

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

SIZE APPEAL OF:

Environmental Restoration, LLC,

Appellant,

RE: Environmental Quality Management,
Inc.

Appealed From
Size Determination No. . 4-2012-045

SBA No. SIZ-5395

Decided: August 28, 2012

APPEARANCES

Russ Gulledge, Environmental Restoration, LLC, Fenton, Missouri, for Appellant

Stanley R. Soya, Esq., Michael R. Golden, Esq., Hugh D. Camitta, Esq., and Heather Kilgore Weiner, Esq., Pepper Hamilton LLP, Washington D.C., for Environmental Quality Management, Inc.

Sam Q. Le, Esq., Office of General Counsel. Washington, D.C.. for the U.S. Small Business Administration

DECISION

I. Introduction and Jurisdiction

On May 23, 2012, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area IV (Area Office) issued size determination number 4-2012-045, finding that Environmental Quality Management, Inc. (EQM) is a small business under the size standard associated with solicitation SOL-R9-11-00003.¹ Specifically, the Area Office found that EQM was not affiliated with Argentum Capital Partners II, L.P. (ACP II) or Metalico, Inc. (Metalico). Environmental Restoration, LLC (Appellant), which had originally protested EQM's size, contends that the size determination is erroneous with respect to EQM's relationship with Metalico. Appellant does not contest the Area Office's determination that EQM is not affiliated with ACP II. Appellant requests that SBA's Office of Hearings and Appeals (OHA) reverse the size determination and determine that EQM is not a small business. For the reasons

¹ Due to clerical error, the size determination is incorrectly dated May 23, 2011, and incorrectly numbered 4-2011-045.

discussed *infra*, the appeal is granted with regard to EQM's relationship with Metalico, and that issue is remanded to the Area Office for further review and investigation. The appeal is otherwise denied.

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 fifteen days of receiving the size determination, so it is timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Business Relationships

EQM is majority owned by EQM Technologies & Energy, Inc. (EQMTE), which in turn is owned by ACP II, a venture capital fund and SBA-licensed Small Business Investment Company (SBIC). The Argentum Group manages, but holds no ownership interest in, ACP II.

Metalico is a publicly-traded corporation with a six-person board of directors. Mr. Carlos E. Agüero founded Metalico and is the company's President and Chief Executive Officer. He is also Chairman of Metalico's board of directors. Among the other members of Metalico's board are Mr. Walter H. Barandiaran and Mr. Paul A. Garrett.

Messrs. Agüero, Barandiaran, and Garrett serve on EQM's board of directors as well. EQM's board consists of five members.

B. Solicitation and Protest

On December 28, 2010, the U.S. Environmental Protection Agency (EPA) issued solicitation SOL-R9-11-00003 (RFP) seeking emergency and rapid response services. The Contracting Officer (CO) set aside the procurement exclusively for small businesses, and assigned North American Industry Classification System (NAICS) code 562910, Remediation Services, with a corresponding size standard of 500 employees.

On April 17, 2012, the CO announced that EQM was the apparent awardee. On April 20, 2012, Appellant protested EQM's size. Appellant alleged that EQM is affiliated with The Argentum Group and Metalico. Mistakenly believing that The Argentum Group was an SBIC,² Appellant alleged that EQM was affiliated with The Argentum Group because “control or the power to control may be traced through an SBIC to a party or parties controlling the SBIC.” (Protest at 1.) Appellant asserted that EQM was affiliated with Metalico due to common management and common ownership. (*Id.* at 2-3.) According to the protest, EQM and Metalico are affiliated through common management because three individuals (Messrs. Agüero, Barandiaran, and Garrett) sit on the boards of both companies, and constitute a majority of the boards. Appellant alleged that EQM and Metalico are affiliated based on common ownership

² The Argentum Group is not actually an SBIC, but as noted *supra*, ACP II is. Accordingly, the Area Office considered whether EQM was affiliated with ACP II.

because the three common directors hold ownership interests in EQM and Metalico. (*Id.* at 3.) Appellant also alleged EQM was not a small business under the totality of the circumstances, but Appellant offered no rationale to support this allegation.

C. Response to the Protest

In its correspondence to the Area Office, EQM responded that it qualifies for the regulatory exemption from affiliation with an SBIC found in 13 C.F.R. § 121.103(b)(1).

With regard to the Metalico allegations, EQM acknowledged that Metalico is not a small business under the applicable size standard, and that Messrs. Agüero, Barandiaran, and Garrett serve on the boards of both Metalico and EQMTE. EQM emphasized, however, that Metalico has six board members, not five as Appellant alleged. According to EQM, “[t]his fact negates any finding of shared control through an interlocked directorate. Even though three EQMTE directors are on Metalico’s board, they are only three of six board members and thus do not have majority control of the board of Metalico.” (EQM Response at 8 (emphasis in original).)

D. Size Determination

On May 23, 2012, the Area Office issued its size determination finding that EQM is a small business. The Area Office noted at the outset that each of Appellant’s protest allegations referred to “EQM/EQTE,” but no such entity exists. Rather, EQM is the subsidiary of EQMTE; the two entities are separate and distinct. Because EQM was the apparent awardee, the Area Office examined the size of EQM, and not EQMTE.

The Area Office reasoned that affiliation ordinarily would exist between ACP II and EQM because ACP II can control EQM. Here, however, the exception found in 13 C.F.R. § 121.103(b)(1) for business concerns owned by SBICs applied to the relationship between ACP II and EQM.³

The Area Office then considered whether EQM was affiliated with Metalico based on common management. Metalico is not a portfolio company of ACP II, so 13 C.F.R. § 121.103(b)(1) is not applicable. The Area Office further recognized that “[i]f [the protest] allegation is true, and if both Boards had five or fewer directors, common management might be found.” (Size Determination at 6.)

The Area Office found that three individuals—Messrs. Agüero, Barandiaran, and Garrett—do serve on the boards of directors of both Metalico and EQM. However, given that Metalico’s board consists of six members, the Area Office found that Messrs. Agüero, Barandiaran, and Garrett do not control Metalico because “[t]hree directors do not constitute a majority of a six-member Board of Directors.” (*Id.*) The Area Office stated that three directors conceivably could exercise negative control over a board if they “have the power to ‘lock up’ a

³ As noted above, Appellant does not contend that this portion of the size determination is erroneous, so further discussion of the issue is not warranted.

Board and prevent it from taking any action requiring a simple (or greater) majority.” (*Id.*) Nevertheless, the Area Office found no negative control because “the regulation [*i.e.*, 13 C.F.R. § 121.103(a)(3)] requires that negative control be exercised by a minority shareholder.” (*Id.*) The Area Office found that the stock of Metalico was widely held and there was no single minority shareholder with the power to prevent a quorum or otherwise block action by the board of directors.

Finally, the Area Office determined there was not affiliation under the totality of the circumstances for two reasons. First, the SBIC affiliation exception, 13 C.F.R. § 121.103(b)(1), applied to the relationship between ACP II and EQM. Second, there were no plausible grounds for finding affiliation that, in aggregate, would lead to a finding of affiliation.

The Area Office then found EQM's average number of employees did not exceed the size standard associated with the RFP. Therefore, EQM is an eligible small business.

E. Appeal Petition

On June 6, 2012, Appellant filed the instant appeal of the size determination with OHA. Appellant concedes at the outset that there is no error in the Area Office's determination that EQM is not affiliated with ACP II. Appellant explains that “[w]e could not find error in the Area Office's determination that EQM is not affiliated with the SBIC and therefore this appeal does not address that affiliation.” (Appeal at 3.)

Appellant insists, however, that the Area Office did err in concluding that EQM is not affiliated with Metalico. Appellant maintains that the exception at 13 C.F.R. § 121.103(b)(1) applies only to EQM's relationship with ACP II, and does not insulate EQM from affiliation with Metalico.

Appellant first argues that the regulation on negative control does not require that negative control be exercised by a minority shareholder. Rather, the regulation states that “negative control includes, but is not limited to, instances where a minority shareholder has the ability under the concern's charter, by laws or shareholder's agreement to prevent a quorum or otherwise block action by the board of directors or shareholders.” 13 C.F.R. § 121.103(a)(3). According to Appellant, “OHA has often determined that negative control exists through factors other than minority shareholders.” (Appeal at 3.) Appellant also argues that negative control need not actually be exercised to exist. All that is necessary is the power to exercise negative control.

Appellant contends that EQM and Metalico are affiliated because the firms' three common directors can exercise affirmative control over EQM and negative control over Metalico. Appellant points out that, under Metalico's bylaws, the three directors on its six-member board can prevent a quorum or create a deadlock, thereby exercising negative control. (*Id.* at 6.)

Next, Appellant argues the Area Office did not address the information it provided regarding two directors' investments in Metalico and EQM. Appellant includes a chart

delineating the investments in the two companies by Messrs. Agüero, Barandiaran, and Garrett. (*Id.* at 9.) The chart indicates that all three individuals hold stock in Metalico, that Messrs. Agüero and Barandiaran hold convertible notes in EQM, and that Metalico itself owns 5.9% of EQM. Appellant argues that, although Mr. Garrett apparently does not hold a direct ownership interest in EQM, he is indirectly invested in EQM through the Metalico stake. In Appellant's view, this information demonstrates affiliation based on identity of interest, 13 C.F.R. § 121.103(f), and the present effect rule, 13 C.F.R. § 121.103(d)(1). Appellant further observes that, if the stock interests of the three individuals were aggregated, they collectively control the largest block of Metalico's stock. (*Id.* at 11.)

Appellant also complains that, contrary to the size determination, Mr. Agüero—Metalico's President, CEO, Chairman, and largest shareholder—has the power to control the company. (*Id.*)

Appellant also maintains that the Area Office erred by not finding affiliation through the totality of the circumstances. Appellant contends the Area Office should have considered the companies' common directors, owners, and investments.

Finally, Appellant expresses disagreement with the Area Office's analysis of the SBIC affiliation exception, 13 C.F.R. § 121.103(b)(1). Appellant again states, however, that “we cannot demonstrate clear error in fact or law to dispute the Area Office's determination in that facet of our protest.” (Appeal at 12.)

F. New Evidence

With its appeal, Appellant moved to introduce Metalico's bylaws as new evidence. Appellant maintains that there is good cause to admit the bylaws because it is unclear whether the Area Office considered them, and the bylaws are significant in determining whether negative control exists. It is unnecessary to rule on this motion because Metalico's bylaws are already included in the record, and therefore do not constitute new evidence.

G. EQM's Response

On May 2, 2012, EQM filed its response to the appeal. EQM argues Appellant has not demonstrated any clear error of fact or law with the size determination. First, EQM addresses Appellant's argument that the directors common to EQM and Metalico can exercise negative control over Metalico. EQM argues the Area Office reviewed the record and reasonably determined that three directors do not have negative control of a six-member board. EQM argues negative control is a case-by-case determination because the nature and degree of control must be considered. *Size Appeal of EA Eng'g, Sci. and Tech., Inc.*, SBA No. SIZ-4973 (1998).

EQM also argues the Area Office determined correctly that no individual shareholder can control Metalico, as the largest shareholder owned 12.7% of the outstanding stock. Accordingly, it was reasonable to find that no shareholder “has the ability ... to prevent a quorum or otherwise block action by the board of directors.”

EQM then argues the Area Office properly concluded that, as a result of the exemption from affiliation with SBICs, 13 C.F.R. § 121.103(b)(1), EQM was not affiliated with ACP II. EQM contends that upholding the effectiveness of the SBIC affiliation exception requires it to be applied “upstream” to the entities that control the SBIC, as well as “downstream” to the entities the SBIC controls.

Next, EQM argues the Area Office determined correctly that the SBIC exception applies to EQM and that Appellant demonstrated no clear error in this conclusion. EQM argues further that it would preclude an SBIC from investing in companies that have operating subsidiaries if the exception did not apply to all companies downstream from the SBIC.

Finally, EQM argues Appellant has not demonstrated the Area Office erred in finding no affiliation based on the totality of the circumstances. EQM maintains that *Size Appeal of Procedyne Corp.*, SBA No. SIZ-4354 (1999), a case cited by Appellant, has no bearing on the facts of this appeal.

H. SBA Response

On July 3, 2012, eight days after the close of record, SBA timely intervened⁴ and filed its response to the appeal petition. SBA argues that the SBIC exception to affiliation applies to companies that the SBIC controls. In this case, explains SBA, the exception bars any affiliation between ACP II and EQMTE. Since an affiliation analysis proceeds in a step-by-step fashion, starting with the protested concern, *Size Appeal of Baldt, Inc.*, SBA No. SIZ-4987 (2008), EQM could be affiliated with ACP II, if at all, only through EQMTE. That connection has been severed, however, so EQM is not affiliated with ACP II. SBA does not address Appellant's arguments with regard to potential affiliation between EQM and Metalico.

III. Discussion

A. Standard of Review

Appellant has the burden of proving, by a preponderance of the evidence, all elements of the appeal. Specifically, Appellant must prove the size determination is based upon a clear error of fact or law. 13 C.F.R. § 134.314. OHA will disturb an 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).

⁴ By regulation, “SBA may intervene as of right at any time in any case until 15 days after the close of record, or the issuance of a decision, whichever comes first.” 13 C.F.R. § 134.210(a). I therefore reopen the record and accept SBA's response.

B. Analysis

1. Affiliation with ACP II

Although Appellant expresses disagreement with the Area Office's analysis of the SBIC exception, Appellant indicates that it does not seek to appeal that issue, and twice states that it was unable to locate any legal or factual error in that portion of the size determination. *See* Section II.E, *supra*. It appears, then, that Appellant does not contest the size determination with regard to whether EQM is affiliated with ACP II. Because that issue has not been appealed, the Area Office's determination with regard to affiliation with ACP II remains the final decision of the SBA. 13 C.F.R. § 121.1101(a).

2. Common Management

Appellant's principal argument on appeal is that the Area Office erred in concluding that EQM was not affiliated with Metalico. As Appellant emphasizes, Metalico is not an SBIC, and the SBIC exception from affiliation does not apply to the affiliation analysis between EQM and Metalico.

Appellant maintains that EQM and Metalico are affiliated because Messrs. Agüero, Barandiaran, and Garrett are directors of both firms, and can exercise affirmative control over EQM and negative control over Metalico. The Area Office recognized the potential validity of Appellant's theory, stating that “[i]f [the protest] allegation is true, and if both Boards had five or fewer directors, common management might be found.” (Size Determination at 6.) The Area Office ultimately rejected Appellant's argument, however, because Metalico's board consists of six members rather than five. According to the Area Office, with only three votes, Messrs. Agüero, Barandiaran, and Garrett are not a majority of the board, and cannot affirmatively control Metalico. Further, the Area Office found that Messrs. Agüero, Barandiaran, and Garrett cannot negatively control Metalico because “the regulation [*i.e.*, 13 C.F.R. § 121.103(a)(3)] requires that negative control be exercised by a minority shareholder.” (*Id.*)

I agree with Appellant that the Area Office's analysis of this issue was flawed. First, the Area Office found that Metalico is a widely-held corporation, but appears to have overlooked that Mr. Agüero is the firm's President, CEO, Chairman, and largest shareholder. Thus, Mr. Agüero may have the power to control Metalico under 13 C.F.R. § 121.103(c)(3) (“If a concern's voting stock is widely held and no single block of stock is large as compared with all other stock holdings, the concern's Board of Directors and CEO or President will be deemed to have the power to control the concern in the absence of evidence to the contrary.”). In other words, Mr. Agüero conceivably might control Metalico pursuant to 13 C.F.R. § 121.103(c)(3), even though Messrs. Agüero, Barandiaran, and Garrett do not constitute a majority of the Metalico board.

If Mr. Agüero does control Metalico, and also controls EQM, the two firms may be affiliated through common management. 13 C.F.R. § 121.103(e). In this regard, OHA has held that “[c]ommon management affiliation does not require total control of a concern, just critical influence or the ability to exercise substantive control over a concern's operations.” *Size Appeal of DMI Educational Training LLC*, SBA No. SIZ-5275, at 6 (2011). Accordingly, the Area

Office erred by not examining whether Mr. Agüero controls, or exercises “critical influence,” over both Metalico and EQM.

Even supposing that Mr. Agüero alone does not control both Metalico and EQM, it is possible that he could do so in conjunction with Messrs. Barandiaran and Garrett. Indeed, 13 C.F.R. § 121.103(e) indicates that affiliation may arise through “one or more” common officers or directors, and the size determination suggested that Messrs. Barandiaran and Garrett could, collectively, control EQM, because they are a majority of the firm's board. Appellant maintains that Messrs. Agüero, Barandiaran, and Garrett share an identity of interest based on their common investments, and therefore may reasonably be considered as a group for purposes of analyzing control. Appellant's protest gave specific details of the directors' alleged common investments, but the Area Office did not explore this issue or determine whether the directors shared sufficient common investments to give rise to an identity of interest. Accordingly, the factual record is presently incomplete as to whether there are valid grounds to find identity of interest between Messrs. Agüero, Barandiaran, and Garrett.

Finally, the Area Office's analysis of negative control also appears flawed. The Area Office recognized that Messrs. Agüero, Barandiaran, and Garrett together “may have the power to ‘lock up’ a Board and prevent it from taking any action requiring a simple (or greater) majority.” (Size Determination at 6.) Yet the Area Office found no negative control because it determined that 13 C.F.R. § 121.103(a)(3) “requires that negative control be exercised by a minority shareholder.” (*Id.*) The regulation, however, provides that “[n]egative control includes, but is not limited to, instances where a minority shareholder has the ability ... to prevent a quorum or otherwise block action by the board of directors.” 13 C.F.R. § 121.103(a)(3). Contrary to the size determination, then, the regulation does not necessarily require that negative control be exercised only by minority shareholders. Further, it is unclear as a factual matter whether Messrs. Agüero, Barandiaran, and Garrett are minority shareholders in EQM and Metalico. As Appellant emphasizes, Mr. Agüero and Mr. Barandiaran could have minority interests in EQM through convertible notes, because SBA treats such securities to having a “present effect” on the holder's ability to control the concern. 13 C.F.R. § 121.103(d)(1).

Accordingly, I find it appropriate to remand this issue to the Area Office for further consideration. Based on the available record, it appears the Area Office did not consider whether Mr. Agüero controls, or is in a position to exercise “critical influence,” over both Metalico and EQM. Further, although Messrs. Agüero, Barandiaran, and Garrett can perhaps control both Metalico and EQM if their interests are aggregated, there remains a significant question as to whether these individuals share an identity of interest, such that they may reasonably be treated as a unified group for purposes of analyzing control. The size determination lacks discussion of this theory of affiliation, and the record does not indicate the extent to which the three directors share common investments. I find, therefore, that the Area Office prematurely ruled out possible affiliation between EQM and Metalico, without fully exploring Appellant's protest allegations. Under such circumstances, it is proper to remand the size determination for further review. *E.g. Size Appeal of Mark Dunning Industries, Inc.*, SBA No. SIZ-5284 (2011).

IV. Conclusion

Appellant has demonstrated that the size determination is clearly erroneous with regard to potential affiliation between EQM and Metalico. Accordingly, the appeal is GRANTED to the extent discussed above, and is otherwise DENIED. The issue of potential affiliation between EQM and Metalico is REMANDED to the Area Office for further review.

KENNETH M. HYDE
Administrative Judge