United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: CJW Construction, Inc., Appellant, Appealed From Size Determination No. 6-2011-046	SBA No. SIZ-5254 Decided: June 24, 2011

APPEARANCES

James F. Nagle, Esq., and Jonathan A. DeMella, Esq., Oles Morrison Rinker & Baker, LLP, for Appellant

DECISION

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 there was clear error of fact or law in the Area Office's finding Appellant affiliated with Macro-Z Technology Company, and thus other than small. *See* 13 C.F.R. § 134.314.

III. Background

A. The Size Determination

CJW Construction, Inc. (Appellant), is a participant in the U.S. Small Business Administration (SBA) 8(a) Business Development (BD) program. Appellant initially received its 8(a) BD certification on July 23, 2004. Its primary North American Industry Classification System (NAICS) code is 237990, Other Heavy and Civil Engineering Construction, with a corresponding $33.5 million annual receipts size standard.

On February 11, 2011, SBA's Director of the Division of Program Certification and Eligibility (DPCE) requested that SBA's Office of Government Contracting — Area VI in San Francisco, California (Area Office), perform a size determination on Appellant, to determine its

continued eligibility. On February 15, 2011, the Area Office requested that Appellant formally respond to the request. On February 22, 2011, Appellant filed its response with the Area Office, together with an SBA Form 355 and accompanying documents.

On April 19, 2011, the Area Office issued Size Determination no. 6-2011-046 (Size Determination). There, it found that Appellant was incorporated in June, 2001, and is wholly owned by Carla J. Whitehead, who serves as President, Chief Financial Officer, Secretary, and sole director. Ms. Whitehead and her husband, Charles Whitehead, each own 50% of CW&CW Investors, LLC (CW&CW). CW&CW was established in 2010 for the purpose of purchasing equipment and renting it exclusively to Appellant. The Area Office concluded Ms. Whitehead has the ability to control both Appellant and CW&CW through ownership.

In 2001, Ms. Whitehead entered into a partnership with Macro-Z, a Santa Ana, California based concern. This partnership was named MZT Investors Partnership (MZTIP). As of August 4, 2010, MZTIP had four equal members. Ms. Whitehead, Christopher Whitehead (Ms. Whitehead's son), Alan J. Perkovich, and Zachary Zatica. Mr. Perkovich is employed by Appellant, and is not related to the Whiteheads or the Zaticas. Christopher Whitehead is employed by Macro-Z.

Macro-Z is wholly owned by Bryan Zatica, father of Zachary Zatica. The Area Office found that MZTIP's purpose is to hold life insurance policies, whose proceeds it will use to provide cash for Macro-Z's operations in the event of Bryan Zatica's death.

Ms. Whitehead's personal tax return indicates that she holds 33% of MZTIP's shares while the partnership agreement (executed in 2001 and amended in 2010) indicates her share is 25%. Appellant states these differences are due to membership reporting changes throughout the year, and the fact that Bryan Zatica has the option to add and delete members of MZTIP at any time, so that its membership has varied in size over the years.

The Area Office found that there was an identity of interest between Carla and Christopher Whitehead, due to the family relationship, and that whether Ms. Whitehead had a 25% or 33% interest in MZTIP, their combined interests were sufficient to control MZTIP.

The Area Office thus concluded Appellant was affiliated with MZTIP.

Appellant has a mentor-protégé agreement with Macro-Z, valid and in good standing as of February 11, 2011. There were a number of joint ventures formed under this agreement.

CJW-MZT Project I was established in May, 2007, to bid on a Department of Homeland Security contract and has not generated any income. Appellant owned a 70% interest and Macro-Z owned a 30% interest.

The CJW-MZT Project II was established in 2009 to bid on a Department of Defense procurement and updated for each project on which it made successive bids. This joint venture generated no income during the applicable fiscal years. Again, Appellant owned a 70% interest and Macro-Z owned a 30% interest. This joint venture made four offers on procurements over a

two-year period. One procurement on which it made an offer was unrestricted.

The CJW-MZT Project III joint venture was established May 19, 2010, to make an offer on a Corps of Engineers procurement, but received no award and generated no income. Again, Appellant owned a 70% interest and Macro-Z owned a 30% interest.

CJW-MZT A bid on a Department of Defense solicitation in February, 2010, but received no award and generated no income. Again, Appellant owned a 70% interest and Macro-Z owned a 30% interest.

LarKor-CJW JV was established September 25, 2009. LarKor Construction Company owned 51%, Ms. Whitehead owned 49%. This joint venture generated no income.

Appellant submitted another CJW and LarKor JV Agreement dated June 30, 2010, for a construction procurement. Appellant owned 51% and LarKor owned 49%. This joint venture received no award and generated no income.

BURR-CJW Joint Venture was established in March, 2010, and is 45% owned by Appellant and 55% owned by Burr Construction, Inc. This joint venture has generated no income.

The joint venture BCL JV is between Appellant, Burr and LarKor. Appellant holds a 25% interest, LarKor 24% and Burr 51%. While this joint venture has received an award, it generated no income during the fiscal years considered for the Size Determination.

The Area Office concluded that CJW-MZT Project II was a separate entity that combined the efforts of Appellant and Macro-Z on a continuing basis, because it submitted more than two offers over a two-year period. The Area Office also concluded Appellant controlled CJW-MZT Project II because of its 70% interest in the joint venture.

The Area Office also found that Appellant and Macro-Z are both in the construction industry. Appellant has received contracts from Macro-Z and Macro-Z has received contracts from Appellant.

The Area Office found that Ms. Whitehead had been a key employee of Marco-Z while she was employed there from 1994 to 2002. The Area Office found Ms. Whitehead worked as Accounting Manager, which included the duties of Accounting, Human Resources, Field Project Engineer, Safety Manager, and Project Manager. She also performed Quality Control duties.

Appellant subcontracted its quality control management services to Macro-Z from 2001 to 2003. Appellant received assistance from Macro-Z in increasing its bonding limit on some projects. Appellant received this assistance at least two years prior to ratification of the mentor-protégé agreement.

The Area Office requested that Appellant explain why it was not affiliated with Macro-Z under the newly organized concern rule. Ms. Whitehead stated that she incorporated Appellant in

June 2001 and continued to work for Macro-Z until April, 2002. Ms. Whitehead stated that Appellant still does business with Macro-Z under contractual agreement through the mentor-protégé program primarily for adding capabilities such as knowledge of Design Bid Build and Design Bid projects in relation to building construction.

The Area Office concluded that Appellant was affiliated with CW&CW and CJW-MZT Project II based on common ownership. The Area Office further concluded that Appellant was affiliated with Macro-Z under the newly organized concern rule.

The Area Office further concluded Appellant and Macro-Z were affiliated under the totality of the circumstances due to close continuing relationship evidenced by: a continual flow of subcontracts from Macro-Z to Appellant and from Appellant to Macro-Z since Appellant's inception through 2009; employment of Mr. Perkovich, a Construction Manager at Appellant and a former Project Manager/Superintendent for Macro-Z from 2001 to 2004; employment of Christopher Whitehead at Macro-Z, employment of Ms. Whitehead before and during Appellant's initial operations, and ownership of MZTIP by Carla and Christopher Whitehead, Mr. Perkovich, and Zachary Zatica.

The Area Office examined Appellant's annual receipts, and those of CW&CW, CW-MZT Project II, and MZTIP, and found the aggregated annual receipts to be within the applicable size standard. However, when combined with Macro-Z, Appellant's receipts exceed the applicable size standard. The Area Office thus found Appellant other than small.

B. The Appeal

Appellant received the Size Determination on April 19, 2011, and filed the instant appeal on May 4, 2011.

Appellant argues, first, that it and Macro-Z have been in an SBA-approved mentor-protégé relationship since 2005. Appellant further asserts that it disclosed Ms. Whitehead's former employment by Macro-Z to SBA prior to approval of the mentor-protégé relationship. Feb. 11, 2011 Letter from Watkins to Gambardella. Appellant further asserts that SBA was aware of the contractual relationships between Appellant and Macro-Z prior to the approval of the mentor-protégé agreement, but this is not reflected in the record.

Appellant argues that the Area Office erred in finding affiliation between a mentor and a protégé in contravention of 13 C.F.R. § 124.520(d)(4), which provides that no affiliation may be found between a mentor and a protégé based on the agreement or any assistance provided pursuant to the agreement. Appellant argues that OHA has held SBA may not consider business transaction or relationships occurring after approval of the mentor-protégé agreement to find affiliation. *Size Appeal of The ORASA Group, Inc.*, SBA No. SIZ-4966 (2008). Appellant argues that transactions occurring after the agreement is approved may only be considered if there is a specific finding that the transaction was not at arm's-length or was so extraordinary as to raise the suspicion in a reasonable person that the approval of the mentor-protégé agreement was contrary to applicable law or regulations. *Size Appeal of Technical Support Services*, SBA No. SIZ-4794 (2006).

Appellant argues that the mentor-protégé program is an exception to the general rules of affiliation, and the Area Office erred in finding Appellant affiliated with its mentor, Macro-Z. Appellant asserts the Area Office misconstrued the relationship between Appellant and Macro-Z, and that none of the transactions between the two firms was unusual or not at arm's length.

Appellant further asserts the CJW-MZT Project II's violation of the "three offers in two years" rule should not be considered here, because Appellant misunderstood the regulation, and only one of these offers resulted in an award. Appellant further asserts that since the regulation has been changed to limit a joint venture from being awarded more than three contracts over two years is recognition that the old regulation is unduly restrictive.

Appellant also argues it is not affiliated with Macro-Z under the newly organized concern rule. Appellant asserts that Ms. Whitehead was not a key employee of Macro-Z when she worked there, because she did not have critical influence in or substantive control over the operations or management of the concern. Ms. Whitehead's primary responsibility at Macro-Z was accounting. The other positions she held only on an as-needed basis and never permanently. Appellant argues the Area Office merely made the conclusory finding that Ms. Whitehead "could be" a key employee, and rested its overall finding that Appellant was a newly organized concern on that.

Further, Appellant argues that it and Macro-Z are in different lines of business. Appellant's work is focused on dredging, soil excavation, and quality control. Macro-Z's work is focused on Design-Build and Design-Bid-Build construction of buildings and structures.

Appellant also argues that Macro-Z's assistance to Appellant was not significant. In Appellant's early stages, Macro-Z provided assistance to increase Appellant's bonding limit on a couple of projects. These actions were for Appellant's benefit, not Macro-Z's, are essential to assist small businesses, and are the reason for the mentor-protégé program. While there were subcontracts between the two firms from 2001 to 2004, most of these involved Appellant subcontracting to Macro-Z. Macro-Z granted only one subcontract to Appellant prior to the approval of the mentor-protégé agreement. Appellant argues that this one contract is *de minimis* assistance and, as such, should not be counted as assistance under the newly organized concern rule. *Size Appeal of Fischer Business Solutions, LLC*, SBA No. SIZ-5075 (2009).

Appellant further denies it is affiliated with Macro-Z under the totality of the circumstances. Appellant points out that while Christopher Whitehead works for Macro-Z, his title is Senior Estimator, and he is in no position to control Macro-Z. Further, he has never worked for nor owned any interest in Appellant. Christopher Whitehead is in no position to control both companies. Mr. Perkovich is a construction manager for Appellant and was previously employed by Macro-Z until March, 2004. At no point was he employed by both companies. Ms. Whitehead offered Mr. Perkovich a job when she learned he was leaving Macro-Z.

Further, Appellant asserts Ms. Whitehead cannot control Macro-Z based on her interest in MZTIP. Ms. Whitehead has a minority interest in MZTIP. (Appellant does not address the issue

of Ms. Whitehead's ability to control the concern when her and Christopher's interests are aggregated.) MZTIP has no income and no assets. The partnership was created to ensure Macro-Z's continued operation in the event of Bryan Zatica's death. MZTIP has no contracts with Macro-Z. Bryan Zatica can add and remove members of the partnership at will. This, Macro-Z gives Ms. Whitehead no ability to control Macro-Z, at least while Bryan Zatica is alive.

Further, Appellant disclosed this interest to SBA prior to its admission to the 8(a) program, through copies of her personal income tax returns which identified MZTIP. The connections between the concerns which the Area Office relied upon to find Appellant and Macro-Z connected are simply not sufficient to support a finding of affiliation.

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).

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 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 Size Determination only if the 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 of the Appeal

Under SBA's regulations, concerns are affiliated when one controls, or has the power to control the other or a third party controls or has the power to control both. 13 C.F.R. § 121.103(a)(1). The important consideration in determining whether concerns are affiliated with each other is control, whether one of the concerns controls or has the power to control the other.

Here, the Area Office found affiliation between Appellant, CW&CW, and CJW-MZT Project II. However, these affiliations do not result in Appellant being found other than small, and Appellant does not contest them on appeal. These findings are therefore not at issue here. The Area Office also found Appellant affiliated with MZTIP, a finding which also does not add to Appellant's size. Appellant does dispute this finding.

The main issue here is whether Appellant is affiliated with Macro-Z, a finding which does result in Appellant being found other than small. The Area Office found affiliation between Appellant and Macro-Z on two grounds, the newly organized concern rule and the totality of the circumstances.

1. Mentor-protégé Agreement

Appellant and Macro-Z are mentor and protégé firms. Appellant was founded in 2001,

became an 8(a) certified firm in 2004, and entered into an SBA-approved mentor/protégé agreement with Macro-Z in 2005. No determination of affiliation or control may be found between these two firms based on the mentor/protégé agreement or any assistance provided pursuant to that agreement. 13 C.F.R. § 124.520(d)(4). Therefore, the Area Office cannot rely on any assistance Macro-Z provided Appellant under the agreement to find affiliation.

Further, SBA had already examined the relationship between Appellant and Macro-Z in 2004 when Appellant became an 8(a) firm. The February 11th letter from SBA's Director of DPCE states that SBA was aware of Ms. Whitehead's and Appellant's relationship with Macro-Z at the time of Appellant's application to the program and SBA's approval of the mentor/protégé relationship. The thrust of the DPCE Director's request was not to examine Appellant's relationship with Macro-Z, but with other concerns with which Appellant might be affiliated. The Area Office examined those other concerns, and concluded that while Appellant was affiliated with some of them, those affiliations did not render Appellant other than small. The Area Office then went on to examine Appellant's affiliation with its mentor. The Area Office found affiliation between Appellant and Macro-Z under the newly organized concern rule based upon their relationship prior to SBA's approval of the mentor/protégé agreement.

However, § 124.520(d)(4) offers broad protection to the concerns in an approved mentor/protégé relationship. *Size Appeal of Safety and Ecology Corporation*, SBA No. SIZ-5177, at 23-24 (2010). Here, SBA had already examined the relationship between Appellant and Macro-Z when it approved Appellant's 8(a) application and mentor/protégé agreement. The Area Office should not have reached behind these approvals to examine a relationship which had already been examined and approved by SBA. Accordingly, the Area Office's finding that Appellant was a newly organized concern was in error because it reached behind the SBA's approval of the mentor/protégé relationship between the two concerns.

2. Newly Organized Concern

Even if the Area Office had not erred in looking behind the mentor/protégé agreement, it erred in finding Appellant affiliated with Macro-Z under the newly organized concern rule, because Ms. Whitehead had not been an owner, officer, director or key employee of Macro-Z prior to founding Appellant.

The newly organized concern rule provides that firms are affiliated where four conditions are met: (a) Former officers, directors, principal stockholders, managing members or key employees of one concern organize a new concern; and (b) The new concern is in the same or related industry or field of operation; and (c) The individuals who organized the new concern serve as the new concern's officers, directors, principal stockholders, managing members or key employees; and (d) The one concern is furnishing or will furnish the new concern with contracts, financial or technical assistance, indemnification on bid or performance bonds, and or other facilities, whether for a fee or otherwise. 13 C.F.R. § 121.103(g). A key employee is one who, because of their position in the concern, has a critical influence or substantive control over the operation or management of the concern. *Id.*

Here, irrespective of the other three conditions, the record does not support the Area

Office's conclusion that Ms. Whitehead was a key employee of Macro-Z prior to her leaving to start Appellant. Ms. Whitehead was certainly not a stockholder, officer or director of Macro-Z. Ms. Whitehead was an accountant for Macro-Z. She also held at various times positions in Macro-Z as Human Resources Manager, Field Project Engineer, Safety Manager, and Project Manager, and she also performed Quality Control duties. Ms. Whitehead stated she held all these jobs temporarily on an as-needed basis. More importantly, they are all largely administrative support positions, or positions subordinate to the concern's management. There is nothing in the record to reflect that in any of these jobs was Ms. Whitehead in any position to have a critical influence or substantive control over Macro-Z's management. Accordingly, Ms. Whitehead was not a key employee of Macro-Z and thus the first element of the test to determine whether Appellant was a newly organized concern was missing here.

3. Totality of the Circumstances

The Area Office also found Appellant affiliated with Macro-Z under the totality of the circumstances. Concerns may be found affiliated under the totality of the circumstances when no single factor is sufficient to constitute affiliation. 13 C.F.R. § 121.103(a)(5). Totality of the circumstances should only be the basis for a finding of affiliation when affiliation cannot be established under any of the specific affiliation rules, yet the relationship between the parties taken as a whole is indicative of affiliation. *Size Appeal of LOGMET, LLC*, SBA No. SIZ-5155, at 10 (2010).

It is not clear whether the Area Office considered as part of the totality of the circumstances the number of joint ventures that were formed between Appellant and Macro-Z. It is true that affiliation may be found between a mentor and a protégé for reasons other than the assistance provided under the agreement. 13 C.F.R. § 121.103(b)(6). However, these joint ventures are part of the assistance contemplated under the mentor/protégé agreement, and are thus not indicia of affiliation. *Size Appeal of Safety and Ecology Corporation*, SBA No. SIZ-5177, at 23-24 (2010). That is especially true here, where the low success rate of these joint ventures means Appellant cannot have been economically dependent upon them.

It is also not clear whether the Area Office considered Appellant's violation of the "3-in-2" rule as part of the totality of the circumstances here. The rule provides that joint venture may not submit more than three offers over a two-year period. 13 C.F.R. § 121.103(h). Here, CJW-MZT Project II made four offers over a two-year period. The Area Office concluded this joint venture was a separate entity controlled by Appellant. Appellant argues that because it unintentionally violated the rule, and that the rule has since been changed, that this violation should be ignored. However, this cannot be the manner in which SBA handles even an allegedly unintentional violation of the regulation. The question is, what is the effect of that violation here. A violation of the rule does not compel the conclusion that the joint venture parties are automatically generally affiliated, nor does it strip a mentor/protégé relationship of the protection offered by § 124.520(d)(4). *Size Appeal of Safety and Ecology Corporation*, SBA No. SIZ-5177, at 25-27 (2010).

Rather, it means the relationship between the parties is no longer limited to contract-specific affiliation under 13 C.F.R. § 121.103(h), and the Area Office may examine the

relationship underlying the joint entity for general, all-purpose affiliation. *Size Appeal of Safety and Ecology Corporation*, SBA No. SIZ-5177, at 25-27 (2010). Where SBA has approved the relationships, it should not undercut those approvals to find affiliation unless those violations are particularly egregious. *Id.* Here, while CJW-MZT Project II made four offers over a two-year period, it received only one award and generated no income during the period in which size is to be determined. I therefore conclude that while Appellant violated the 3-in-2 rule with CJW-MZT Project II, this does not result in a finding of affiliation with Macro-Z.

The Area Office identified a number of other indicia of affiliation to support its totality of the circumstances finding. The Area Office mentioned the continual flow of subcontracts between the firms. However, the subcontracts Macro-Z awarded to Appellant are exempt from consideration because of the mentor/protégé relationship. Subcontracts Appellant awarded to Macro-Z are not evidence of economic dependence by Appellant upon Macro-Z or control of Appellant by Macro-Z, and thus are not evidence of affiliation. *Size Appeal of Accent Service Company, Inc.*, SBA No. SIZ-5237, at 6, 7 (2011). That Mr. Perkovich, a construction manager for Appellant was previously employed by Macro-Z is not an indicia of affiliation without some showing that Mr. Perkovich was in a position to exercise control over either concern. There is no evidence that he was. That Christopher Whitehead is employed by Macro-Z as a Senior Estimator does not give him power to control Macro-Z. While it is appropriate to consider Christopher and Ms. Whitehead as one party with their interests aggregated (13 C.F.R. § 121.103(f)), Christopher Whitehead's subordinate position at Macro-Z is not sufficient to find that the family members have control of both concerns. Ms. Whitehead's original employment at Macro-Z was considered at the time of SBA's certification of Appellant as an 8(a) firm and approval of the mentor/protégé agreement, and in any event is too far in the past to be relevant to the question of affiliation today.

Finally, the Area Office considered the Whiteheads' participation in MZTIP as one of the factors supporting a totality of the circumstances finding. The Area Office properly aggregated Ms. Whitehead's interests with those of her son to treat them as one party. 13 C.F.R. § 121.103(f). They can thus be found to be affiliated with MZTIP, over their power to control the concern. However, this partnership is a not for profit company with negligible income. While participation in MZTIP may mean Ms. Whitehead will acquire an ownership interest in Macro-Z in the future, it grants her no control over the company now. There is nothing in the Whiteheads' participation in MZTIP that gives them any power to control Macro-Z now, or that gives Macro-Z or the Zaticas any ability to control Appellant now. Accordingly, the Area Office erred in finding this participation by Ms. Whitehead in MZTIP as a factor that supports a finding of affiliation under the totality of the circumstances.

The Area Office thus erred in finding Appellant affiliated with Macro-Z under the newly organized concern rule and under the totality of the circumstances. Appellant has met its burden of establishing clear error by the Area Office in the size determination. The Size Determination is based upon clear error of fact and law, and I must reverse it.

V. Conclusion

Appellant met its burden of proving that the Area Office committed clear errors of law

based upon the record before it. Accordingly, this appeal is GRANTED, and the Size Determination is REVERSED.

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

CHRISTOPHER HOLLEMAN
Administrative Judge