Cite as: *in the Matter of The Wexford Group Int'l, Inc.*, SBA No. SDV-105 (2006)

United States Small Business Administration
Office of Hearings and Appeals

IN THE MATTER OF:

The Wexford Group International, Inc.,

Appellant,

Solicitation No. W9124Q-06-USA-REF-SUPPORT

Department of the Army

U.S. Army Contracting Agency, Southern Region

White Sands Missile Range, New Mexico

SBA No. SDV-105

Decided: June 29, 2006

APPEARANCES

Robert H. Koehler, Esq., Patton Boggs LLP, McLean, Virginia, for Appellant, The Wexford Group

Marc Goldschmitt, President, Veteran Enterprise Technology Services, LLC, Reston, Virginia, Protestor

Kevin R. Harber, Esq., U.S. Small Business Administration, Office of the General Counsel, Washington, D.C.

DIGEST

Pursuant to 13 C.F.R. § 125.9, a service-disabled veteran owned small business concern (SDVO SBC) must be at least 51% unconditionally and directly owned by one or more service-disabled veterans. Unconditional ownership means there are no conditions or limitations upon a service-disabled veteran's present right to exercise full control and ownership of the SDVO SBC. Stock ownership of a concern held in an ESOP trust interferes with an absolute right of ownership and therefore does not constitute unconditional ownership.

Direct ownership means that a service-disabled veteran owns their business without any intervening entities, such as an ESOP trust. There is a narrow exception where direct ownership may be found via a trust where the service-disabled veteran is the grantor, trustee, and current beneficiary of the revocable trust.

The Office of Hearings and Appeals, established not by statute, but by regulation, having no power of its own to promulgate regulations, and possessing no express delegation of authority to pass on the validity of regulations or statutes, has no authority to pass on the legality or constitutionality of SBA's regulations.

DECISION

Jurisdiction

This appeal arises from an April 26, 2006 Decision of the SBA's Associate Administrator for Government Contracting ("AA/GC") sustaining a protest filed by Veteran Enterprise Technology Services, LLC ("VETS"). On March 17, 2006, VETS protested that The Wexford Group International, Inc. ("Appellant") was: (1) Not owned by service-disabled veterans; and (2) Not a small concern. Consequently, VETS alleged Appellant was not eligible for award of a contract under Solicitation No. W9124Q-06-USA-REF-SUPPORT, because the contracting officer set aside award for Service-Disabled Veteran Owned Small Business Concerns ("SDVO SBC"). Appellant filed an appeal of the AA/GC's decision with this Office on May 9, 2006.

The U.S. Small Business Administration Office of Hearings and Appeals ("this Office") reviews appeals under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121, 125, and 134. Therefore, this Office has jurisdiction to resolve this appeal.

Issue

Whether the AA/GC made a clear error of fact or law in finding Appellant was not at least 51% unconditionally and directly owned by one or more service-disabled veterans.

Background

On December 20, 2005, the Contracting Officer for the Department of the Army, U.S. Army Contracting Agency, Southern Region ("CO") issued Solicitation No. W9124Q-06-USA-REF-SUPPORT ("solicitation"). The CO informed all interested parties that work under the contract was set aside for service-disabled veteran-owned small business concerns under North American Industry Classification System ("NAICS") code 541330, Engineering Services.

The CO awarded Contract No. W9124Q-06-C-0123 to Appellant on March 14, 2006. The CO informed the unsuccessful offerors of the award on March 15, 2006. VETS protested the award to the CO on March 17, 2006.

The CO forwarded VETS' protest to the Headquarters of the U.S. Small Business Administration on March 21, 2006. SBA's Office of the AA/GC forwarded a copy of VETS' protest to Appellant on March 23, 2006. In this notice letter, SBA requested supporting documentation demonstrating Appellant "was 51% unconditionally and directly owned by one or more service-disabled veterans at the time it submitted its offer" in response to the solicitation. SBA provided a list of proof it required, which included proof that Appellant's owners have been

recognized as service-disabled by the Department of Defense ("DOD") or the Department of Veterans Affairs ("VA"), plus complete information about who owned Appellant.

SBA set a due date of March 30, 2006, for Appellant to provide information concerning VETS' protest. VETS provided additional information pertinent to its protest before March 30, 2006. Appellant responded to the SBA on April 7, 2006. After receiving information from Appellant, SBA requested Appellant provide additional information and answer several questions (E-mail of April 19, 2006). Among the matters SBA asked Appellant to address was proof of service-disabled status for the list of other service-disabled veterans employed by Appellant. In Appellant's April 21, 2006 response, it asserted that:

> The current makeup of shareholders includes service disabled veterans who own a combined 59.1% of the issued and outstanding shares of WGI [Appellant]. Of that group, the shares owned by Mr. William Reno and Mr. Henry Kinnison combined equal 51.9% of the outstanding shares in WGI. Since we provided clear documentation on both Mr. Reno's and Mr. Kinnison's Service Disabled Veteran status, and since together they amount to more than the required 51%, we believe we have proven that WGI is more than 51% owned by service disabled veterans. We would be happy to re-gather all the supporting service disability documents from the myriad other veteran owners of the company, but that would require more time than was given. While happy to do so, we do not believe it necessary to re-gather these documents as we have already demonstrated service disabled veteran ownership of Wexford in excess of 51%.

On April 26, 2006, the AA/GC issued a decision sustaining VETS' protest wherein the AA/GC found Appellant was not at least 51% owned by service-disabled veterans. The AA/GC relied upon applicable regulations, most notably 13 C.F.R. § 125.9. The AA/GC found service-disabled veterans control Appellant's Board of Directors, but service-disabled veterans directly own less than 51% of Appellant's stock.

Facts

The preponderance of the evidence establishes that:

1. Mr. William H. Reno and Mr. Henry L. Kinnison are service-disabled veterans. The Record contains no evidence establishing the status of any service-disabled veterans in addition to Mr. Reno or Mr. Kinnison.

2. Appellant has 2,500,000 shares of common stock outstanding.

3. On May 12, 2005, John D. Johnson transferred 1,249,900 shares of Appellant's common stock to The Wexford Group International Employee Stock Ownership Trust ("ESOP"). At the same time, Mr. Reno purchased 100 shares of Appellant's common stock.

4. Appellant created the ESOP in 2005. The ESOP holds 1,249,900 shares of Appellant's common stock in trust. Mr. Bryan Stanford is the trustee and Mr. Paul Roche is the administrator

of the trust. There is nothing in the Record establishing that either Mr. Sanford or Mr. Roche is a service-disabled veteran.

5. As of the date of Appellant's offer under the solicitation, without considering any stock held in trust by the ESOP, Mr. Reno owned 1,250,100 shares or 50.0004% of Appellant's common stock.

6. Although there are some contrary assertions, a master register of all ESOP common stock holdings (totaling 1,249,900 shares) shows:

a. The ESOP holds 23,235 shares of Appellant's common stock in trust for Mr. Kinnison; and

b. The ESOP holds 24,985 shares of Appellant's common stock in trust for Mr. Reno.

7. If Mr. Reno's 1,250,100 shares of Appellant's common stock were aggregated with the shares the ESOP holds in trust for he and Mr. Kinnison, that would total 1,298,320 shares or 51.93% of all of Appellant's outstanding shares of common stock.

8. The ESOP documents are long and complicated. Neither Mr. Reno nor Mr. Kinnison is a trustee, trust administrator, trust grantor or current beneficiary. Among the provisions of the ESOP are:

a. Stock allocated to individuals in the ESOP vests at the rate of 20% for the first year it is placed in the ESOP. That being true, 9,644 shares of Appellant's common stock have vested in the favor of Mr. Reno and Mr. Kinnison as of the date of the offer for the solicitation.[1]

b. Stock held in the ESOP is subject to the right of first refusal. There are comprehensive provisions providing that the ESOP and Appellant have the right to buy stock held by the ESOP for any individual (or that individual's estate) first, as long as it meets a price offered by the other willing buyer, which is presumed to be the fair market value of the stock. There are provisions for bankruptcy, termination of the marital relationship, and other involuntary dispositions.

c. If an employee with shares held in trust by the ESOP is dismissed or resigns, the employee receives those shares of Appellant's common stock that have vested.

d. Common stock shares may be voted as the individual desires, with first priority being given to voting for matters that support the continuation/well-being of the trust.

[1] Together they own 48,220 shares. Twenty percent of this amount (less than one year since creation of the ESOP in May of 2005) means 9,644 shares have vested.

Appellant's Allegations

Appellant makes several allegations about why the AA/GC's eligibility determination is clearly in error. Appellant alleges:

(1) The AA/GC's eligibility determination violated 13 C.F.R. § 125.9 (the AA/GC engaged in private rule making in violation of 13 C.F.R. § 101.108 and the Administrative Procedure Act (5 U.S.C. § 553));

(2) Imposing a restriction for ESOP-held stock on service-disabled veterans unlawfully discriminates against veterans; and

(3) The AA/GC violated the Veterans Entrepreneurship and Small Business Development Act of 1999.

I will address issues (2) and (3) independently in Section II.E and F, below. I have addressed Issue (1) throughout the rest of the decision.

SBA's Response

The SBA presented the following arguments in its Response:

(1) The absence of an explicit prohibition against ownership via an ESOP in the SDVO SBC regulations should not require SBA to permit such arrangements;

(2) The AA/GC's decision to exclude Appellant's shares held by an ESOP did not violate Public Law 106-50;

(3) The AA/GC's decision to exclude Appellant's shares held by an ESOP did not result in unlawful discrimination against service-disabled veterans; and

(4) Even if SBA were barred from categorically prohibiting ownership of an SDVO SBC via an ESOP, Appellant would remain ineligible under the current ownership requirements regarding trusts.

Discussion

I. Introduction

Both SBA and Appellant raised arguments in response to the AA/GC's decision finding Appellant was not 51% unconditionally and directly owned by service-disabled veterans. My view is at variance with some of the issues briefed by the parties. That is, I believe I must first look to the plain meaning of 13 C.F.R. § 125.9 to decide if the AA/GC based her decision upon clear error of fact or law. If I decide the AA/GC's determination is reasonably consistent with the plain meaning of 13 C.F.R. § 125.9, her decision stands.

II. Applicable Law

A. Timeliness

Protestors must file protests of service-disabled concern status within five business days. 13 C.F.R. § 125.25(d)(2). Appeal of an AA/GC's decision must be within 10 business days after receipt of the AA/GC's decision. 13 C.F.R. § 134.503.

B. Standard of Review

The standard of review for appeals is whether the AA/GC's determination was based on clear error of fact or law. 13 C.F.R. § 134.508. In determining whether there is a clear error of fact or law, this Office does not evaluate whether Appellant met the eligibility requirements of 13 C.F.R. § 125.9 *de novo*. Rather, we (this Office) review the record to determine whether the AA/GC based its decision upon a clear error of fact or law. (*See Size Appeal of Taylor Consulting, Inc.*, SBA No. SIZ-4775 (2006), for a full discussion of the clear error standard of review.) Consequently, I will disturb the AA/GC's decision only if I have a definite and firm conviction the AA/GC erred in making a key finding of law or fact.

C. Proof of Service-Disabled Status

This Office does not review VA or DOD determinations pertaining to the status of an individual as a veteran, a service-connected disabled veteran, or a veteran with a permanent and severe disability. 13 C.F.R. § 134.508. Therefore, when the protest record contains VA or DOD documents that show an individual is a service-disabled veteran, we accept them at face value, unless the Record shows a challenge to or a rebuttal of the genuineness of those documents. Further, neither the AA/GC nor this Office may accept bare assertions of service-disabled status, for veterans may readily obtain written proof of their status and 13 C.F.R. § 134.508 effectively requires such proof.

D. SDVO SBC Ownership

1. Overview of 13 C.F.R. § 125.9

The primary requirement of 13 C.F.R. § 125.9 is that a service-disabled concern "must be at least 51% unconditionally and directly owned by one or more service-disabled veterans." (emphasis added). The regulation further provides (in relevant part):

> (a) *Ownership must be direct*. Ownership by one or more service disabled veterans must be direct ownership. A concern owned principally by another business entity that is in turn owned and controlled by one or more service-disabled veterans does not meet this requirement. Ownership by a trust, such as a living trust, may be treated as the functional equivalent of ownership by service-disabled veterans where the trust is revocable, and service-disabled veterans are the grantors, trustees, and the current beneficiaries of the trust.

. . .

> (d) *Ownership of a corporation*. In the case of a concern which is a corporation, at least 51% of the aggregate of all stock outstanding and at least 51% of each class of voting stock outstanding must be unconditionally owned by one or more service-disabled veterans.

13 C.F.R. § 125.9.

Service-disabled veteran owned concerns must be 51% unconditionally and directly owned by service-disabled veterans. This means it is insufficient for a concern to be directly owned if it is not unconditionally owned, or vice versa. Thus, I will separately address what unconditional and direct ownership mean below.

2. The Meaning of Unconditional Ownership Under 13 C.F.R. § 125.9

The first ownership requirement contained in 13 C.F.R. § 125.9 is that it must be unconditional. However, the regulation does not define the word "unconditional." Absent a specific definition, the plain and ordinary meaning of the word applies.[2] The word unconditional is defined as: "not limited in any way, not bound or restricted by conditions or qualifications, absolute." *Webster's Third New International Dictionary* 2486 (1993) ("*Webster's*").

In the context of 13 C.F.R. § 125.9, unconditional necessarily means there are no conditions or limitations upon an individual's present or immediate right to exercise full control and ownership of the concern. Nor can there be any impediment to the exercise of the full range of ownership rights. Thus, a service-disabled veteran: (1) Must immediately and fully own the company (or stock) without having to wait for future events; (2) Must be able to convey or transfer interest in his ownership interest or stock whenever and to whomever they choose; and (3) Upon departure, resignation, retirement, or death, still own their stock and do with it as they choose. In sum, service-disabled veterans must immediately have an absolute right to do anything they want with their ownership interest or stock, whenever they want.

3. The Meaning of Direct Ownership Under 13 C.F.R. § 125.9

The regulations require direct ownership by service-disabled veterans but do not define the word "direct." 13 C.F.R. § 125.9(a). Rather, the regulation first describes a situation that is not direct, *i.e.*, a concern owned principally by another business entity that is in turn owned and controlled by one or more service-disabled veterans does not qualify. 13 C.F.R. § 125.9(a).

Thus, the definition of the word "direct" as it is commonly used is relevant. The word "direct" as used in 13 C.F.R. § 125.9 is an adverb since it modifies "owned." *Webster's* defines the adverb "direct" as being "from point to point without deviation, from the source or the original without interruption or diversion, without an intervening agency or step. . . ." *Webster's*,

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[2] *See Rumsfeld v. United Technologies Corp.*, 315 F.3d 1361, 1369-70 (Fed. Cir. 2003), where the court of appeals used *Webster's* to determine the ordinary meaning of the word "cost."

at 640. Therefore, the plain meaning of the word "direct" in 13 C.F.R. § 125.9 is that the service-disabled veteran must own their business without any intervening entities.

SBA permits a narrow exception to direct ownership in 13 C.F.R. § 125.9(a). That is, 13 C.F.R. § 125.9(a) grants the AA/GC the discretion to treat a trust as the functional equivalent of ownership when service-disabled veterans are the grantors, trustees, and current beneficiaries of a revocable trust. Because this is a narrow exception to the express rule prohibiting indirect ownership, this Office and the AA/GC must strictly construe it.

E. Violation of the Veterans Entrepreneurship and Small Business Development Act

Appellant cites the general statement of purpose of the Veterans Entrepreneurship and Small Business Development Act of 1999, Public Law 106-50 ("the Act"). Specifically, Appellant argues the language about expanding business opportunities for veterans has applicability to this appeal.

As SBA's counsel points out, the Act does not address Employee Stock Ownership Plans or Trusts. Also, as correctly stated by the SBA, the General Purpose of the Act does not confer any specific or actionable legal rights upon veteran-owned businesses or impose any binding requirements upon SBA as it administers the Act.

Moreover, SBA's implementation of the Act, its authorship of 13 C.F.R. § 125.9 (part of the regulation it promulgated interpreting the Act), and its ultimate interpretation of 13 C.F.R. § 125.9 are entitled to considerable deference. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).

As long as the AA/GC did not make a clear error of fact or law in interpreting 13 C.F.R. § 125.9, this Office will not change its interpretation. Consequently, since there is nothing in the Act for 13 C.F.R. § 125.9 to be in conflict with, neither 13 C.F.R. § 125.9 nor the AA/GC's interpretation of 13 C.F.R. § 125.9 are in conflict with the Act. Accordingly, I will not further address this issue and find it has no merit as a matter of law.

F. Discrimination

Appellant argues that permitting ownership through ESOPs in HUBZone and Small Business Innovation Research ("SBIR") programs while prohibiting them in the 8(a) Business Development, Small Disadvantaged Business ("SBD") and SDVO SBC programs results in unlawful discrimination against concerns seeking to participate in the SDVO SBC program. Appellant effectively challenges the SDVO SBC regulations by making an allegation of discrimination without explaining what law or policy the alleged discrimination violates.

The regulatory preamble to the SDVO SBC regulations provides that the program's ownership requirements are "consistent with SBA's other programs, including the 8(a) Business Development Program." 69 Fed. Reg. 25,263 (May 5, 2004). In addition, the regulatory preamble's discussion of control requirements for SDVO SBC stated that "SBA utilizes the same criteria for its 8(a) BD Program and SBA believes that this definition has worked well in

determining who controls a business concern for purposes of eligibility into [sic] the 8(a) BD Program. In addition, SBA and its Office of Hearings and Appeals (OHA) has [sic] established policy on this criteria that will be helpful for this program." *Id.* Therefore, despite the failure of the SDVO SBC regulations to specifically address ownership via an ESOP, Appellant should have been on notice that SBA would draw upon 8(a) BD regulations to fill in the gaps in the SDVO SBC regulations. Regardless, it is ultimately irrelevant, for the direct ownership issue in this appeal is whether Appellant's service-disabled owners qualify for ownership under the narrow exception provided in 13 C.F.R. § 125.9(a).

As the SBA argues, there are different policy considerations underlying the 8(a), the SBIR, and the SDVO SBC programs. Appellant's approach would deny agencies (like the SBA) the ability to distinguish between programs created with differing policy considerations. Plainly, it is illogical for there to be one set rule for all programs regardless of their purpose. This would defeat the discretion Congress expects agencies to exercise when it entrusts them with a statutory program. *See Chevron*, 467 U.S. at 844.

Moreover, as the SBA accurately states, there is no law guaranteeing equal treatment among all classes of small businesses. Therefore, Appellant's allegation of "discrimination" has no legal meaning.

Finally, SBA promulgated the SDVO SBC regulations, like 13 C.F.R. § 125.9, so it could administer a statutorily mandated program. SBA published the SDVO SBC regulations and preamble in the Federal Register where they were subject to public comment. It is settled that this Office, established not by statute, but by regulation, having no power of its own to promulgate regulations, and possessing no express delegation of authority to pass on the validity of regulations or statutes, has no authority to pass on the legality or constitutionality of SBA's regulations. *See Size Appeal of Terra Excavating, Inc.*, SBA No. SIZ-4785 (2006); *Size Appeals of Valenzuela Engineering, Inc., and Curry Contracting Co., Inc.*, SBA No. SIZ-4151, at 7 (1996) (citing *Johnson v. Robison*, 415 U.S. 361, 368 (1974)). Therefore, this Office has no authority to consider challenges to duly promulgated regulations and thus cannot consider Appellant's argument on that point.

III. Analysis

A. Timeliness

The CO received VETS' protest within five business days and it is therefore timely. 13 C.F.R. § 125.25(d)(2). Appellant appealed the AA/GC's decision within 10 business days of receiving it as required by 13 C.F.R. § 134.503. Thus, this matter is properly before this Office.

B. Did the AA/GC make a clear error of fact or law in finding Appellant was not at least 51% unconditionally and directly owned by one or more service-disabled veterans?

1. Service-Disabled Veterans Do Not Unconditionally Own 51% of Appellant's Common Stock

Service-disabled veterans cannot own stock held by the ESOP unconditionally. The 1,249,900 shares of Appellant's common stock held by the ESOP on behalf of Appellant's employees:

a. Vests at the rate of 20% per year;

b. Can be transferred only if the Appellant and the ESOP do not want to buy it, and there are strict provisions dealing with bankruptcy and involuntary disposition; and

c. Is not owned by employees who resign or are dismissed from Appellant's employ beyond the 20% per year vesting rate.

While the limitations imposed upon stock ownership in the ESOP may be typical, they plainly and unequivocally interfere with the absolute rights of ownership a person would enjoy in common stock bought through a stockbroker (or over the internet). Under these conditions, since Mr. Reno only owns 50.0004% of Appellant's common stock (outside of the 48,220 shares the ESOP holds for he and Mr. Kinnison), I cannot say the AA/GC made a clear error of fact or law in determining Appellant was not eligible to compete for the solicitation since it was not 51% unconditionally owned by service-disabled veterans. That is, I do not have a definite and firm conviction the AA/GC made a clear error of fact or law. Rather, I would find that Appellant is not unconditionally owned by service-disabled veterans based upon the evidence in the Record.

2. Service-Disabled Veterans Do Not Directly Own 51% of Appellant's Common Stock

It is undisputed that Appellant relies upon stock held by the ESOP trust on behalf of Mr. Reno and Mr. Kinnison to reach 51% ownership. As discussed above, the first problem with this plan is that neither owns the shares held by the ESOP unconditionally. Appellant's second problem is that the ESOP is an intervening legal entity between Mr. Reno and Mr. Kinnison and the shares the ESOP holds. Therefore, their ownership is quintessentially indirect and cannot be used by Appellant to establish eligibility as a service-disabled veteran under 13 C.F.R. § 125.9.

Nor does the narrow exception found in 13 C.F.R. § 125.9(a) aid Appellant. As discussed above (Section D.3), the only exception to direct ownership permitted by 13 C.F.R. § 125.9 is for trusts “where the trust is revocable, and service-disabled veterans are the grantors, trustees, and current beneficiaries of the trust.”. The ESOP does not meet the terms of that exception (Fact 4). Therefore, the AA/GC lacked the discretion to find Appellant eligible as 51% service-disabled veteran owned concern based upon stock owned by the ESOP.

3. Appellant Has Failed to Meet Its Evidentiary Burden

Appellant has also failed to sustain its evidentiary burden. Even if the shares held by the ESOP for Mr. Reno and Mr. Kinnison could be added to Mr. Reno's 50.0004% ownership stake, there is still no evidence in the Record showing the shares had fully vested with Mr. Reno and Mr. Kinnison. That is, because of the ESOP's vesting requirements (summarized on page 4 of the Appeal Petition), only 9644 shares of Appellant's stock can be added to Mr. Reno's 50.0004%, because the ESOP had only been in operation for one year before Appellant submitted its offer (Fact 3).[3] Thus, I cannot find that the Record supports 51% ownership by service-disabled veterans.

Conclusion

Service-disabled veteran concerns must be 51% unconditionally and directly owned by service-disabled veterans. The AA/GC found Appellant was not 51% unconditionally and directly owned by service-disabled veterans. In this Appeal, Appellant failed to show the AA/GC made a clear error of fact or law in determining it was ineligible to qualify as a service-disabled veteran owned concern. Rather, the Record shows that Appellant:

a. Is not unconditionally owned by service-disabled veterans because the ESOP plainly limits the ownership rights of Mr. Reno and Mr. Kinnison, *i.e.*, their ownership rights are limited and not absolute;

b. Is not directly owned by service disabled veterans because the ESOP is not the kind of trust that constitutes direct ownership under 13 C.F.R. § 125.9(a); and

c. Did not prove it was 51% owned by service-disabled veterans, even if the shares of common stock held by the ESOP could be unconditionally and directly owned by service-disabled veterans.

For the foregoing reasons, Appellant's Appeal is DENIED and the AA/GC's determination that Appellant is not a SDVO SBC is SUSTAINED.

This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.515(a).

THOMAS B. PENDER
Administrative Judge

[3] Twenty percent of 48,220 shares (the total listed as allocated to Mr. Reno and Mr. Kinnison on the spreadsheet provided by Appellant) is 9644.