

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

SIZE APPEAL OF:

Environmental Quality Management, Inc.

Appellant,

Appealed From
Size Determination No. 04-2012-65

SBA No. SIZ-5429

Decided: December 20, 2012

APPEARANCES

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

DECISION

I. Introduction and Jurisdiction

On October 5, 2012, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area IV (Area Office) issued Size Determination 4-2012-65, finding that Environmental Quality Management, Inc. (Appellant) is not an eligible small business. Specifically, the Area Office determined that Appellant is affiliated with Metalico, Inc. (Metalico) based on common management. Appellant contends that the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse or remand the size determination. For the reasons discussed *infra*, the appeal is granted, and the size determination 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 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

Appellant is majority owned by EQM Technologies & Energy, Inc. (EQMTE), which in turn is majority owned by Argentum Capital Partners II, L.P. (ACP II), a venture capital fund and SBA-licensed Small Business Investment Company (SBIC). EQMTE is incorporated in the state of Delaware.

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 the 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 EQMTE's board of directors as well. Mr. Barandiaran is the chairman of EQMTE's board of directors, which consists of five members. EQMTE has no employees.

Messrs. Barandiaran and Garrett, but not Mr. Agüero, also serve on Appellant's board, which consists of four members.

B. Solicitation and Protest

On December 28, 2010, the U.S. Environmental Protection Agency issued solicitation SOL-R9-11-00003 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 Appellant was the apparent awardee. On April 20, 2012, Environmental Restoration, LLC (ERL) protested Appellant's size, alleging, among other things, that Appellant is affiliated with Metalico due to common management and common ownership. (Protest at 2-3.) According to the protest, Appellant 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 both boards. ERL also alleged that Appellant and Metalico are affiliated based on common ownership, because the three common directors hold ownership interests in Appellant and Metalico. (*Id.* at 3.)

C. Prior Size Determination and Remand

On May 23, 2012, the Area Office issued Size Determination 4-2012-045, concluding that Appellant is not affiliated with Metalico. In reaching this determination, the Area Office reasoned 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.” *Size Appeal of Envtl. Restoration, LLC*, SBA No. SIZ-5395, at 3 (2012) (quoting prior determination). Further, although three members could prevent a quorum or create a deadlock on a six-person board, the Area Office found that Messrs. Agüero, Barandiaran, and Garrett do not 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.* The Area Office then aggregated the employees of Appellant and its various acknowledged affiliates and determined Appellant was an eligible small business.

ERL appealed Size Determination 4-2012-045 to OHA, contending that Appellant and Metalico are affiliated because Messrs. Agüero, Barandiaran, and Garrett are directors of both concerns (or of Appellant's parent company, EQMTE), and can thereby exercise affirmative

control over Appellant and negative control over Metalico. ERL maintained that there is no legal requirement that negative control be exercised only by a minority shareholder. *Id.* at 4.

OHA agreed with ERL that the Area Office improperly construed the regulation on negative control. In addition, the Area Office did not explore whether Mr. Agüero alone could control Metalico, in his capacity as the firm's President, CEO, Chairman, and largest shareholder. *Id.* at 7. Further, the Area Office did not address whether Messrs. Agüero, Barandiaran, and Garrett share sufficient common investments to give rise to an identity of interest, and therefore may reasonably be considered as a group for purposes of assessing control. OHA remanded the case to the Area Office to consider (1) whether Mr. Agüero alone controls, or exercises “critical influence” over, both Metalico and Appellant, or (2) whether Messrs. Agüero, Barandiaran, and Garrett share an identity of interest based on their common investments. *Id.*

D. Supplemental Information

On October 1, 2012, Appellant submitted comments to the Area Office on the issues raised in *Size Appeal of Envvtl. Restoration, LLC*, SBA No. SIZ-5395 (2012).

Appellant asserted that Mr. Agüero does not control, or exercise critical influence over, Appellant. Appellant emphasized that “Mr. Agüero is not a member of [Appellant's] Board of Directors, does not own any stock in [Appellant], and is not an employee and does not have any other contractual relationship with [Appellant].” (Comments at 1.) Further, although Mr. Agüero is a director of EQMTE and holds a small ownership interest (1.4%), he cannot control EQMTE.

Appellant further contended that there is no basis to find an identity of interest among Messrs. Agüero, Barandiaran, and Garrett. Appellant explained that Mr. Agüero acquired his small interest in EQMTE, and serves on EQMTE's board, due to a previous merger. Mr. Barandiaran owns less than 1% of EQMTE's outstanding stock, and his directorship represents the interests of ACP II, which holds a controlling share of EQMTE. Mr. Garrett too owns less than 1% of EQMTE. Thus, argued Appellant, because these directors have such small shareholdings and represent divergent interests, they do not have the ability to control EQMTE or share an identity of investment interest. (*Id.* at 2.)

E. The Instant Size Determination

On October 5, 2012, the Area Office rendered the instant size determination, finding that Appellant and Metalico are affiliated based on common management.

The Area Office first examined whether Mr. Agüero alone could control both Appellant and Metalico. The Area Office concluded that Mr. Agüero controls Metalico in his individual capacity, not because he is its largest shareholder, but because he is its chief executive officer, president, and chairman of its board of directors. (Size Determination at 2.) The Area Office determined, however, that Mr. Agüero does not control Appellant in his individual capacity, as he is not one of Appellant's officers, employees, directors, or shareholders. (*Id.*)

Next, the Area Office considered whether a group of persons collectively control Appellant and Metalico. The Area Office noted that affiliation based on common management exists when “one or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns.” 13 C.F.R. § 121.103(e). Furthermore, OHA has recognized 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 Educ. Training LLC*, SBA No. SIZ-5275, at 6 (2011).

The Area Office observed that Messrs. Agüero, Barandiaran, and Garrett serve on both EQMTE's and Metalico's boards of directors, and EQMTE controls Appellant. The Area Office went on to reason that, given EQMTE's majority ownership of Appellant, affiliation might arise between Appellant and Metalico if Messrs. Agüero, Barandiaran, and Garrett have the ability to exercise critical influence or substantial control over both Metalico and EQMTE. The Area Office then determined that the three directors, collectively, do have the ability to control EQMTE, because they comprise the majority of the board.

The Area Office next found that the three directors also have the ability to control Metalico, because they have the ability to prevent Metalico from taking action requiring the presence of a simple majority. (Size Determination at 4.) In reaching this conclusion, the Area Office noted that Messrs. Agüero, Barandiaran, and Garrett comprise half of Metalico's board of directors, and that Metalico's bylaws require a majority to constitute a quorum for the transaction of business. Thus, EQMTE and Metalico are affiliated through common management. Because EQMTE controls Appellant, Appellant and Metalico are likewise affiliated.

The Area Office determined that Appellant, standing alone, does not exceed the size standard. (*Id.* at 5.) However, once its employees are aggregated with those of its affiliates, Appellant is not an eligible small business.

F. Appeal

On October 23, 2012, Appellant filed the instant appeal. Appellant contends that the size determination is clearly erroneous and should be reversed. Alternatively, should OHA find that the Area Office did not make a determination consistent with the remand instructions, Appellant requests that OHA remand the case for a new determination.

Appellant maintains that, contrary to the size determination, Messrs. Agüero, Barandiaran, and Garrett do not control the board of EQMTE, and the record demonstrates this fact. Appellant emphasizes that ACP II controls EQMTE by virtue of its majority ownership of EQMTE's voting stock. According to Delaware state law¹ and EQMTE's bylaws,² the majority

¹ Under Delaware law, “[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors.” Del. Gen. Corp. L. § 141(k).

² EQMTE's bylaws provide that “[a] special meeting of stockholders may be called at any time by the Chairman of the Board (the ‘Chairman’), the Chief Executive Officer or the

shareholder, ACP II, has the power to convene a special meeting of stockholders, remove any or all of the directors without cause, and elect new directors in their stead. Thus, ACP II has complete control of EQMTE, and any ability that Messrs. Agüero, Barandiaran, and Garrett may have to control EQMTE is illusory. (Appeal at 10-12.)

Appellant goes on to argue that the Area Office erred as a matter of law in concluding that the three directors can exercise control over EQMTE. Appellant contends OHA precedent makes plain that a concern's directors do not control a company where, under state law, the majority owner could unilaterally remove those directors without cause. *Size Appeal of The Clement Group, LLC*, SBA No. SIZ-5146 (2010).

Appellant reiterates that Messrs. Agüero, Barandiaran, and Garrett have very small ownership interests in EQMTE and their directorships represent different interests. Thus, argues Appellant, the record demonstrates that there is no identity of interest among the three directors. Appellant then takes issue with the Area Office's determination that those three directors “comprise a majority of the Board and must be deemed to control it.” Appellant argues that, contrary to OHA's remand order, the Area Office failed to consider whether Messrs. Agüero, Barandiaran, and Garrett share any common purpose or identity of interest. (*Id.* at 14-15.)

Appellant contends this is also true of the directors' involvement with Metalico. Although Mr. Agüero acts on behalf of Metalico, Mr. Barandiaran serves on Metalico's board as a representative of ACP II. Thus, argues Appellant, to conclude that these directors act in unison on either board has no factual basis in the record. (*Id.*)

Lastly, Appellant contends ACP II's status as an SBIC should preclude Mr. Barandiaran's involvement with Metalico's board from being considered under an affiliation analysis. Appellant emphasizes that EQMTE is not affiliated with ACP II by virtue of 13 C.F.R. § 121.103(b)(1). To give proper effect to 13 C.F.R. § 121.103(b)(1), affiliation should not “proceed from ACP II to the persons who control it and to entities such persons may in turn control.” (Appeal at 16.) To do otherwise would negate the effectiveness of the SBIC exception and undermine the SBIC program. (*Id.* at 15-16.)

Board of Directors pursuant to a resolution adopted by a majority of the Board of Directors and shall be called by any of them or by the Secretary upon receipt of a written request to do so specifying the matter or matters, appropriate for action at such a meeting, proposed to be presented at the meeting and signed by holders of shares representing at least 25% of the shares of stock that would be entitled to be voted on such matter or matters if the meeting were held on the day such request is received and the record date for such meeting were the close of business on the preceding day. Any such meeting shall be held at such time and at such place, within or without the State of Delaware, as shall be determined by the body or person calling such meeting and as shall be stated in the notice of such meeting.” EQMTE Bylaws § 1.2.

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).

B. Analysis

Appellant argues persuasively that the instant appeal is substantially similar to *Size Appeal of The Clement Group, LLC*, SBA No. SIZ-5146 (2010). In that case, an area office found that the owners of the challenged firm could exert negative control over an alleged affiliate, because they were two of the four directors on the board of the alleged affiliate. On appeal, OHA determined that Alabama state law rendered any such negative control illusory. Specifically, OHA held that the majority shareholder of the alleged affiliate could simply remove the two directors in question. OHA explained:

[Alabama law], which applies to Alabama business corporations such as [[the alleged affiliate], provides: ‘The shareholders may remove one or more directors with or without cause unless the articles of incorporation provide that directors may be removed only for cause.’ A review of [the alleged affiliate's] Articles of Incorporation reveals no such provision. Thus, [the challenged firm] is correct in its conclusion that [the majority shareholder of the alleged affiliate], as President and 51% shareholder, has the power to remove [any directors] should they ever attempt to control [the alleged affiliate] by preventing a quorum. She need only call a shareholder meeting for that purpose and vote to remove the [directors]. Because she is the majority shareholder of [the alleged affiliate] her votes would control the outcome.

Clement Group, SBA No. SIZ-5146, at 6.

Similar circumstances are present in the instant appeal. EQMTE is incorporated in the state of Delaware, and Delaware law provides that “any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors.” Del. Gen. Corp. L. § 141(k). ACP II holds a majority of EQMTE's voting shares. Thus, in accordance with Delaware law and EQMTE's bylaws, *see* Section II.F. *supra*, ACP II may remove directors from EQMTE's board of directors and elect others to replace them. Accordingly, although it might appear that Messrs. Agüero, Barandiaran, and Garrett collectively control EQMTE's board, such control is merely illusory. I find, therefore, that the Area Office erred in determining that Messrs. Agüero, Barandiaran, and Garrett have the power to control Appellant's parent company, EQMTE. As a consequence, the

Area Office also erred in determining Appellant and Metalico are affiliated based on common management.

IV. Conclusion

The Area Office determined that Appellant is a small business when its employees are aggregated with those of its acknowledged affiliates. However, Appellant exceeded the size standard once its employees were aggregated with Metalico and EQMTE. The record reveals that EQMTE has no employees, so Appellant would exceed the size standard only if it is affiliated with Metalico. Appellant has demonstrated that it is not affiliated with Metalico. Accordingly, the appeal is GRANTED, and the size determination is REVERSED. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(d).

KENNETH M. HYDE
Administrative Judge