleshman is not employed directly by DESA. The invoices submitted by Petitioner confirm that the earnings in question are payments made to Petitioner pursuant to its subcontract with DESA; they are not Ms. Fleshman's personal income. The earnings are thus no different from any other contract-based income. Accordingly, the time spent executing the DESA contract is time spent on Petitioner's affairs and must be counted when determining whether Ms. Fleshman devotes full time to Petitioner. By arbitrarily segregating the DESA-sourced income from the "other" contracts, the SBA raised an unsupported inference that Ms. Fleshman had not shown the necessary commitment to Petitioner.

Overall, the SBA struggles and fails to find evidence to buttress its conclusion that Ms. Sumpter controls, or has the ability to control, Petitioner. However, that was not its only justification for termination under 13 C.F.R. § 124.303(a)(4). It also found that Petitioner was

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[5] Both Petitioner and DESA have now scrubbed any reference to each other from their respective web sites.

overly reliant on DESA, and “DI plays such a substantial role through its marketing, planning and performing sub-contracts such that TDG appears to be not able to operate independently.”

SBA regulations state that a non-disadvantaged individual or entity may be found to control an 8(a) BD Program participant if “business relationships exist . . . which cause such dependence that the applicant or participant cannot exercise independent business judgment without great economic risk.” 13 C.F.R. § 124.106(g)(4).

The examples cited in the Termination Letter may not be persuasive evidence of actual control by Ms. Sumpter, but they are evidence of significant interconnectedness between the two companies. Both companies act or have acted as subcontractors for the other company. Petitioner maintains an office in DESA Inc.'s headquarters in order to more efficiently manage its contractual obligations to the elder company. Petitioner's own headquarters is in a building owned by Ms. Sumpter. Petitioner holds meetings in DESA's building, and Ms. Sumpter is a vocal participant in those meetings. Petitioner and the SBA debate whether Ms. Sumpter's presence in these meetings is as Petitioner's marketing contractor or as its manager. Regardless of the actual answer, it is clear that Ms. Sumpter plays a critical role in Petitioner's success. Additionally, Petitioner acknowledged that DESA was responsible for almost 40% of Petitioner's revenues in 2010, and was paying Petitioner between $7,000 and $10,000 per month from 2010 to 2012.

Given these connections, the SBA concluded that Petitioner could not risk its relationship with DESA without substantial harm to its own health. Whether that conclusion is correct is not for the Court to answer. The SBA has provided evidence that rationally supports its ultimate conclusion. It therefore has articulated a reasonable basis for its termination of Petitioner's participation in the 8(a) BD Program.

IV. Conclusion

If there is more than one ground for terminating an 8(a) BD Program participant, and at least one of those grounds is reasonable, the decision cannot be found arbitrary, capricious, or contrary to law. *NAMO, LLC*, SBA No. BDP-458; *Alabasi,* SBA No. BDP 368; *Garza Telecomms., Inc*., SBA No. MSB-620. Accordingly, the Court thus has no need to examine the remainder of the SBA's determination, and the decision will be **AFFIRMED**.

So ORDERED,

J. JEREMIAH MAHONEY
Administrative Law Judge

Notice of Finality. This decision on appeal constitutes a final agency decision that is binding on the parties. 13 C.F.R. § 134.409(a). However, within 20 days of its issuance the court may reconsider the 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).