United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF:	
Kadix Systems, LLC	SBA No. SIZ-5016
Appellant	Decided: December 16, 2008
Appealed from Size Determination No. 2-2008-121	

APPEARANCES

Leslie H. Lepow, Esq., J. Alex Ward, Esq., Damien C. Specht, Esq., Jenner & Block, LLP, for Appellant Kadix Systems, LLC.

Sam Q. Le, Esq., Office of General Counsel, for the Small Business Administration.

DECISION

HOLLEMAN, Administrative Judge:

I. Jurisdiction

This appeal is decided under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134.

II. Issue

Whether the Area Office correctly drew and adverse inference against the challenged firm. *See* 13 C.F.R. § 121.1008(d).

III. Background

A. Solicitation, Award, and Protest

On June 13, 2008, the Department of the Army (Army) issued the Solicitation No. W91WAW-08-R-0074 for Information Technology support services. The Contracting Officer (CO) designated North American Industry Classification System (NAICS) code 541611, Administrative Management and General Management Consulting Services, with a

corresponding $6.5 annual receipts million size standard, as the appropriate NAICS code for this procurement. On July 11, 2008, the Army issued Amendment 1, which set the procurement totally aside for small business, and designated NAICS code 541511, Custom Computer Programming Services, with a corresponding $23 million annual receipts size standard, as the appropriate NAICS code, and extended the due date for offers to July 18, 2008.

On August 19, 2008, the CO notified unsuccessful offerors that award had been made to Kadix Systems, LLC (Appellant).

On August 25, 2008, MILVETS Systems Technology, Inc. (MILVETS) filed a size protest against Appellant. MILVETS asserts, based upon a news release, that Appellant was acquired by Dynamics Research Corporation (DRC), a large business, effective August 1, 2008. MILVETS asserted, based upon information on Appellant in the news release, that Appellant must exceed the size standard. MILVETS also pointed to information contained in DRC's July 30, 2008, Securities and Exchange Commission (SEC) filings. MILVETS further asserted, based upon the extensive purchase agreement on the SEC's website, that Appellant and DRC must have reached some sort of preliminary agreement prior to July 30th. Therefore Appellant was affiliated with DRC prior to July 30th, and thus was other than small as of the date of self-certification.

On August 27, 2008, the CO referred the MILVETS protest to the Small Business Administration (SBA) Office of Government Contracting - Area 2, in Philadelphia, Pennsylvania (Area Office), for a size determination.

On August 29, 2008, the Area Office wrote Appellant, informed it of the protest, and requested Appellant submit, together with a completed SBA Form 355 and certain other information:

- [Y]our response to the allegations of the protest letter with any supporting evidence

- [A]ll documentation for the agreement in principle for your firm to be purchased or merged with Dynamics Research Corporation.

On September 5, 2008, Appellant submitted its response to the Area Office. Appellant's submission included the July 30, 2008, Membership Interest Purchase Agreement (Purchase Agreement). Appellant asserted that it made its self-certification as a small business on July 14, 2008, with the submission of its offer to the Army. Appellant further asserts that on July 14th there was no binding acquisition agreement between Appellant and DRC. The binding agreement was executed on July 30th, and DRC purchased Kadix on August 1st. Appellant stated that it executed a nonbinding letter of intent (LOI) with DRC before July 14th, but asserted this LOI was not an agreement in principle for DRC to purchase Kadix. Appellant did not submit to the Area Office a copy of the LOI itself.

B. The Size Determination

On October 3, 2008, the Area Office issued Size Determination No. 2-2008-121 (size determination) finding Appellant other than small. The Area Office reviewed Appellant's documentation, and found Appellant was, by itself, a small business.

The Area Office noted that Appellant did not provide a copy of the LOI, and did not respond to the protest allegation that Appellant and DRC must have executed an agreement in principle prior to July 30th. The Area Office noted the Purchase Agreement was extensive, it included an adjustment for the purchase price of 8(a) contracts migrated after April 30, 2008, and the copy submitted to the Area Office was captioned "Execution Version", implying that other versions of the document were drafted. The Area Office determined that the extensive length of the Purchase Agreement indicated that it was the intent of the parties, or that there was an agreement in principle, to execute the transaction. The length and complexity of the document indicates that the parties were beyond the negotiation stage and well into finalizing the transaction before July 30th and, therefore, there must have been an agreement in principle before July 30th.

From Appellant's failure to provide the LOI, the Area Office drew an adverse inference that the LOI would have confirmed that there was an agreement in principle in place on July 14th, when Appellant self-certified that it was small, for DRC to purchase or merge with Appellant. Accordingly, the Area Office determined Appellant was affiliated with DRC, and thus, other than small.

C. The Appeal

On October 17, 2008, Appellant filed the instant appeal. Appellant argues that the Area Office's adverse inference was unreasonable because it had not specifically requested the LOI; indeed, it did not request it at all. The Area Office requested all documentation for the agreement in principle, which Appellant understood to be a request for the July 30th Purchase Agreement.

Appellant further asserts that a letter of intent and an agreement in principle are different types of documents and are not interchangeable.

Appellant also asserts it did explain why it did not produce the LOI. First, the Area Office did not request it. Second, to produce the LOI would imply it was more than an agreement to negotiate. Appellant asserted that if the Area Office wanted the LOI, it could have requested it, but instead went ahead and issued the size determination.

Appellant asserts the Area Office erred in making an adverse inference, because such an inference must directly relate to the probable contents of the information requested. Appellant asserts that it quoted language from the LOI that no contract or agreement to sell Appellant would exist until the definitive agreement was executed and delivered. This provision is a standard one providing there is no agreement until a binding agreement is reached at a later date.

The LOI's own terms provided that it was not an agreement for DRC to purchase Kadix and that negotiations would be continuing. The adverse inference is directly contradicted by the text of the LOI, and it is therefore unreasonable.

The LOI is not an agreement in principle for DRC to acquire Kadix, and thus did not create affiliation. It merely spelled out the parties' understanding of how negotiations toward a possible acquisition would be conducted. Appellant points to SBA regulations and OHA precedent that agreements to open or continue negotiations are not agreements in principle to merge, and are thus not given present effect. The LOI is an agreement governing the parties' negotiations rather than an agreement in principle for DRC to purchase Appellant. The LOI expressly provides that the parties agree that no contract for sale shall exist until the definitive agreement was executed and delivered by the parties.

Appellant asserts the size determination rests on the adverse inference, and since the inference is unreasonable, the size determination is itself based on clear error and must be reversed.

D. The SBA Response

On October 23, 2008, I issued an Order requesting Agency Comments in this matter. On November 12, 2008, SBA filed its comments. SBA asserts that a challenged firm has the burden of establishing its size. It is the Area Office which determines what information is relevant, not the challenged firm. Appellant recognized that the LOI was relevant, but provided only conclusory statements as to its provisions. As to Appellant's argument that the Area Office's request was not specific, this presupposes that the LOI is not part of the agreement in principle, which cannot be established without examining the LOI. SBA asserts that the Area Office was correct and that its determination must be upheld.

E. Appellant's Reply

On November 19, 2008, Appellant replied to SBA's response. Appellant points out that SBA does not defend the Area Office's contention that the length and complexity of the Purchase Agreement meant there was an earlier agreement in principle. SBA also fails to address the inconsistency between the Area Office's adverse inference and the facts presented to the Area Office. SBA failed to address the Area Office's decision not to consider Appellant's explanation why it did not produce the LOI, which was that the LOI, by its own provisions, was not an agreement in principle. SBA fails to address the Area Office's decision not to request the LOI after Appellant disclosed its existence.

Appellant again argues the Area Office's inference was improper, because it had failed to specifically request the LOI, and concedes as much in the text. Appellant argues it met its burden of establishing its small business status by supplying those documents it submitted to the Area Office, which demonstrated that it was small and had not entered into a purchase agreement until after its submission of its offer. Appellant further argues that the LOI was not specifically requested, and so there was no obligation to produce it, even if it was relevant. Appellant further argues that SBA's argument that it cannot prove the LOI is not an agreement in principle without

producing it turns logic on its head. The correspondence between the firms might have amounted to an agreement in principle, but there was no obligation to produce that correspondence. Finally, SBA's assertion that request was "specific enough" is deficient, because the case law requires that it be specific. Appellant asserts the Area Office improperly drew an adverse inference, and thus the size determination is based on an error of law.

IV. Discussion

A. Timeliness and Standard of Review

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

Appellant has the burden of proving, by a preponderance of the evidence, all elements of its appeal. Specifically, Appellant must prove the Area Office size determination is based on a clear error of fact or law. 13 C.F.R. § 134.314; *Size Appeal of Procedyne Corp.*, SBA No. SIZ-4354, at 4-5 (1999). OHA will disturb the Area Office's size determination only if the Administrative Judge, after reviewing the record and pleadings, has a definite and firm conviction the Area Office erred in making its key findings of fact or law. *Size Appeal of Taylor Consultants, Inc*., SBA No. SIZ-4775, at 11 (2006).

B. The Merits

It is clear that Appellant, considered apart from its relationship with DRC, is a small business. The question is, is Appellant affiliated with DRC.

A concern's size is determined as of the date of its submission of its self-certification that it is small with its initial offer, including price. 13 C.F.R. § 121.404(a). Appellant submitted its initial offer on July 14th, and its size must be determined as of that date. The Purchase Agreement with DRC was dated July 30th. Accordingly, to find Appellant affiliated with DRC, there must be some basis for finding such affiliation was established prior to July 14th.

If the firms are affiliated, their annual receipts must be aggregated to determine Appellant's size. 13 C.F.R. § 121.103(a)(6). Here, if Appellant is affiliated with DRC, it is other than small. It is the challenged firm's burden to establish that it is small. 13 C.F.R. § 121.1009(c).

In determining size, SBA considers agreements in principle to merge to have present effect in power to control a concern. 13 C.F.R. § 121.103(d)(1). However, agreements to negotiate towards a merger or sale are not agreements in principle, and are not given present effect. 13 C.F.R. § 121.103(d)(2). The Area Office here concluded that there was an agreement in principle for two reasons. First, that the length and complexity of the July 30, 2008, Purchase Agreement meant that there must have been an agreement in principle prior to its execution. Second, the Area Office, having not been provided the LOI, drew an inference against Appellant that the LOI was an agreement in principle, and thus found Appellant other than small.

The Area Office's first reason for finding an agreement in principle existed does not withstand scrutiny. The mere fact that an agreement is lengthy and complicated does not necessarily mean that there was any agreement reached prior to its execution. Many business transactions are finalized only after long negotiation over many points. While the parties may both seek an agreement, one is not final until the final contract is signed. Often, major business deals fall apart at the last minute, despite long negotiation and extensive drafting of lengthy documents. The Area Office can point to no authority to support its reasoning on this point, and for it to find that an agreement in principle must have existed simply because the final document is lengthy and complex is without foundation, and a clear error.

The Area Office's second reason for finding an agreement in principle existed stands on firmer ground. The Area Office based its inference that the LOI was an agreement in principle on the rule providing that if a challenged firm fails to submit requested information, or submits incomplete information, SBA may presume that the disclosure would demonstrate that the concern is an other than small business. 13 C.F.R. § 121.1008(d).

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 its absence. 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); *Size Appeal of Management Support Technology, Inc.*, SBA No. SIZ-4976, at 3 (2008).

Here, the LOI is relevant to the issue of whether there was an agreement in principle, and it is clearly a document to which Appellant was a party. The question remains, was the request for information specific.

The Area Office requested Appellant's response to the protest, and *all documentation* for the agreement in principle for the agreement with DRC. The LOI was clearly an important document in the process of negotiating and concluding the transaction between Appellant and DRC. Appellant itself recognized its relevance, by referring to it in its response to the Area Office. However, Appellant did not submit the LOI itself. Appellant submitted selective quotations from, and conclusory statements concerning, the LOI in its submission to the Area Office, but not the LOI itself.

Appellant asserts that a letter of intent and an agreement in principle are different things. While this statement is true, whether a document is a letter of intent, or is actually an agreement in principle, is to be determined not by the caption on the document, or a partial quotation from the document, or a self-serving characterization of the document, but by the substance of the entire document itself. A document captioned as a letter of intent may, by its terms, be sufficiently binding to be given present effect as an agreement in principle. *Size Appeal of WRS Infrastructure and Environment, Inc.*, SBA No. SIZ-5007, at 9-10 (2008).

The Area Office, while not requesting the LOI by name, did request "all documentation" concerning the agreement with DRC. Appellant recognized that the LOI was relevant, referred to it, quoted it, characterized it, but did not submit it. It is thus clear that the phrase "all documentation" is broad enough to have encompassed the LOI, and that the Area Office's request was thus, sufficiently specific that Appellant should have produced it.

Further, Appellant's argument that to have produced the letter would imply it was more than an agreement to negotiate is specious at best. The Area Office could not have relied on the fact of its production to determine whether it was an agreement in principle, but only on the LOI's text.

In addition, Appellant's argument that the inference is in contradiction to the facts presented is without basis. Appellant merely provided quotations from and characterizations of the document. Appellant's attempt to rely on these to establish that the LOI is not an agreement in principle flies in the face of the best evidence rule, which would require that the LOI itself be examined in full to determine the nature of the agreement.

Appellant's argument that it met its burden of establishing that it is small, and therefore that the Area Office could not draw the adverse inference against it is without foundation. A challenged firm can only meet its burden once all potential affiliations are examined, and the issue of its affiliation with DRC cannot be resolved without an examination of the LOI. Appellant's self-serving assertion that it has met its burden does not establish that it has, in fact, done so.

Appellant has attempted to arrogate to itself the role of determining what information is relevant to the issue of determining its size. However, it is settled that it is the Area Office's role to determine what is relevant to a size determination, and not the challenged firm's; otherwise, firms could submit only information favorable to themselves. *Size Appeal of Continuant, Inc.*, SBA No. SIZ-4839, at 4 (2007). Appellant knew the LOI was responsive to the request for "all documentation", and informed the Area Office of its existence, but then attempted to argue it was not relevant by quoting from it selectively and by making a conclusory characterization of the document as merely a letter of intent. However, only an examination of the document itself could determine whether it was actually a mere letter of intent.

Given Appellant's failure to submit the LOI, the Area Office was justified in drawing the adverse inference that the LOI was in fact an agreement in principle, and that Appellant was affiliated with DRC and thus, other than small.

Appellant has failed to meet its burden of establishing clear error by the Area Office, and the appeal is DENIED, and the Area Office's size determination is AFFIRMED.

V. Conclusion

For the above reasons, I DENY the instant appeal and AFFIRM the Area Office's size determination.

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

_____

CHRISTOPHER HOLLEMAN
Administrative Judge