United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Gulf-Shred, Inc., dba Shred-it Mobile/Biloxi Appellant Appealed from Size Determination Nos. 3-2010-114	SBA No. SIZ-5136 (RMD) SIZ-5149 Decided: August 9, 2010

APPEARANCE

Robert Wallace, President, for Appellant.

DECISION

I. Introduction and Jurisdiction

On June 29, 2010, the Small Business Administration's (SBA) Office of Government Contracting, Area III (Area Office) issued Size Determination No. 3-2010-114 (Size Determination on Remand) finding that Gulf-Shred, Inc., dba Shred-it Mobile/Biloxi (Appellant) is other than a small concern under the $7 million annual receipts size standard applicable to Solicitation No. VA-256-10-RQ-0035. For the reasons discussed below, the Size Determination on Remand is reversed.

OHA decides size determination appeals under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134. Appellant filed its appeal within fifteen days of receiving the Size Determination on Remand, so the appeal is timely. 13 C.F.R. § 134.304(a)(1). Accordingly, this matter is properly before OHA.

II. Issue

Did the Area Office make a clear error of fact or law in concluding that the indemnity clause in the franchise agreement did not allow the Appellant to profit from its efforts or bear the risk of loss commensurate with franchise ownership? *See* 13 C.F.R. § 121.103(i).

III. Background

A. The Solicitation, Protest, and the March 11, 2010 Size Determination

1. On January 8, 2010, the Department of Veterans Affairs, Gulf Coast Veterans Health Care System, in Biloxi, Mississippi, issued Request for Quotations No. VA-256-10-RQ-0035 for onsite document destruction services. The Contracting Officer (CO) set the procurement aside for Service-Disabled Veteran-Owned Small Business Concerns (SDVO SBC), and assigned to it North American Industry Classification System (NAICS) code 561990, which has a $7 million annual receipts size standard. Offers were due on February 10, 2010. On February 19, 2010, the CO notified unsuccessful offerors that Gulf-Shred Inc. dba Shred-it Mobile/Biloxi (Appellant) was the apparent successful offeror.

2. On February 22, 2010, Fibre Technologies, LLC (Fibre), timely protested Appellant's size status to the CO. Appellant asserted, based on materials from various databases, that Appellant is a "branch" of Shred-it, an international company headquartered in Canada that has 140 branches around the world. On February 23, 2010, the CO forwarded the size protest to the Small Business Administration (SBA) Office of Government Contracting, Area III, in Atlanta, Georgia (Area Office), for a size determination.[1]

3. The Area Office file shows that Robert A. Wallace is Appellant's sole owner, sole director, and president. Appellant's other officers are members of Mr. Wallace's family. Mr. Wallace and his wife together own B&B Recycling of Alabama, LLC (BBR) and B&B Investments, LLC (BBI), a commercial real estate company.

4. Appellant's previous owner entered into a Franchise Agreement with Shred-it America, Inc. (Shred-it). Mr. Wallace eventually obtained complete ownership of Appellant. The only part of the Franchise Agreement relevant to this appeal is the following clause[2], which states:

XVIII. INDEPENDENT CONTRACTOR AND INDEMNIFICATION

> A. **Contractor**. It is understood and agreed by the parties hereto that this Agreement does not create a fiduciary relationship between them, that the Franchisee shall be an independent contractor, and that nothing in this Agreement is intended to make either party an agent, legal representative, subsidiary, joint venturer, partner, employee or servant of the other for any purpose whatsoever. Franchisor shall not have the power to hire or fire Franchisee's employees, and except as herein expressly provided, Franchisor may not control or have access to Franchisee's funds or the expenditures thereof, or in any other way exercise dominion or control over the franchise business.

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[1] Fibre also protested Appellant's status as an SDVO SBC. That protest was referred elsewhere for resolution.

[2] The entire Independent Contractor and Indemnification Clause will be referred to as the "clause." The separate Independent Contractor or Indemnification segments of the clause will be referred to as the independent contractor "provision" or the indemnification "provision."

B. **No Liability**. It is understood and agreed that nothing in this Agreement authorizes Franchisee to make any contract, agreement, warranty or representation on Franchisor's behalf, or to incur any debt or other obligation in Franchisor's name, and that Franchisor shall in no event assume liability for or be deemed liable hereunder as a result of any such action or by reason of any act or omission of Franchisee in Franchisee's conduct of the franchise business or any claim or judgment arising therefrom against Franchisor. Franchisee agrees at all times to defend at his own cost, and to indemnify and hold harmless to the fullest extent permitted by law, Franchisor, its corporate parent, the corporate subsidiaries, affiliates, successors, assigns and designees of either entity, and the respective directors, officers, employees, agents, shareholders, designees, and representatives of each (Franchisor and all other hereinafter referred to collectively as "Indemnities") from all losses and expenses incurred in connection with any action, suit, proceeding, claim, demand, investigation, or formal or informal inquiry (regardless of whether same is reduced to judgment) or any settlement thereof which arises out of or is based upon any of the following: Franchisee's alleged infringement or any other violation or any alleged violation of any patent, trademark or copyright or other proprietary right owned or controlled by third parties; Franchisee's alleged violation or breach of any contract, federal, state or local law, regulation, ruling, standard or directive of any industry standard; libel, slander, or any other form of defamation by Franchisee; Franchisee's alleged violation or breach of any warranty, representation, agreement or obligation in this Agreement; any acts, errors or omissions of Franchisee or any of its agents, servants, employees, contractors, partners, proprietors, affiliates, or representatives; latent or other defects in the franchise business, whether or not discoverable by Franchisor or Franchisee; the inaccuracy, lack of authenticity or nondisclosure of any information by any customer of the franchise business; any services or products provided by Franchisee at, from or related to the operation at the franchise business; any services or products provided by any affiliated or nonaffiliated participating entity; any action by any customer of the franchise business; and, any damage to the property of Franchisee or Franchisor, their agents or employees, or any third person, firm or corporation, whether or not such losses, claims, costs, expenses, damages, or liabilities were actually or allegedly caused wholly or in part through the active or passive negligence of Franchisor or any of its agents or employees, or resulted from any strict liability imposed on Franchisor or any of its agents or employees.

5. On March 11, 2010, the Area Office issued Size Determination No. 3-2010-48 (the March 11, 2010 Size Determination). First the Area Office determined Appellant is affiliated with BBR and BBI. Next the Area Office concluded Appellant is not affiliated with its franchisor Shred-it. Because the combined receipts of Appellant, BBR, and BBI for the three applicable years do not exceed the size standard, the Area Office concluded Appellant is an eligible small business.

6. On March 24, 2010, Fibre timely appealed the March 11, 2010 Size Determination to SBA's Office of Hearings and Appeals (OHA). On May 27, 2010, I remanded the case to the Area Office. *Size Appeal of Fibre Technologies, LLC*, SBA No. SIZ-5136 (2010).

C. The Size Determination on Remand

On June 29, 2010, the Area Office issued Size Determination No. 3-2010-114 (Remand) (the Size Determination on Remand). The Area Office again found Gulf-Shred affiliated with BBR and BBI. Next, the Area Office considered the franchise relationship with Shred-it. Based upon the contents of the Independent Contractor and Indemnification Clause of the Franchise Agreement, the Area Office determined the control requirements inherent in the indemnity provision of the entire clause "do not allow [Appellant] to profit from its efforts or bear the risk of loss commensurate with ownership since [Appellant] the franchisee is responsible for the franchisor's negligent actions, which is not normally a responsibility commensurate with ownership." Hence, the Area Office found Appellant to be affiliated with Shred-it pursuant to 13 C.F.R. § 121.103(i). Thus affiliated with Shred-it, Appellant was found ineligible for the instant contract.

D. The Appeal Petition

Appellant received the Size Determination on Remand on June 29, 2010, and filed its Appeal Petition on July 13, 2010.

Appellant asserts the Area Office incorrectly focused on the indemnity provision while ignoring the fact that the Franchise Agreement expressly disavows any control of Appellant by the Franchisor. Further, Appellant argues, all the indemnity provision does is ensure that Appellant, not the Franchisor, remains expressly responsible for all liability arising out of Appellant's own conduct. Therefore, the Size Determination on Remand demonstrates a complete lack of understanding of the indemnity provision and ignores the rest of the Franchise Agreement.

Appellant requests that I reverse the Size Determination on Remand and conclude that Appellant is an eligible small business.

IV. Analysis

A. Timeliness and Standard of Review

Appellant filed its Appeal Petition within 15 days of its receipt of the Size Determination on Remand. Therefore, the Appeal Petition is timely. 13 C.F.R. § 134.304(a)(1).

OHA reviews a size determination issued by an SBA area office 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 that the Area Office committed an error. *Id.* Clear error means the position of an area office lacks reason or is contradicted by the evidence in the record. Under the clear error standard, I must affirm the judgment of an area office unless I have 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 10-11 (2006).

B. The Merits

The regulation governing franchises provides:

> *Affiliation based on franchise and license agreements.* The restraints imposed on a franchisee or licensee by its franchise or license agreement relating to standardized quality, advertising, accounting format and other similar provisions, generally will not be considered in determining whether the franchisor or licensor is affiliated with the franchisee or licensee provided the franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership. Affiliation may arise, however, through other means, such as common ownership, common management or excessive restrictions upon the sale of the franchise interest.

13 C.F.R. § 121.103(i).

Appellant is correct. Section XVIII. A. of the Franchise Agreement expressly disavows control of the Franchisee by the Franchisor (Fact 4). In ignoring the independent contractor provision of the combined clause that provides only Appellant can control its own business, the Area Office has made the classic mistake of failing to give meaning to the entire agreement before it. Hence, I hold the Area Office has made a clear mistake of law, for Shred-it has no power to control Appellant under the Franchise Agreement, which is a *sine qua non* of 13 C.F.R. § 121.103(i).

In addition, the Area Office has misconstrued § XVIII. B., the indemnity provision of the Franchise Agreement. The indemnity provision requires Appellant (as the Franchisee) to completely defend, as well as indemnify and hold harmless, Shred-it (as Franchisor) from all losses that may be incurred by any party (to include employees), including product liability, doing business with Appellant (Fact 4). Even though the indemnity clause is broad and potentially onerous, I find no connection between Appellant's responsibilities and obligations under the indemnity provision and the ability of Appellant to make a profit or suffer a loss from its franchise ownership. In effect, all the Franchisor is seeking to do is insulate itself from legal liabilities associated with the franchisees' operation of their franchises, a sound business practice. Moreover, I note that no responsible business operates without buying insurance designed to mitigate or prevent risk of loss to itself for its business operations. Hence, all Appellant has to do to avoid the consequences of the indemnity provision is to buy business risk insurance to cover its potential liability.

The trigger for the indemnity provision is for someone doing business with, or employed by Appellant, to suffer a loss and seek redress from Shred-it. This means there is no certainty the indemnity provision will be triggered; in addition to the indemnity provision not being connected to Appellant's ability to make a profit or a loss, the lack of certainty inherent in the operation of the provision makes application of the provision too speculative and remote to reliably predict it will have any effect on the ability of Appellant to profit or suffer a loss from the operation of its franchise. Consequently, the Area Office should not have found the indemnity provision had any effect on Appellant.

Finally, I note the Area Office has not explained just how the indemnity provision can deprive Appellant of the ability to profit or suffer a loss from its franchise ownership. Instead, the Area Office merely asserts that making Appellant responsible for Shred-it's negligence is not a responsibility normally commensurate with ownership. While it is possible the Area Office's assertion may be true, there is no evidence in the Record to prove it. Therefore, I cannot sustain the finding that being responsible for a franchisor's negligence is not a responsibility commensurate with ownership.

Appellant is not affiliated with its franchisor Shred-it. Accordingly, Appellant is an eligible small business under the $7 million annual receipts size standard applicable to the instant procurement.

V. Conclusion

For the above reasons, I GRANT the appeal and REVERSE the Size Determination on Remand.

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

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THOMAS B. PENDER
Administrative Judge