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

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| SIZE APPEAL OF: | |
| Firewatch Contracting of Florida, LLC | SBA No. SIZ-4994 |
| Appellant | Decided: September 8, 2008 |
| Appealed from Size Determination Nos. 3-2008-56 | |

APPEARANCES

Victoria Johnson, Esq., Baker & Hostetler LLP, Cleveland, Ohio, for Appellant.

DECISION

PENDER, Administrative Judge:

## I. Introduction and Jurisdiction

This appeal arises from a July 15, 2008 size determination (3-2008-56) finding Firewatch Contracting of Florida, LLC (Appellant) to be an other than small business for a $31 million annual receipts size standard. The size determination arose from a protest filed by KEVCON, Inc. (KEVCON). For the reasons discussed below, the size determination is AFFIRMED.

The Small Business Administration (SBA) Office of Hearings and Appeals (OHA) decides size appeals under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134. Accordingly, this matter is properly before OHA for decision.

## II. Issues

Whether the Area Office committed a clear error of fact or law in finding a supermajority voting requirement related to hiring and compensation of officers is sufficient to establish negative control. *See* 13 C.F.R. § 121.103(a)(3) and 13 C.F.R. § 134.314.

Whether the Area Office made a clear error of fact or law when it drew an adverse inference from Appellant's failure to supply requested data. *See* 13 C.F.R. § 121.104(d), 13 C.F.R. § 1009(d), and 13 C.F.R. § 134.314.

## III. Background

### A. Findings of Fact

1. The Department of Veterans Affairs (VA) issued Invitation for Bids No. VA-101-07-IB-0039 (IFB) for Phase 1B Development of the South Florida National Cemetery on January 17, 2008. The Contracting Officer set the procurement aside for Service-Disabled Veteran-Owned Small Business Concerns (SDVO SBC). The Contracting Officer (CO) opened bids on March 27, 2008. On May 13, 2008, the CO notified unsuccessful offerors that Appellant was the apparent successful offeror.

2. On May 14, 2008, KEVCON protested Appellant's SDVO SBC status with the CO.[1] KEVCON's SDVO SBC protest included allegations concerning Appellant's status as a small business. The core of KEVCON's size protest was that Mr. Christopher Valerian, Appellant's president and managing principal, is also president of R. Group Management Ltd. (RGM), and thus Appellant and KEVCON are affiliated and Appellant is other than small. Based upon KEVCON's allegations and as permitted by 13 C.F.R. § 121.1001(a)(iii), the Acting Director, Office of Government Contracting, filed a size protest against Appellant with the SBA, Office of Government Contracting, Area III (Area Office) on June 19, 2008.

3. On June 20, 2008, Appellant responded to the protest and supplied: a VA determination that Mr. Melvin E. Lowe is a service-disabled veteran; Appellant's certificate of good standing as a limited liability company; Appellant's 2006 tax return and a draft of its 2007 return; Appellant's Operating Agreement, Articles of Organization and Amendments, and General Indemnity Agreement; and resumes of Appellant's officers. Appellant stated it has no affiliates and Mr. Valerian is the only owner who holds a position in other concerns. Appellant stated Mr. Valerian is president of RGM, which sold all of its assets in November 2006 and no longer engages in business. Appellant provided RGM's tax returns for 2006 and 2007. Appellant stated Mr. Valerian is also the managing member of Live Earth, LLC (Live Earth). Appellant stated Live Earth owns: 85% of Boxer Realty Redevelopment Company; 100% of Sunny Farms Landfill, LLC; 85% of Champion City Recovery, LLC; and 100% of New Amsterdam and Seneca Rail Road Company, LLC (Acquired Subsidiaries). Appellant stated Live Earth was formed in October 2007 and purchased the Acquired Subsidiaries in January 2008. Appellant stated no tax returns for Live Earth or the Acquired Subsidiaries are available.

4. On June 30, 2008, Appellant supplemented its filing at the Area Office's request. Appellant supplied: its SBA Form 355; Appellant's financial statements for the last three years and financial statements for RGM; signed Internal Revenue Service (IRS) form 4506 (Request for Copy of Tax Return) for Appellant, RGM, Live Earth, and the Acquired Subsidiaries; a copy of Appellant's proposal for the IFB; operating agreements for RGM, Live Earth, and the Acquired Subsidiaries; and federal tax returns for Appellant and RGM. Appellant reiterated that

[1] The Director, Office of Government Contracting, determined Appellant was not controlled by a service-disabled veteran. OHA affirmed this determination on August 1, 2008. *See Appeal of Firewatch Contracting of Florida, LLC*, SBA No. VET-137 (2008).

Live Earth has no financial statements or tax returns available other than the year-to-date income statements provided to the Area Office.

5. On July 2, 2008, Appellant submitted a copy of an executed purchase agreement documenting Live Earth's purchase of the Acquired Subsidiaries. On July 8, 2008, Appellant submitted an affidavit from Mr. Valerian.

6. Appellant's submissions established Appellant is a limited liability company. Mr. Lowe, Appellant's managing member, chief executive officer, secretary, and a service-disabled veteran, owns 60% of Appellant. Mr. Valerian, Appellant's president and treasurer, owns 40% of Appellant. Appellant's Operating Agreement, Section 7.1(a), provides that the management and control of Appellant is vested exclusively in Mr. Lowe; this control, however, is constrained by the supermajority voting requirements to take certain actions, such as replacing the managing member or changes to Appellant's Operating Agreement or Articles of Organization. Further, Section 7.1(c) of the Operating Agreement provides:

> Officers. Members holding at least 67% of the Membership Percentages may appoint such officers as such Members deem reasonably necessary to effectuate the purposes and the *operation* of the Company, which may include, without limitation, a Chief Executive Officer, a President, one or more Vice Presidents, a Secretary, an Assistant Secretary and a Treasurer (collectively, the "Officers") . . . The Officers, subject to the direction and control of the Managing Member, shall do all things and take all actions necessary to run the business of the Company. Each Officer shall have the duties assigned to him or her by the Managing Member and the Members. Except as determined by the Managing Member and the Members holding at least 67% of the Membership Percentages, no Officer of the Company shall receive any compensation for services rendered to the Company by such person in such capacity. Any Officer may be removed at any time, with or without cause, by the Members holding at least 67% of the Membership Percentages . . . Any vacancy in any office may be filled by the Members holding at least 67% of the Membership Percentages.

(emphasis added).

## B. The Size Determination

On July 15, 2008, the Area Office issued its size determination. Based on Appellant's failure to provide tax records for all of Appellant's affiliates, the Area Office found Appellant to be other than a small business concern under the $31 million size standard.

The Area Office found, due to provisions in Appellant's Operating Agreement requiring supermajority voting to take various actions, Mr. Lowe needs Mr. Valerian's approval to appoint or remove officers or replace the managing member. The Area Office also found Mr. Valerian can use his 40% membership interest to block an action or prevent a quorum since unanimous agreement is needed by all members to amend, modify, waive, or repeal the Operating

Agreement or make major decisions. Accordingly, citing 13 C.F.R. § 121.103(a)(3), the Area Office determined Mr. Lowe and Mr. Valerian have the power to control Appellant.

The Area Office noted Mr. Valerian is president of RGM and owns a 4.71% interest in RGM. The Area Office determined RGM, a defunct company, was not affiliated with Appellant when Appellant submitted its bid proposal.

The Area Office found Mr. Valerian is president of Live Earth and owns a 15.38% interest in Live Earth. The Area Office asserted that, after being formed in October 2007, Live Earth obtained controlling interest in the Acquired Subsidiaries. The Area Office determined that, due to the fact that ownership interest in Live Earth is widely held and no single block is large as compared to others, Mr. Valerian, as President and 15.38% ownership, has the power to control Live Earth and its Acquired Subsidiaries. In addition, the Area Office found Mr. Valerian exerted day-to-day control over the operation of Live Earth and its Acquired Subsidiaries. Thus, the Area Office found Appellant affiliated with Live Earth and its Acquired Subsidiaries based on Mr. Valerian's ability to exert negative control over Appellant and his ability to control Live Earth and its Acquired Subsidiaries.

The Area Office stated the annual receipts of Live Earth and its Acquired Subsidiaries are necessary to calculate Appellant's size because Appellant acquired Live Earth and its Acquired Subsidiaries before the date Appellant self-certified as small. The Area Office stated Mr. Valerian declared that the Acquired Subsidiaries were in financial distress when acquired and that Live Earth closed on the purchase without receiving financial or income statements. The Area Office noted Appellant requested additional time to obtain copies of the tax returns by submitting Form 4506 to the IRS. However, the Area Office stated Mr. Valerian signed Form 4506, even though he was not the registered owner for the three previous years, and Appellant provided no indication how long it would take to acquire the tax records from the IRS.

Ultimately, because Appellant bears the burden of establishing its small business size and was unable to furnish the requested information, the Area Office assumed disclosure would be adverse to Appellant's interest and found Appellant to be other than a small business.

C. The Appeal

On July 30, 2008, Appellant filed the instant appeal. Appellant asserts the Area Office committed clear errors of fact and law when the Area Office stated: a size determination cannot be made without reviewing the tax returns for Live Earth and its Acquired Subsidiaries for 2005, 2006, and 2007; Appellant failed to furnish required financial information; and Appellant is affiliated with Live Earth and its Acquired Subsidiaries due to supermajority provisions in Appellant's Operating Agreement and Mr. Valerian's control of the companies.

Appellant states the Area Office's determination is contrary to 13 C.F.R. § 121.104 which explains the methods for calculating average annual receipts for a concern. Appellant argues 13 C.F.R. § 121.104(a)(2) specifically states that when a concern that has not filed a tax return with the IRS for a fiscal year in the period of measurement, SBA can calculate a concern's average annual receipts using other available information, such as audited financial statements or

an affidavit from a person with knowledge of the facts. Moreover, Appellant asserts, if a concern does not have three complete fiscal years, annual receipts are calculated by dividing the business's annual receipts by the number of weeks in business and then multiplying the quotient by 52. Appellant argues the Area Office erred in declining to calculate Live Earth's annual receipts, using the certified year-to-date income statements provided and the information in Mr. Valerian's affidavit.

Additionally, Appellant argues the Area Office erred in finding Appellant affiliated with Live Earth and its Acquired Subsidiaries due to supermajority requirements in Appellant's Operating Agreement. Appellant asserts the supermajority provisions relate only to extraordinary events and the supermajority requirements do not impede the managing member's ability to control Appellant's long-term decisions and day-to-day operations. Appellant asserts OHA rejected a blanket prohibition against supermajority requirements in *Size Appeal of EA Engineering, Science, and Technology, Inc.*, SBA No. SIZ-4973 (*EA Engineering*).

Finally, Appellant argues there is no evidence that Mr. Valerian controls Appellant. Appellant states Mr. Lowe unconditionally and directly owns 60% of Appellant and he possesses the training and experience to control Appellant's daily operations. Appellant asserts that Appellant and Live Earth operate in separate, unrelated industries and there are no agreements, leases, or licenses between them. Appellant argues there is no evidence that Mr. Valerian controls Appellant.

## IV. Discussion

### A. Timeliness

Appellant filed its appeal within 15 days of receiving the size determination. Thus, the appeal is timely. 13 C.F.R. § 134.304(a)(1).

### B. Standard of Review

The standard of review for this appeal is whether the Area Office based its size determination upon clear error of fact or law. 13 C.F.R. § 134.314. In evaluating whether there is a clear error of fact or law, OHA does not consider Appellant's size *de novo*. Rather, OHA reviews the record to determine whether the Area Office based its size determination upon a clear error of fact or law. See *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775 (2006), for a full discussion of the clear error standard of review. Consequently, I will disturb the Area Office's size determination only if I have a definite and firm conviction the Area Office made key findings of law or fact that are mistaken.

## C. The Merits

### 1. Affiliation Based on Negative Control

SBA's affiliation regulation provides:

> Control may be affirmative or negative. Negative control includes, but is not limited to, instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

13 C.F.R. § 121.103(a)(3). This text from 13 C.F.R. § 121.103(a)(3) does not provide detailed guidance about what constitutes negative control, other than mentioning that preventing a quorum or having the ability to block action by the board of directors and shareholders is relevant. Thus, identification of the kind of power that constitutes negative control has been the subject of development over many years by OHA.

Section 7.1(c) of the Operating Agreement provides that Mr. Lowe cannot hire or fire the officers needed to operate Appellant without the consent of Mr. Valerian, *e.g.*, Mr. Lowe cannot fire Mr. Valerian unless Mr. Valerian agrees to be fired (Fact 6). Nor can Mr. Lowe independently overcome the supermajority voting requirements to establish officer compensation. This means Appellant's Operating Agreement grants Mr. Valerian significant negative power to control Appellant's operations. Accordingly, Mr. Valerian has the power to control Appellant. *See Size Appeal of Dependable Courier Services, Inc.*, SBA No. SIZ-2110 (1985) (*Dependable Courier*).

The supermajority voting requirements in Appellant's Operating Agreement are distinguishable from those underlying *EA Engineering*. For example, the supermajority requirements in *EA Engineering* did not limit the directors' ability to establish compensation or hire and fire corporate officers. *EA Engineering*, at 3 (Fact 11). Here, similar to *Dependable Courier*, the negative control contained in the Operating Agreement restricts the ability of Mr. Lowe to operate Appellant as he chooses.

### 2. Appellant's Affiliations

Other than Mr. Valerian's ability to control Appellant, Appellant's appeal does not challenge the Area Office's finding that Mr. Valerian can or does control Live Earth and its Acquired Subsidiaries. Therefore, based upon this lack of objection and the Record, I find Mr. Valerian can and does control Live Earth and its Acquired Subsidiaries.

### 3. Adverse Inference

The Area Office concluded that Appellant is not a small business under the instant size standard. The Area Office found Appellant is affiliated with Live Earth and its Acquired Subsidiaries. Relying on 13 C.F.R. § 121.1008(d), the Area Office drew an inference that full

disclosure of the information required concerning the annual receipts of Live Earth and its Acquired Subsidiaries would show Appellant is not a small business.

OHA applies a three-part test to determine whether an area office has properly requested information from a challenged business and thus is permitted to draw an adverse inference in the absence of actual information. First, the requested information must be relevant to an issue in the size determination. Second, there must be a level of connection between the challenged business and the business from which the information is requested. Third, the request for information must be specific. If all of these criteria are met, the challenged business must submit the information to the area office or suffer an adverse inference that the information would show that the challenged business was other than small. 13 C.F.R. § 121.1008(d) and 1009(d); *Size Appeal of USA Jet Airlines, Inc.*, SBA No. SIZ-4919 (2008) (*USA Jet*); *Size Appeal of Quantrad Sensor, Inc.*, SBA No. SIZ-4255 (1997) (*Quantrad*).

As explained above, the Area Office correctly found Mr. Valerian had the power to control Appellant. Next, the Area Office correctly found Mr. Valerian had the power to control Live Earth and the Acquired Subsidiaries since he was Live Earth's President, owned 15.38% of Live Earth, and because no single ownership block in Live Earth is large as compared to the others. 13 C.F.R. § 121.103(c)(2) and (3). The Area Office found Live Earth controlled its Acquired Subsidiaries because Live Earth owned controlling interest in these concerns. Therefore, the Area Office had no choice but to aggregate the annual receipts of Live Earth and its Acquired Subsidiaries for the three most recent years in order to calculate Appellant's size (13 C.F.R. § 121.104(a), (c), and (d)). Based upon the foregoing, I conclude: (1) There is a connection between Appellant and Live Earth and the Acquired Subsidiaries; and (2) Information concerning the annual receipts of Live Earth and its Acquired Subsidiaries is relevant to the size determination.

Finally, the Area Office's request for information was specific. The Area Office asked for information verifying the annual receipts of Live Earth and its Acquired Subsidiaries so it could evaluate whether Appellant exceeded the applicable size standard pursuant to 13 C.F.R. § 121.104. Therefore, I find the Area Office's request for information concerning Live Earth's Acquired Subsidiaries meets the three-part test articulated in *Quantrad* and *USA Jet*.

Appellant did not provide the information the Area Office required. Instead, Appellant provided an affidavit from Mr. Valerian in which he disclaimed having any knowledge of financial statements or tax returns for any of the Acquired Subsidiaries for the relevant years, other than the information contained on a 2008 year-to-date income statement for Live Earth. The Area Office found Appellant was required to provide the tax records. In its Appeal, Appellant argues the Acquired Subsidiaries were in financial distress when Live Earth obtained them from Regus Industries, LLC and Live Earth did not receive financial statements or tax returns for any of the Acquired Subsidiaries and their records were un-auditable and non-certifiable. Appellant further argues the Area Office should have relied on the 2008 year-to-date income statement and Mr. Valerian's affidavit to calculate the annual receipts of Live Earth and its Acquired Subsidiaries. However, Appellant's arguments misstate and misapply applicable law and ignore its burden of proof.

In the first instance, the relevant part of 13 C.F.R. § 121.104(a) provides:

. . .

> (1) *The Federal income tax return* and any amendments filed with the IRS on or before the date of self-certification *must be used to determine the size status of a concern*. SBA will not use tax returns or amendments filed with the IRS after the initiation of a size determination.
>
> (2) When a concern has not filed a Federal income tax return with the IRS for a fiscal year which must be included in the period of measurement, SBA will calculate the concern's annual receipts for that year using any other available information, such as the concern's regular books of account, *audited* financial statements, or information contained in an affidavit by a *person with personal knowledge* of the facts.

(emphasis added). Accordingly, pursuant to 13 C.F.R. § 121.104(a)(1), if any of the Acquired Subsidiaries had filed tax returns for the years in question, the Area Office must use those tax returns for the size determination and can rely upon no other information. If one of these entities had yet to file a return, then other reliable information could be used, including an affidavit from someone with personal knowledge.

Secondly, Appellant admitted Mr. Valerian lacked personal knowledge concerning the finances of the Acquired Subsidiaries and that the records of the Acquired Subsidiaries were both "un-auditable and un-certifiable." This admission means Appellant was asking the Area Office to rely upon inherently unreliable information to sustain its burden of proof. This is troubling, for if the records of the Acquired Subsidiaries were as unreliable as Appellant states, then Appellant should not have expected the Area Office could utilize such records or any information derived from such records and thus Appellant should have known it was incapable of meeting its burden of proof. *See* 13 C.F.R. § 121.1009(c).

The bottom line here is that Appellant did not provide the documents the Area Office required it to provide so it could conduct its size determination. Since the Area Office's request for documents to Appellant met the three-part test, it is irrelevant why Appellant did not provide the documents. Accordingly, I hold that based upon the Record before me, the Area Office had no choice but to take the adverse inference permitted under 13 C.F.R. § 121.1008(d) and 1009(d) and thus did not make a clear error of fact or law in determining Appellant and its affiliates exceeded the size standard.

## V. Conclusion

For the above reasons, the Area Office's size determination is AFFIRMED and Appellant's appeal is DENIED.

This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(b).

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THOMAS B. PENDER
Administrative Judge