United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: C2G Ltd. Co., Appellant, Appealed From Size Determination No. 3-2011-08	SBA No. SIZ-5186 Decided: January 18, 2011

APPEARANCES

Katherine S. Nucci, Esq., Thompson Coburn LLP, Washington, D.C., for Appellant

Kenneth Dodds, Esq., Office of General Counsel, U.S. Small Business Administration, Washington, D.C., for the Agency

DECISION

I. Introduction & Jurisdiction

On December 13, 2010, the U.S. Small Business Administration's (SBA) Office of Government Contracting, Area III (Area Office) issued Size Determination No. 3-2011-08 finding C2G Ltd. Co. (Appellant) other than small upon Appellant's request for recertification. For the reasons discussed below, the appeal is granted, and the size determination is reversed.

SBA's Office of Hearings and Appeals (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 the instant appeal within thirty days of receiving the size determination. Thus, the appeal is timely. 13 C.F.R. § 134.304(a)(2). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Original Size Determination No. 3-2010-141

On August 26, 2010, the Area Office issued Size Determination No. 3-2010-141[1] finding Appellant other than small due to its affiliation with CAV International, Inc. (CAV). Specifically, the Area Office determined Appellant was economically dependent upon CAV, which created an identity of interest between the firms. 13 C.F.R. § 121.103(f). The Area Office found Appellant received 100% of its revenue from CAV in 2006, 99.44 % in 2007, and 99.5% in 2008. Accordingly, the Area Office concluded Appellant would not be a viable business without its contracts from CAV, and the entities are thus affiliated. *See Size Appeal of Faison Office Prods., LLC*, SBA No. SIZ-4834 (2007); *Size Appeal of J&R Logging*, SBA No. SIZ-4426 (2001). Upon aggregating the average annual receipts of Appellant with those of CAV, the Area Office determined Appellant was not a small business under the size standard applicable to the procurement at issue.

B. Size Determination No. 3-2011-08

On October 15, 2010, Appellant applied to the Area Office for recertification of its small business size status under the $25 million size standard applied in the original size determination. Appellant indicated that its relationship with CAV ended on September 30, 2010, when the consulting agreement between the firms expired. On December 13, 2010, the Area Office issued Size Determination No. 3-2011-08 finding that Appellant remains affiliated with CAV. The Area Office explained that there is no documentation to indicate that Appellant will be able to survive without CAV, and the relevant completed fiscal years upon which the Area Office based its size determination (2007, 2008, and 2009) still reflect Appellant's income from its CAV contracts.

The Area Office also examined the agreements between Appellant and CAV. The firms entered into various agreements for consulting services, the most recent of which covered the period from January 11, 2010, through September 30, 2010. The firms also had a teaming agreement in connection to four solicitations for which Appellant submitted offers as the prime contractor with CAV as its subcontractor. The Area Office explained that one of those solicitations was cancelled, two were awarded to other firms, and one remained pending at the time the size determination was issued. The Area Office found that even though the teaming agreement expired on September 30, 2010, Appellant may still have been awarded the pending solicitation. The Area Office thus concluded it was unable to determine whether Appellant would continue to have a contractual relationship with CAV in the future.

The Area Office next analyzed Appellant's existing teaming agreements with three other firms and determined Appellant is not affiliated with any of those firms. The Area Office also listed Appellant's existing subcontracting agreements (each related to a specific procurement)

[1] The size determination was issued upon a protest filed in connection with Department of the Air Force Solicitation No. FA4452-10-R-0002. The solicitation employed North American Industry Classification System (NAICS) code 541519, Other Computer Related Services, with a corresponding size standard of $25 million in average annual receipts.

with nine other firms. The Area Office did not examine whether Appellant may be affiliated with any of its subcontractors because those procurements were not at issue.

The Area Office proceeded to determine Appellant's size as of October 20, 2010—the date it received Appellant's application for recertification. Because the Area Office found Appellant is still affiliated with CAV, the Area Office concluded Appellant's average annual receipts still exceed the $25 million size standard.

C. Appeal Petition

On December 14, 2010, Appellant filed the instant appeal, citing alleged factual and legal errors committed by the Area Office. First, Appellant claims the Area Office made a factual error when it indicated that one of the solicitations on which Appellant offered as a prime contractor (with CAV as a subcontractor) was still pending. Appellant explains that solicitation had in fact already been awarded to another company at the time the size determination was issued. As support for this assertion, Appellant attaches an award letter dated September 24, 2010, which Appellant contends it submitted to the Area Office on November 3, 2010.

Second, Appellant claims the Area Office made a legal error in failing to apply the "former affiliate" rule set forth at 13 C.F.R. § 121.104(d)(4). Appellant explains that this rule prevents the receipts of a former affiliate from being included with those of the firm at issue if the affiliation ceased before the date for determining size. *See Size Appeal of Hallmark-Phoenix 8, LLC*, SBA No. SIZ-5046 (2009); *Size Appeal of Kamp Servs., Inc.*, SBA No. SIZ-3488 (1991). Appellant argues that as of the date to determine size, it had no financial or contractual relationship with CAV. Appellant also asserts it provided information to the Area Office in connection with the first size determination indicating that Appellant received contracts in 2010 independent of CAV. Additionally, according to Appellant, the fact that Appellant provided assistance to CAV evidences Appellant's expertise in the military cargo/personnel transportation industry. Thus, Appellant disputes the Area Office's contention that there is no evidence Appellant is a viable business without CAV's assistance.

Finally, Appellant emphasizes that 13 C.F.R. § 121.104(d)(4) provides that the exclusion of a former affiliate's receipts "applies during the entire period of measurement, rather than only for the period after which affiliation ceased." Accordingly, the fact that the last three completed fiscal years reflect receipts to Appellant from CAV does not render the former affiliate rule inapplicable here. Appellant asserts it has sufficiently rebutted the presumption of affiliation that arises under the identity of interest rule and requests that OHA reverse the size determination.

D. Agency Comments

On December 30, 2010, the SBA filed comments in this matter. The SBA explains the former affiliate rule must be strictly construed. *See Size Appeal of Serv. Eng'g Co.*, SBA No. SIZ-2660 (1998). Accordingly, the rule applies where stock has been sold before the date to determine size or where a former affiliate ceases to exist before the date to determine size, but not where the former affiliate has only taken steps toward dissolution. *See Hallmark-Phoenix 8, LLC*, SBA No. SIZ-5046; *Size Appeal of Nat'l Serv. Co.*, SBA No. SIZ-2111 (1985).

On the basis of these cases, the SBA argues the former affiliate rule does not apply here because Appellant has not provided evidence that the basis for its affiliation with CAV, economic dependence, ceased to exist prior to the date to determine size. According to the SBA, for a concern to prove it is no longer economically dependent upon another firm, it must prove it no longer derives a large percentage of revenue from that firm. Here, the SBA asserts Appellant failed to address its economic dependence (or lack thereof) on CAV in 2010, and there is only evidence that Appellant derived nearly all of its revenue from CAV from 2006 through 2009. The SBA alleges Appellant asks the Agency to ignore that Appellant derived the vast majority of its revenue from CAV for the past five years simply because the consulting agreement between the firms expired. However, the SBA contends the Area Office's finding of affiliation was not based upon the consulting agreement, but on Appellant's economic dependence on CAV through revenue. The SBA explains that parties to a consulting agreement are not necessarily economically dependent, and firms with no consulting agreement may be economically dependent. The SBA asserts Appellant failed to show its economic dependence no longer existed as of the date to determine size, and the Agency cannot recertify firms based on mere speculation. The SBA contends the size determination is not based upon clear error and urges OHA to deny the appeal.

E. Appellant's Reply

On January 3, 2011, with permission from OHA, Appellant filed a reply to the Agency's comments. Appellant asserts the former affiliate rule is not as narrow as the Agency contends and "must be applied to all circumstances that gave rise to the original determination of affiliation between two or more concerns, including cases where concerns were found affiliated under the 'identity of interest' rule." Appellant explains OHA has previously reversed the Area Office's denial of recertification because the firm seeking recertification severed all connections with its alleged affiliate where the bases for affiliation were the newly organized concern rule and the identity of interest rule. *Size Appeal of Three S Constructors, Inc.*, SBA No. SIZ-2766 (1987); *see also Kamp Servs., Inc.*, SBA No. SIZ-3488. Appellant asserts it has established that it has severed all ties with CAV and can exist as a viable business without CAV's assistance.

Appellant also challenges the Agency's assertion that the expiration of the consulting agreement does not mean that Appellant will not continue to derive revenue from CAV. Appellant argues it is the Agency that is speculating that Appellant will continue to derive revenue from CAV despite the evidence that Appellant no longer has a relationship with CAV. Appellant contends affirming the size determination would create a de facto rule "that once a small business is found affiliated with a large concern due to 'economic dependence,' it would never be eligible for recertification because of an unwarranted presumption that the small business will continue to be economically dependent on a large concern through perpetuity." Appellant concludes the size determination should be reversed because Appellant has established that all connections between it and CAV completely ceased on September 30, 2010.

II. Discussion

A. Standard of Review

Appellant has the burden of proving, by a preponderance of the evidence, all elements of its appeal. Specifically, Appellant must prove the size determination is based upon a clear error of fact or law. 13 C.F.R. § 134.314. Consequently, OHA will disturb the Area Office's size determination only if, after reviewing the record, the administrative judge has a definite and firm conviction that 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. Analysis

This size determination was issued in connection with a recertification application. The applicable regulation provides:

> A concern may request SBA to recertify it as small at any time by filing an application for recertification with the Government Contracting Area Office responsible for the area in which the headquarters of the applicant is located, regardless of the location of the parent companies or affiliates. No particular form is prescribed for the application; however, the request for recertification must be accompanied by a current completed SBA Form 355 and any other information sufficient to show a significant change in its ownership, management, or other factors bearing on its status as a small concern.

13 C.F.R. § 121.1010(a).

Thus, the regulation requires that a concern applying for recertification as a small business demonstrate that its business circumstances have changed to such a degree as to render it a small business under the applicable size standard. *Size Appeal of Kamp Servs., Inc.*, SBA No. SIZ-3488, at 5 (1991). The Area Office's focus of inquiry, then, should have been to carefully examine the application for recertification to determine whether Appellant's circumstances had changed. The Area Office failed to do this. Indeed, the Area Office did not even reference the applicable regulation in the size determination.

First, the Area Office based its size determination at least in part on a factual error. The size determination states:

> [T]here is still a possibility that [Appellant] could receive the award for the pending solicitation that has not been awarded. Therefore, the teaming agreement between [Appellant] and CAV is still in existence and at this time we cannot determine if in the future the companies will still have a contractual relationship.

(Size Determination 4.) Contrary to this statement, the referenced contract had been awarded at the time the size determination was issued, and the award letter is in the record. Consequently,

Appellant could not have been awarded the contract, and there was no basis for the Area Office to conclude that Appellant's teaming agreement with CAV continued.

The Area Office also that found that "[t]here is no concrete documentation to support that [Appellant] as a business will be able to generate enough sales to be economically independent from CAV." (Size Determination 2.) However, this is not the legal standard for recertification. The regulation does not require that the concern seeking recertification demonstrate that it can generate enough revenue to succeed independent of its former affiliate. The Area Office thus erred in applying this standard to Appellant's application.

The Area Office further found that "[s]ufficient time has not passed for [Appellant's] financial statements to reflect the decrease of income from CAV." Again, this is not a requirement for recertification, and the Area Office erred in applying it. The test is whether Appellant's circumstances had changed sufficiently for it to be considered other than small.

In the original size determination, Appellant was found other than small due to its affiliation with CAV. Appellant then moved to sever all ties with CAV and subsequently sought recertification. Appellant relies upon the former affiliate rule, which provides that the receipts of a challenged firm's former affiliates are not included in the calculation of annual receipts if affiliation ceased before the date for determining size. 13 C.F. R. § 121.104(d)(4). This exclusion applies for the entire period of measurement used to determine size. *Id.* The SBA correctly contends that the rule is to be strictly construed. *Size Appeal of Serv. Eng'g Co.*, SBA No. SIZ-2660, at 9 (1987). For example, a firm that has ceased to exist is a former affiliate (and its receipts are excluded under the rule) only if the liquidation or dissolution process is fully completed prior to the date to determine size. *Size Appeal of Hallmark-Phoenix 8, LLC*, SBA No. SIZ-5046, at 4 (2009).

Here, Appellant was found affiliated with CAV in the first size determination based upon the identity of interest rule. Appellant has ended that relationship and severed its ties with CAV. The record reflects that the most recent consulting agreement between Appellant and CAV expired on September 30, 2010. As noted above, there are no current teaming agreements between the firms. There is, therefore, no longer any contractual relationship between the firms. The contractual ties between Appellant and CAV were thus severed as completely as if CAV had been dissolved. Therefore, CAV is a former affiliate, not a current one, and its receipts may not be counted when determining Appellant's size.

Nonetheless, the SBA asserts the size determination is correct because Appellant failed to provide evidence that it no longer derives a large portion of its revenue from CAV. Of course, Appellant cannot prove that it did not derive a large portion of its revenue from CAV over the past three complete fiscal years. However, Appellant can and did prove that its contracting relationship with CAV has been terminated. The SBA contends the consulting agreement was not the basis of the Area Office's finding of affiliation, but rather the revenue stream flowing from CAV to Appellant was the basis for affiliation. Thus, according to the SBA, Appellant needed to prove the revenue stream has changed, and the consulting agreement is essentially irrelevant to the determination. What the SBA fails to consider, however, is that the entire basis underlying that revenue stream was the consulting agreement. Given that Appellant did derive

nearly 100% of its revenue from CAV in the past three years pursuant to this agreement, the expiration of that agreement is clearly a significant change in circumstances for Appellant's small business size status. The revenue stream cannot continue without the agreement. Thus, Appellant has met its burden of establishing a significant change in its business circumstances.

Additionally, although not strictly required by the regulation, Appellant has obviously taken other steps to establish itself as a viable business entity. The Area Office lists in detail nine specific contracts on which Appellant is the prime contractor and eleven other firms with which Appellant has established teaming or subcontracting agreements.Thus, Appellant did address the Area Office's concern that it could not survive on its own.

Moreover, I agree with Appellant that the SBA bases its argument on speculation. The SBA contends it has no way of knowing whether Appellant will continue to work with CAV in the absence of the consulting agreement. The size protest system is a self-policing system. If Appellant is awarded a contract in conjunction with CAV, another offeror will likely protest the award. Until the SBA knows that Appellant is continuing its work with CAV, it may not merely assume that Appellant will do so. Appellant is aware that it will be found affiliated with CAV if it continues to work with CAV in the manner in which the firms worked together in the past. Obviously, it would be unwise for Appellant to continue such a relationship.

The Area Office failed to properly apply the applicable regulation. Instead, the Area Office imposed arbitrary constraints upon Appellant, basing its size determination on whether sufficient time had passed to reflect a change in Appellant's revenue and on whether Appellant proved it could exist as an independent viable business. I find this was clear error.

Based on the information in the record, I find Appellant has met its burden of establishing clear error in the Area Office's size determination. I conclude the Area Office erred in determining that Appellant is still affiliated with CAV and is not eligible for recertification. Instead, I find Appellant sufficiently proved that it is no longer affiliated with CAV because it proved there was a significant change in factors affecting its size, namely that the basis for its primary revenue stream no longer exists.

The cases cited by the SBA in reference to the former affiliate rule are inapposite here. Each of those cases deals with a scenario in which the alleged former affiliate has ceased to exist or has taken steps toward dissolution. That is not the situation here, and the rule must be applied based on the circumstances presented. Because I have found that CAV is Appellant's former (not current) affiliate, I also find 13 C.F. R. § 121.104(d)(4) serves to exclude CAV's receipts from the calculation of Appellant's average annual receipts. Accordingly, the receipts of CAV should not be aggregated with those of Appellant. The record reflects that the combined average annual receipts of Appellant and its acknowledged affiliate are less than $25 million, and Appellant should be recertified as small under this size standard.

IV. Conclusion

Appellant met its burden to prove the size determination was based upon clear error. Accordingly, this appeal is GRANTED, and the size determination is REVERSED. Appellant must be recertified as a small business under the $25 million size standard.

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

CHRISTOPHER HOLLEMAN
Administrative Judge