United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Coastal Management Solutions, Inc., Appellant, Appealed From Size Determination Nos. 2-2011-105, -106	SBA No. SIZ-5281 Decided: September 2, 2011

APPEARANCES

Thomas O. Mason, Esq., Francis E. Purcell, Jr., Esq., and William A. Wozniak, Esq., Williams Mullen, McLean, Virginia, for Appellant

DECISION[1]

I. Introduction and Jurisdiction

This appeal arises from a Small Business Administration (SBA) size determination issued to Coastal Management Solutions, Inc. (Appellant) in conjunction with Appellant's offer on a procurement set aside for small businesses. In the size determination, SBA's Office of Government Contracting, Area II (Area Office) found Appellant to be other than small due to affiliation with T.A. Consulting, Inc. (TAC) under the "newly organized concern" rule. For the reasons discussed below, the appeal is granted and the size determination is remanded for further review.

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.

[1] Appellant requested confidential treatment of this Decision to protect its sensitive business information. *See* 13 C.F.R. § 134.205. On issuance of the original Decision, I ordered Appellant to recommend which portions should be redacted from the published Decision. Having considered Appellant's recommendations, I now issue a redacted version of the Decision for public release.

Appellant timely filed the instant appeal on July 5, 2011.[2] Accordingly, this matter is properly before OHA for decision.

II. Issue

Did the Area Office commit a clear error of fact or law in applying the newly organized concern rule to determine Appellant's size? 13 C.F.R. § 134.314.

III. Background

A. Solicitation and Protests

On February 15, 2011, the Michigan Air National Guard (ANG) issued Request for Proposals (RFP) W912JB-11-R-4000 for professional and administrative support services. The procurement was set aside for small businesses, and was assigned NAICS code 541219, Other Accounting Services, with a corresponding size standard of $8.5 million in average annual receipts. On May 3, 2011, the ANG announced that it had selected Appellant for award. An unsuccessful offeror protested Appellant's size, alleging that Appellant's revenues exceeded the size standard. The Contracting Officer (CO) filed a separate size protest noting potential connections between Appellant and TAC. Neither protest alleged that Appellant is a new concern or that Appellant might be affiliated with TAC under the "newly organized concern" rule.

B. Size Determination

On June 16, 2011, the Area Office issued the instant the size determination finding that Appellant is not a small business because Appellant is affiliated with TAC under the "newly organized concern" rule. The Area Office did not find Appellant and TAC to be affiliated on any other grounds. In addition, the Area Office expressly determined that Appellant is not affiliated with TAC through economic dependence. Size Determination at 5.

The Area Office reviewed the elements of the "newly organized concern" rule, and found that each element had been met.[3] Specifically, the Area Office determined that Ms. Amy

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[2] Ordinarily, an appeal petition must be filed within fifteen calendar days of receipt of the size determination. 13 C.F.R. § 134.304(a). In this case, Appellant received the size determination on June 17, 2011. Fifteen calendar days after June 17, 2011 was July 2, 2011. Because July 2, 2011 was a Saturday, and July 4, 2011 was a Federal holiday, the appeal petition was due on the next business day: Tuesday, July 5, 2011. 13 C.F.R. § 134.202(d).

[3] The "newly organized concern" rule provides that: "Affiliation may arise where former officers, directors, principal stockholders, managing members, or key employees of one concern organize a new concern in the same or related industry or field of operation, and serve as the new concern's officers, directors, principal stockholders, managing members, or key employees, and 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. A concern may rebut such an affiliation determination by demonstrating a clear line of fracture between the two concerns." 13 C.F.R. § 121.103(g).

Przymuzala founded Appellant in August 2005. Prior to founding Appellant, Ms. Przymuzala worked for TAC. Although Ms. Przymuzala did not serve as an officer or director of TAC, she owned [a substantial minority interest in] TAC and continues to hold that interest. Ms. Przymuzala is Appellant's President sole owner, and sole director. Furthermore, Appellant and TAC have had ongoing business relationships with one another. At the time Appellant submitted its proposal for the RFP, Appellant "derive[d] [a significant percentage] of its revenue through a subcontract with TAC." Size Determination at 7.

The Area Office concluded that Appellant is affiliated with TAC under the newly organized concern rule. Appellant's receipts alone do not exceed the applicable size standard, but when Appellant's receipts are combined with those of TAC, Appellant is other than a small concern.

In the size determination, the Area Office noted that another size determination (2-2009-79) involving Appellant had been issued on September 30, 2009. A copy of the earlier determination is included in the record. In the earlier determination, Appellant was found to be a small business. The prior determination addressed the "newly organized concern" rule, and determined that Appellant was not affiliated with TAC under that rule. Size Determination 2-2009-79, at 4 - 5. Specifically, the earlier determination stated:

> There is no evidence that TAC is providing financial or technical assistance to [Appellant]. TAC and [Appellant] are located in different offices/locations and there is no evidence that both firms share equipment, facilities, administrative functions, and personnel .... There is a subcontracting agreement between [Appellant] and TAC that is standard with no unusual terms or conditions. The information provided indicates that there is a clear fracture between [Appellant] and TAC.

Size Determination 2-2009-79, at 5. The prior determination went on to conclude that Appellant "is not dependent on TAC for revenues" and that "there is no affiliation between [Appellant] and TAC." *Id.* at 6.

C. Appeal

Appellant contends the instant size determination is flawed for four reasons. First, Appellant argues that the contractual relationship between Appellant and TAC is not sufficient to meet the fourth element of the newly organized concern rule. Second, Appellant asserts that it has established a clear line of fracture from TAC. Third, Appellant argues that application of the newly organized concern rule to Appellant is not appropriate because Appellant is not a "new" concern. Fourth and finally, Appellant maintains that a determination that Appellant and TAC are affiliated under the "newly organized concern" rule does not effectuate the purposes of that rule. Appellant further moves to supplement the record with additional evidence: a declaration from Ms. Przymuzala, and a document indicating that Appellant's subcontract with TAC will not be renewed.

IV. Discussion

A. Standard of Review

Appellant has the burden of proving all elements of its appeal. Specifically, Appellant must demonstrate that the size determination is based upon a clear error of fact or law. 13 C.F.R. § 134.314. 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

As discussed *supra*, the Area Office found Appellant to be affiliated with TAC under the "newly organized concern" rule, 13 C.F.R. § 121.103(g). OHA has distilled the "newly organized concern" rule into four required elements: (1) the former officers, directors, principal stockholders, managing members, or key employees of one concern organize a new concern; (2) the new concern is in the same or related industry or field of operation; (3) the persons who organized the new concern serve as the new concern's officers, directors, principal stockholders, managing members, or key employees; and (4) 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. *Size Appeal of Sabre88, LLC*, SBA No. SIZ-5161, at 7 (2010). If these four elements are met, affiliation may be rebutted by demonstrating a clear line of fracture between the two concerns. *Id.* The purpose of the "newly organized concern" rule is to prevent circumvention of the size standards by the creation of "spin-off" firms that appear to be small, independent firms but are, in actuality, affiliates or extensions of large firms. *Size Appeal of J.W. Mills Management, Inc.* SBA No. SIZ-4909, at 5 (2008).

Here, the Area Office determined that the first element of the test was satisfied because Appellant's founder, Ms. Przymuzala, was (and still is) a "principal stockholder" of TAC with [substantial minority] ownership. Size Determination at 7. The second element was met because the two companies "are in similar lines of business." *Id.* The third element was satisfied because Ms. Przymuzala is President, director, and 100% owner of Appellant. The fourth element was met because Appellant and TAC have contractual relationships which account for [a significant percentage] of Appellant's revenues. *Id.* Appellant was unable to convince the Area Office of a clear line of fracture between the companies. As a result, the Area Office determined that Appellant and TAC were affiliated under the "newly organized concern" rule.

In challenging the size determination, Appellant maintains that the Area Office erroneously found the fourth element of the test to be met, because Appellant "was performing as a subcontractor to TAC in only one instance for a single customer." Appeal at 4. Appellant urges that the instant case is similar to *Size Appeal of Fischer Business Solutions, LLC*, SBA No. SIZ-5075 (2009), where OHA determined that the ties between two companies were inadequate to meet the fourth element of the newly organized concern test. Appellant also asserts that the Area Office should have a found a clear line of fracture between Appellant and TAC.

I see no merit to these arguments. In *Fischer*, OHA reviewed the purported ties between two companies and concluded that they "do not amount to more than *de minimis* assistance." *Fischer* at 5. By contrast, in the instant case, the Area Office determined — and Appellant does not dispute — that the arrangement between Appellant and TAC accounted for [a significant percentage] of Appellant's revenues. OHA has previously held that such high levels of subcontracting are sufficient to meet the fourth element of the test. *E.g., Sabre88*, at 3, 8 (fourth element of newly organized concern test is met when challenged firm derived one third of its revenues from alleged affiliate). Nor has Appellant persuasively established a clear line of fracture between itself and TAC. Rather, Appellant concedes that Ms. Przymuzala continues to hold a [substantial minority] interest in TAC. As a result, there remains an ongoing relationship between the companies, and no clear line of fracture. *Size Appeal of Vortec Development, Inc.*, SBA No. SIZ-4866, at 9 (2007) (no clear fracture shown when there is a "continuing business relationship" between the firms). Although Appellant represents that Ms. Przymuzala has "every intention of relinquishing her interest as soon as practicable," this does not establish that a clear line of fracture currently exists, or that one existed at the time Appellant self-certified as a small business. The fact that the Area Office previously did find clear fracture between Appellant and TAC in its 2009 determination is also not dispositive. Rather, OHA has held that "a prior size determination is not binding on either an Area Office or OHA." *Size Appeal of Miltope Corp.*, SBA No. SIZ-5066, at 7 (2009).

Appellant's better argument is that the Area Office should not have applied the "newly organized concern" rule at all, because Appellant is a "mature, established business," not a new concern. Appeal at 8. Appellant emphasizes that it was incorporated in 2005 and has performed numerous contracts since its inception. Further, Appellant has a record of "continuous and increasing" earnings over this time period:

Year	Revenues
2005	$[XXXXXX]
2006	$[XXXXXX]
2007	$[XXXXXX]
2008	$[XXXXXX]
2009	$[XXXXXX]
2010	$[XXXXXX]

Id. Appellant argues that, under OHA precedent, the "newly organized concern" rule is applicable to nascent firms, or to those which newly become active after a period of dormancy. In Appellant's view, the rule does not apply to a firm which "has been an active concern for over six years, continuously performing contracts and receiving revenues." *Id.* at 9.

In its prior cases, OHA has found that mere passage of time does not necessarily bar application of the "newly organized concern" rule. For instance, in *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, (2006) OHA determined that a firm which had been incorporated six years earlier was still "newly organized." OHA observed, however, that the firm had been dormant for most of that six-year period, and had only begun to earn revenues in the past year. Further, OHA cautioned that the result might be different if the challenged firm had

been an active concern over that entire six-year period. *Taylor* at 16 - 17; *see also Vortec* at 10 (recognizing that a firm may "still be considered newly created where, although technically incorporated [years earlier], the concern did not generate revenue and was dormant" for a lengthy period).

Likewise, OHA has in some instances determined that, once a concern has been an active business for a number of years, that concern can no longer be deemed "new." In *Size Appeal of ACI Mechanical Corp., Inc.*, SBA No. SIZ-3030 (1988), OHA considered alleged affiliation under the newly organized concern rule, and held that "[e]ven though [some] factors point to affiliation under the newly organized concern theory, [the challenged firm] is now six years old, and while no time limit on what is 'newly formed' has ever been established in the regulations or our case law, six years clearly is not new." *ACI* at 6. *See also Size Appeal of Avedon Corp.*, SBA No. SIZ-2042 (1984) (firm which has been active for six years is not "new" for purposes of the newly organized concern rule); *Size Appeal of Neal R. Gross & Co., Inc.*, SBA No. SIZ-3888, at 10 - 11 (1994).

In light of these precedents, I agree with Appellant that application of the "newly organized concern" rule to Appellant's situation was questionable. Once a firm has been an active concern for an extended period, it is not appropriate to apply the "newly organized concern" rule without considering whether the challenged firm can still reasonably be considered a new business. Furthermore, a firm which has been active for several years should be given notice that the Area Office is considering the newly organized concern rule, and should be afforded an opportunity to respond.

In this case, the Area Office recognized that Appellant was "organized as a legal entity in August 2005." Size Determination at 7. Nevertheless, the Area Office summarily invoked the newly organized concern rule without explanation. The record does not reflect that the Area Office considered whether the newly organized concern should still apply to Appellant, which apparently has been an active concern for more than six years. Furthermore, because the newly organized concern rule was not raised in the protests, and the Area Office previously determined that the "newly organized concern" did not apply, it is not clear that Appellant would have understood that its status as a "new" business was still in doubt. Based on Appellant's arguments in this appeal, it appears that Appellant might have presented the Area Office with additional evidence or information if it had known the issue was not yet settled. Accordingly, I am remanding the matter for further review consistent with this decision.

V. Conclusion

For the above reasons, I VACATE the Size Determination and REMAND the case to the Area Office. Accordingly, it is unnecessary to rule on Appellant's Motion for Submission of Additional Evidence.

KENNETH M. HYDE
Administrative Judge