Cite as: *Size Appeal of Summit Technologies & Solutions, Inc.*, SBA No. SIZ-5132 (2010)

**REDACTED DECISION FOR PUBLIC RELEASE**

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

| | |
|---|---|
| SIZE APPEAL OF: | |
| Summit Technologies & Solutions, Inc. | SBA No. SIZ-5132 |
| Appellant | Decided: May 17, 2010 |
| Size Determination Case No. 2-2010-21 | |

APPEARANCE

Matthew Kennedy, President and CEO, for Appellant.

DECISION

I. Background

A. Facts

On March 18, 2009, Summit Technologies & Solutions, Inc. (Appellant), applied to the Small Business Administration (SBA) for certification under the Historically Underutilized Business Zone (HUBZone) Empowerment Contracting program.

Appellant's application lists its primary industry under North American Industrial Classification System (NAICS) code 541611, Administrative Management and General Management Consulting Services, with a corresponding $7 million annual receipts size standard. Appellant's SBA Form 355 also lists this NAICS code as Appellant's primary code. Appellant's Form 355 also lists NAICS code 541712, Research and Development in the Physical, Engineering, and Life Sciences (except Biotechnology), as accounting for 100% of its sales.[1] However, Appellant also describes the services provided as "Consulting Services." Appellant asserted it has an agreement with ARES Corporation (ARES) for a subcontract on a contract classified under NAICS code 541712.

Appellant's narrative states its current subcontract with Orbital Sciences Corporation is under NAICS code 336414, Guided Missile and Space Vehicle Manufacturing, with a corresponding 1,000 employee size standard. Appellant's Articles of Incorporation, filed with

[1] This code has several size standards. From the context of this case, Appellant appears to claim Space Vehicles and Guided Missiles, with a corresponding 1,000 employee size standard.

the West Virginia Secretary of State, lists its primary business as 541690, Other Scientific and Technical Consulting Services, which has a corresponding $7 million annual receipts size standard.

Appellant's application was referred to the SBA Office of Government Contracting - Area II, in Philadelphia, Pennsylvania (Area Office), for a size determination, to resolve whether Appellant was affiliated with ARES.

Matthew Kennedy owns [xxx] shares, or 100%, of Appellant's Class A voting stock. He is Appellant's President, CEO, and sole board member. Mr. Kennedy paid $[xxx] for this stock, or $[xxx] a share.

Appellant has [xxx] shares of Class B non-voting stock outstanding, distributed among 12 other individuals. Class B stock was also sold for $[xxx] a share. Richard Stuart, CEO and majority shareholder of ARES, owns [xxx] shares of Class B stock. William Vantine, vice president and [xxx]% owner of ARES, owns [xxx] shares of Class B stock. Michael Pritchard, an ARES manager and [xxx]% shareholder, owns [xxx] shares of Class B stock. The remaining Class B shareholders are also ARES shareholders. The corporate documents give Class B no special rights as opposed to the Class A stock. Mr. Kennedy thus owns over 50% of all of Appellant's outstanding equity stock. Appellant has no stock options or convertible securities outstanding.

Mr. Kennedy has never owned any ARES stock. Mr. Kennedy is a former ARES employee, working as a consultant from October 1, 2007 to January 31, 2009. He was not a corporate officer, manager, or key employee of ARES. Prior to working for ARES, Mr. Kennedy was a practicing lawyer. Mr. Kennedy's supervisor at ARES was Holli Moss, who is not an ARES stockholder.

Mr. Kennedy stated that while working for ARES he saw the need for HUBZone small businesses, and saw an opportunity. He approached the leaders of ARES about their interest in a mentor-protégé opportunity with a HUBZone firm. Mr. Kennedy states that individual employees of ARES indicated an interest. These individuals eventually became Appellant's Class B shareholders. This was start up capital for Appellant.

Further, Mr. Kennedy personally borrowed start-up capital from ARES at the interest rate of prime plus 2%. This loan has since been paid in full.

There are no merger plans between Appellant and ARES. Appellant and ARES have no common management. There are no family relationships between the Mr. Kennedy and any ARES shareholder. Appellant has not received any contracts from ARES, nor has Appellant awarded any subcontracts to ARES. Appellant had previously paid a reasonable fee to ARES for accounting and payroll services, but now performs these services itself.

Appellant submitted a statement by Mr. Kennedy stating that the non-voting stockholders have no power to exercise any control over Appellant. Mr. Kennedy further stated that Appellant and ARES have completely separate operations, and there are no joint ventures,

franchise, or license agreements between the two firms. Appellant has had one contract since its inception, which was not with ARES.

In response to the Area Office's request, Appellant stated that it paid Mr. Kennedy's moving expenses and ARES did not pay for Mr. Kennedy's residence. Mr. Kennedy receives no compensation from ARES.

In advance of a formal mentor-protégé relationship Appellant and ARES entered into a teaming agreement, which was in effect from February 9, 2009 to December 8, 2009. The agreement was thus in effect on March 16, 2009, the date of Appellant's HUBZone application. This agreement included terms and conditions related to Appellant having subcontracting targets for ARES, making additional equity stock available for ARES shareholders, using ARES as a prime subcontractor on large contracts, and passing on to ARES opportunities Appellant was unable to pursue.

B. The Size Determination

On March 18, 2010, the Area Office issued Size Determination No. 2-2010-21 (Size Determination) concluding Appellant was other then small under the NAICS code 541611 size standard.

The Area Office found no affiliation between Appellant and ARES based upon common ownership, common management, or the newly organized concern rule.

Nevertheless, the Area Office found that the investments by ARES principals in Appellant's non-voting stock meant there were common investments between ARES principals and Mr. Kennedy, which created common interests which would cause the parties to act in unison. Further, the teaming agreement was in effect at the time of Appellant's application, and therefore must also be considered. The Area Office concluded the facts found established that Appellant and ARES were acting in concert for their common interests. Accordingly, the Area Office found affiliation between Appellant and ARES based upon identity of interest.

The Area Office further found that through the purchase of Appellant's non-voting equity stock, ARES principals provided the financing which made Appellant viable. These ARES shareholders will benefit from Appellant's profitability. The Area Office found they have the ability to direct business to Appellant, which could result in personal gain for them.

The Area Office also found that ARES provided Appellant's start-up financing, and ARES had demonstrated it would subcontract work to Appellant. The Area Office found Mr. Kennedy decided to start Appellant after securing a mentor commitment from ARES. Further, Mr. Kennedy is a former employee of ARES. Accordingly, the Area Office concluded Appellant and ARES are affiliated under the totality of the circumstances.

Because Appellant and ARES are affiliated, the Area Office determined Appellant is other than small.

**REDACTED DECISION FOR PUBLIC RELEASE**

C. The Appeal

On April 13, 2010, Appellant filed the instant appeal.

Appellant asserts, first, that while it listed NAICS code 541611 as its primary NAICS code in its application, at the time of its application Appellant was operating exclusively under NAICS code 336414, Guided Missile and Space Vehicle Manufacturing, with a corresponding 1,000 employee size standard. Appellant asserts the application allows for the listing of only one NAICS code. While Appellant does not explicitly state that it is appealing the NAICS code designation for its primary industry, it appears to be doing so.

Appellant argues the Area Office erred in finding affiliation based upon identity of interest. Mr. Kennedy does not and never has owned stock in ARES. He has no common investments with the ARES management other than Appellant. Mr. Kennedy did not hold a management position in ARES.

Appellant asserts that the Area Office's determination is contrary to OHA precedent, citing primarily *Size Appeal of Ameriko/Omserv, a Joint Venture*, SBA No. SIZ-3883 (1994). Appellant argues there is no affiliation based upon identity of interest between the shareholders when the only common investment is the challenged firm. Conversely, Appellant asserts the cases the Area Office relied on *Size Appeal of Les Violins Inc.*, SBA No. SIZ-4021 (1995) and *Size Appeal of Quality Elevator Company*, SBA No. SIZ-3461 (1991), are inapposite because the individuals found affiliated due to common investments in those cases had interest in both the challenged firm and the alleged affiliate.

Appellant argues that even when all the ARES shareholders are aggregated and considered as one party, they still do not control Appellant, as they have no voting stock and less than 50% of all stock.

Appellant further argues that the Area Office erred in finding affiliation based upon the totality of the circumstances. Appellant asserts the start-up financing provided by ARES and its shareholders should not be an indicium of control, as it would render new firms affiliated with all their passive investors.

Appellant argues the fact that ARES shareholders stand to benefit from Appellant's success proves nothing, because this is true of any ownership interest, including those which do not lead to a finding of affiliation.

Appellant asserts the loan Mr. Kennedy received from ARES was not collateralized, has been paid in full, and was at commercially reasonable terms. Therefore, Appellant asserts the loan is not an indicium of control.

Appellant asserts the fact the ARES shareholders may have the ability to direct business to Appellant which would result in gain to them does not result in control over Appellant. Further, it does not render Appellant economically dependent upon ARES.

**REDACTED DECISION FOR PUBLIC RELEASE**

Appellant argues that ARES's subcontracting of work to Appellant, which represents only a small fraction of its revenue, is not indicia of control.

Appellant asserts that the fact the ARES shareholders (including its CEO) were Mr. Kennedy's superiors at ARES is not indicia of affiliation. Appellant asserts a former employer does not control a former employee once he or she has changed jobs.

Appellant asserts the fact Mr. Kennedy was an ARES employee when he moved to West Virginia to start Appellant is not an indicia of affiliation. Mr. Kennedy approached ARES principals with the idea of starting a HUBZone business in West Virginia, and sought financing. Appellant claims Mr. Kennedy's leaving ARES was a clear fracture between the two.

Appellant asserts the teaming agreement is not an indicium of affiliation. Appellant asserts that agreement is voluntary on both sides, subject to termination by either party at any time, and did not obligate either party in any way. Appellant claims the Area Office did not point to specific provisions of the teaming agreement which gave rise to a finding of affiliation. Appellant asserts the Area Office incorrectly states Mr. Kennedy decided to start Appellant after securing a mentor commitment from ARES. Appellant asserts Mr. Kennedy would have started Appellant whether or not ARES became a mentor. Appellant asserts the agreement was entered into in an attempt to informally establish a mentor-protégé relationship with ARES, with the intent of formalizing the relationship after Appellant became a HUBZone firm.

In conclusion, Appellant argues that none of the factors the Area Office relied upon to find affiliation under the totality of the circumstances points to the ability of ARES to control Appellant.

## II. Discussion

### A. Timeliness

Appellant filed its appeal within 30 days of receiving the Size Determination. Thus, the appeal is timely. 13 C.F.R. § 134.304(a)(2).

### B. Standard of Review

OHA reviews a size determination to determine whether it is "based on clear error of fact or law." 13 C.F.R. § 134.314. It is Appellant's burden to prove the Area Office committed clear error. *Id.* A "clear error" means the position of the Area Office lacks reason or is contradicted by the evidence in the record. *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 10-11 (2006). Consequently, under the clear error standard, I may overturn a size determination only if Appellant establishes the Area Office made key findings of law or fact that are mistaken.

**REDACTED DECISION FOR PUBLIC RELEASE**

C. The Merits

1. The Appropriate NAICS Code

The first issue is whether the Area Office used the correct NAICS code in determining Appellant's size. In determining a challenged firm's primary industry, SBA considers the distribution of receipts, employees and costs of doing business for the most recently completed fiscal year. 13 C.F.R. § 121.107. SBA may also consider other factors. *Id.* Among those factors are the industries identified on official filings made by the firm, and its initial designation in its application to SBA, which carries more weight than a later claim. *Size Appeal of Heather Farms Nursery, Inc.*, SBA No. SIZ-4931, at 10 (2008); *Size Appeal of Catalyst Direct, Inc.*, SBA No. SIZ-4572, at 6 (2003).

Here, Appellant made a designation of NAICS code 541611 on its HUBZone application, its SBA Form 355, and a designation of a similar code with the same size standard on its corporate filing with the West Virginia Secretary of State. Appellant did not request that the Area Office use another NAICS code. The evidence for other NAICS codes is sketchy at best, as Appellant has been in business only a short time. While Appellant lists an aerospace NAICS code for its work, Appellant describes that work as consulting. Further, while the contract awarded to ARES may have one NAICS code, there is no showing that the work for Appellant's subcontract, if awarded, would be categorized in that NAICS code. Accordingly, I conclude that I must give greater weight to Appellant's initial designation in its HUBZone application and its Form 355, and find that the appropriate primary industry NAICS code for Appellant is 541611, and therefore the Area Office used the correct NAICS code in making the size determination.

2. Identity of Interest

The second issue is whether Appellant and ARES are affiliated under identity of interest. Affiliation may arise among two or more persons with an identity of interest, due to common investments, or contractual relationships which render one firm economically dependent upon another. 13 C.F.R. § 121.103(f).

The Area Office largely relied on its finding of common investments between Mr. Kennedy and the ARES shareholders. However Mr. Kennedy has no ownership interest in ARES, and there is no evidence of any other common investments between Mr. Kennedy and the ARES shareholders. Their only common investment is Appellant. As Appellant correctly argues, common investment only in the challenged firm is not enough to support a finding of affiliation based upon common investments. *Size Appeal of Ameriko/Omserv*, SBA No. SIZ-3883 (1994). The cases the Area Office relied upon, *Size Appeal of Les Violins, Inc.*, SBA No. SIZ-4021 (1995), and *Size Appeal of Quality Elevator Company*, SBA No. SIZ-3461 (1991), both found affiliation between parties with a number of common investments between them, more than merely their interests in the challenged firm. Accordingly, I conclude that the Area Office erred in finding identity of interest between Mr. Kennedy and the ARES shareholders, based upon common investments.

While there is an identity of interest among the ARES shareholders, they do not control Appellant, as they hold only Class B non-voting stock. A finding of identity of interest among the ARES shareholders does nothing to lead to a finding of affiliation between Appellant and ARES.

Further, the teaming agreement is not enough to find Appellant economically dependent upon ARES. Appellant has not been shown to be dependent for a large stream of its revenue on ARES, and the agreement does not tie Appellant exclusively to ARES. Accordingly, I conclude that the Area Office erred in finding Appellant affiliated with ARES based upon identity of interest.

3. Totality of the Circumstances

The third issue is whether Appellant and ARES are affiliated under the totality of the circumstances. A finding of affiliation is based upon whether one concern controls or has power to control the other. 13 C.F.R. § 121.103(a)(1). In determining whether affiliation exists, SBA will consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation. 13 C.F.R. § 121.103(a)(5).

Here, Mr. Kennedy was a former employee of ARES, although not a key employee. Mr. Kennedy's status as a former employee does not give ARES any means of control over Appellant.

He founded Appellant with a loan from ARES, since repaid, and investment from ARES shareholders, including ARES's majority shareholder and president. However, Mr. Kennedy retains all of the concern's voting stock, and thus has formal control of the company.

The Area Office found that Mr. Kennedy decided to start Appellant after securing a mentor commitment from ARES, but, as Appellant pointed out, this is not supported by the record, which merely states Mr. Kennedy determined that there was interest from ARES in a mentor-protégé opportunity with a HUBZone company. Mr. Kennedy moved to West Virginia at his own expense to start Appellant.

Appellant did execute a teaming agreement with ARES. While the teaming agreement is no longer in effect, it was at the time of Appellant's HUBZone application, which is the date as of which size must be determined, and therefore must be considered. 13 C.F.R. 121.404(b). However, the Area Office failed to analyze the agreement and identify which provisions gave ARES power to control Appellant, and how those provisions did so. A review of the provisions of the agreement as outlined above, merely establishes that ARES shareholders may purchase more non-voting stock, and that Appellant will subcontract work to ARES and pass on opportunities it is unable to pursue. None of these provisions give ARES the power to control Appellant. Accordingly, I find the Area Office erred in finding the teaming agreement gave ARES power to control Appellant, and thus supported a finding of affiliation.

The Area Office noted that Appellant's Class B shareholders have the ability to direct ARES business to Appellant to benefit themselves as equity shareholders, but this does not give

them the ability to control Appellant. While ARES has demonstrated that it will subcontract work to Appellant, it is not clear that this work will be such a large proportion of Appellant's receipts as to render it dependent upon ARES.

In summary, I find that the ties between Appellant and ARES are not so suggestive of affiliation as to render them affiliated under the totality of the circumstances. Mr. Kennedy owns 100% of the voting stock. Appellant has repaid the ARES loan. Mr. Kennedy has no interest in ARES, and was not a key employee there. The Class B shareholders are passive investors, with no power to control the concern. Appellant is not economically dependent upon ARES for contracts.

Accordingly, I find that the Area Office's finding that Appellant is affiliated with ARES under the totality of the circumstances rule is not supported by the record, and is based upon a clear error of law and fact. Appellant is not affiliated with ARES, and is thus an eligible small business.

## III. Conclusion

The Area Office's determination was based upon clear error. Accordingly, the Size Determination is VACATED and REVERSED, and this appeal is GRANTED.

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

CHRISTOPHER HOLLEMAN
Administrative Judge