United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: DefTec Corporation, Appellant, Appealed From Size Determination No. 3-2014-025	SBA No. SIZ-5540 Decided: April 1, 2014

APPEARANCES

Christopher R. Yukins, Esq., Arnold & Porter LLP, Washington, D.C., for Appellant

Michael J. Gardner, Esq., Erik M. Ideta, Esq., Jennifer M. Hall, Esq., Troutman Sanders LLP, Norfolk, Virginia, for Systems Documentation, Inc.

DECISION[1]

I. Introduction and Jurisdiction

On February 12, 2014, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area III (Area Office) issued Size Determination No. 3-2014-025 finding that DefTec Corporation (Appellant) is not a small business under the size standard associated with the instant procurement. Appellant maintains that the size determination is flawed in several respects, and requests that SBA's Office of Hearings and Appeals (OHA) reverse or remand. For the reasons discussed *infra*, the appeal is granted, and the size determination is remanded for further review.

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 the appeal is timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

[1] This decision was initially issued under a protective order. Pursuant to 13 C.F.R. § 134.205, I afforded counsel an opportunity to file a request for redactions if desired. OHA received one or more timely requests for redactions and considered any requests in redacting the decision. OHA now publishes a redacted version of the decision for public release.

II. Background

A. Solicitation and Protest

On October 24, 2013, the U.S. Department of Defense, Joint Improvised Explosive Device Defeat Organization (JIEDDO) issued Request for Proposals (RFP) No. HQ0682-14-R-0001 for developmental testing and evaluation support. The Contracting Officer (CO) set aside the procurement entirely for small businesses and assigned North American Industry Classification System (NAICS) code 541330, Engineering Services. NAICS code 541330 ordinarily is associated with a size standard of $14 million, but the RFP indicated that the work fit within the exception for Military and Aerospace Equipment and Military Weapons, which utilizes a size standard of $35.5 million. Proposals were due November 18, 2013.

On January 9, 2014, the CO announced that Appellant was the apparent awardee. On January 16, 2014, Systems Documentation, Inc. (SDI), an unsuccessful offeror, protested Appellant's size. SDI alleged that Appellant is a new and unproven concern and will be heavily reliant upon a large business, American Systems Corporation (ASC), for contract performance, in violation of the ostensible subcontractor rule, 13 C.F.R. § 121.103(h)(4). The CO forwarded SDI's protest to the Area Office for consideration.

B. Area Office Proceedings

In response to the size protest, Appellant submitted its sworn SBA Form 355, its proposal responding to the RFP, and other documents. Upon reviewing this information, the Area Office determined that Appellant may be affiliated with SEKTYR International, Inc. (SEKTYR), and other concerns associated with SEKTYR, on alternate grounds than raised in SDI's protest. Appellant notified the Area Office that Mr. Charles Barkley, a retired professional basketball player, owns [XX]% of SEKTYR, with the next largest shareholder owning only 8.7%. On February 5, 2014, the Area Office sent an email to Appellant requesting further information about Mr. Barkley's business interests:

> Per our telephone [conversation] yesterday I explained to you that SBA has to determine who has control of [Appellant] and therefore all issues of affiliation must be reviewed.
>
> I mentioned that you need to look at 13 CFR 121.103(c) because Mr. Barkley has the majority ownership in comparison to the other stockholders of [[SEKTYR]. . . . In this case we need to know Mr. Charles Barkley's business interests that he has 50% or more ownership interest in or majority ownership. Then I need to review all the tax returns for 2010, 2011, and 2012. Or I can get a statement from him or his accountant stating [whether] if we include all the other business interest that he has invested in it would exceed the standard of $35.5 million.

(Email from I. Bascumbe to B. Reeder (Feb. 5, 2014).) The email warned Appellant that, if the requested information was not forthcoming, the Area Office "can find your company to be other than small." (*Id.*)

On February 6, 2014, Appellant's legal counsel responded to the Area Office's request, expressing his view that Mr. Barkley's other business interests are not relevant to determining Appellant's size. The Area Office did not respond to counsel's letter, but did email Appellant later the same day to inform Appellant that the Area Office was reviewing potential affiliation with SEKTYR through common management and the newly organized concern rule. The following day, Appellant's counsel emailed the Area Office to address common management and the newly organized concern rule. Appellant's counsel began his email by stating that "we take it that any issues relating to Mr. Barkley are resolved." (Email from C. Yukins to I. Bascumbe (Feb. 7, 2014).) The Area Office replied to the email that same day to request further details about the holdings of SEKTYR's CEO, Mr. David LaChance, but did not renew its request for information about Mr. Barkley's other business interests.

On February 11, 2014, at 12:42 p.m., the Area Office again emailed Appellant, posing several questions about SEKTYR and "ask[ing] one more time" about Mr. LaChance's businesses interests, which Appellant had not yet addressed to the Area Office's satisfaction. (Email from I. Bascumbe to B. Reeder (Feb. 11, 2014).) The email made no mention of Mr. Barkley. The Area Office instructed Appellant to respond by close of business that same day and warned that the Area Office "may presume that any undisclosed information would show that the concern is other than a small business." (*Id.*)

C. Size Determination

On February 12, 2014, the Area Office issued Size Determination No. 3-2014-025. The Area Office rejected SDI's protest allegations, but concluded that Appellant nevertheless is not a small business due to affiliation with SEKTYR and other concerns.

The Area Office explained that Ms. Barbara J. Reeder owns 51% of Appellant, and is Appellant's President/CEO. (Size Determination at 2.) The remaining 49% ownership interest is held by SEKTYR. The Area Office determined that Ms. Reeder has the power to control Appellant by virtue of her majority ownership. (*Id.*)

The Area Office found that the President and CEO of SEKTYR, Mr. LaChance, also serves as Chief Financial Officer (CFO) of Appellant and as a member of Appellant's board of directors. Through these various positions, Mr. LaChance has the power to "exert substantial control/critical influence" over both Appellant and SEKTYR. (*Id.* at 3.) As a result, the Area Office determined, Appellant is affiliated with SEKTYR through common management, 13 C.F.R. § 121.103(e).

The Area Office next explored whether Appellant may be affiliated with SEKTYR under the newly organized concern rule, 13 C.F.R. § 121.103(g). The Area Office found that three of the four elements of the newly organized concern rule test are met. The first element is met because Appellant's founder, Ms. Reeder, is a former key employee of SEKTYR. (*Id.*) The third element of the test is met because Ms. Reeder is Appellant's President/CEO and majority shareholder. (*Id.*) The fourth element of the test is met because SEKTYR provided Appellant significant financial assistance at the time Appellant was founded. (*Id.* at 4.) The second element

of the test, however, is not met because Appellant and SEKTYR operate in different lines of business. (*Id.*) The Area Office concluded that "affiliation may not be found under the newly organized concern rule but the remaining elements fully support a finding of affiliation between [Appellant] and SEKTYR under the totality of the circumstances." (*Id.*)

The Area Office reviewed the ownership and structure of SEKTYR. Based on information furnished by Appellant, the Area Office determined that SEKTYR is owned by 56 shareholders, none of whom holds a majority interest. (*Id.* at 5.) However, Mr. Barkley owns nearly [XX]% of SEKTYR, with the next largest shareholder owning 8.7%. Therefore, "Mr. Barkley's stock ownership, which is the largest block of stock by far in comparison to all other stockholdings, results in Mr. Barkley having the power to control SEKTYR." (*Id.*)

The Area Office stated that, due to Mr. Barkley's control over SEKTYR, the Area Office requested information about Mr. Barkley's other business interests. Appellant, though, did not produce this information, and instead questioned the relevance of the Area Office's request in a letter from Appellant's counsel dated February 6, 2014. (*Id.* at 7-8.) The Area Office concluded that it was "unable to conduct a size determination and has no choice but to apply the adverse inference rule." (*Id.* at 9.)

The Area Office found that the combined average annual receipts of Appellant, SEKTYR, and two other companies controlled by SEKTYR do not exceed the applicable $35.5 million size standard. (*Id.*) However, because Appellant did not submit information concerning Mr. Barkley's other business interests, the Area Office drew an adverse inference that the missing information would have shown that Appellant is other than small. (*Id.* at 9-10.)

D. Appeal

On February 21, 2014, Appellant filed the instant appeal with OHA. Appellant contends that the Area Office committed four major errors, any one of which is sufficient grounds to overturn the size determination.

Appellant argues that the Area Office first erred in determining that Mr. LaChance is Appellant's CFO. According to Appellant, Mr. LaChance "provides financial and accounting services as a 'CFO for Hire', [but] he is not an officer of the company." (Appeal at 9.) As a result, Appellant maintains, the Area Office clearly erred in finding affiliation with SEKTYR through common management.

Second, Appellant asserts that the Area Office incorrectly concluded that Mr. Barkley controls SEKTYR. Appellant states that Mr. Barkley in actuality owns only [XX]% of SEKTYR, "a far smaller share than the nearly [XX]% stake originally presented." (*Id.* at 7.) Further, Mr. Barkley's [XX]% interest is insufficient to enable him to control SEKTYR. Appellant acknowledges that the Area Office based its findings on information submitted by Appellant itself, but maintains that "[t]he earlier, incorrect data regarding holdings in [[SEKTYR] were inadvertently produced because of the significant time pressures in responding to [the Area Office's] requests." (*Id.*) Appellant contends that "this new factual information [concerning Mr.

Barkley's interest in SEKTYR] warrants reversing the [size] determination, which was based in important part on the initial, erroneous facts." (*Id.* at 9.)

Third, supposing that Mr. Barkley does control SEKTYR, and further supposing that Appellant and SEKTYR are affiliated through common management, the Area Office could not reasonably conclude that Mr. Barkley has any power to control Appellant. Appellant emphasizes that Mr. Barkley has no direct involvement with Appellant, and is only tangentially associated with Appellant through his investment in SEKTYR. Appellant complains that "[b]ased on this erroneous conclusion that Mr. Barkley did control [Appellant], the SBA Area Office concluded that Mr. Barkley's other holdings would be relevant to a size determination." (*Id.* at 4.)

Fourth, Appellant maintains that the Area Office improperly applied an adverse inference against Appellant. Appellant explains that, after Appellant did not produce information about Mr. Barkley's holdings, the Area Office drew an adverse inference, assuming that if Mr. Barkley's holdings were included, the total receipts of Appellant and its affiliates would exceed the size standard. This assumption was invalid, Appellant states, because even if Mr. Barkley's other holdings are considered, [XXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXX]. (*Id.* at 15.)

Moreover, Appellant asserts that it fully cooperated with the Area Office, such that an adverse inference was improper. The size determination recognized that Appellant's counsel responded to the request for information about Mr. Barkley's holdings in a letter dated February 6, 2014. In this letter, counsel "politely explain[ed] why Mr. Barkley's holdings were legally irrelevant to the affiliation inquiry." (*Id.* at 12.) The Area Office did not reply to counsel's letter, and counsel emailed the Area Office the next day, stating that "we take it that any issues relating to Mr. Barkley are resolved." (*Id.* at 13, quoting email from C. Yukins to I. Bascumbe (Feb. 7, 2014).) In response, the Area Office requested further details about Mr. LaChance's holdings, but did not revisit its request for information about Mr. Barkley's business interests, or otherwise contradict Appellant's belief that "any issues relating to Mr. Barkley are resolved." (*Id.* at 14.) Thus, Appellant reasonably inferred that the Barkley request was no longer outstanding. (*Id.* at 14-15.) Appellant insists that it was "fully prepared to cooperate, if the Area Office had simply asked for that cooperation." (*Id.* at 15.) Further, it is a violation of due process for the Area Office to draw an adverse inference based on the Area Office's "own failure to request further information." (*Id.*)

Accompanying its appeal, Appellant moves to introduce new evidence. Specifically, Appellant seeks to admit information about Mr. Barkley's business interests, including tax returns and declarations from Mr. Barkley and his financial advisor; a declaration from Mr. LaChance discussing alleged errors in the size determination; and a common stock ledger purporting to show that Mr. Barkley owns only [XX]% of SEKTYR. Appellant maintains that the new evidence is relevant and corroborates the arguments discussed in the appeal.

On March 10, 2014, Appellant filed a supplemental letter summarizing and reiterating its appeal contentions. Appellant urges OHA to expeditiously grant its appeal and reverse the size determination, without remanding to the Area Office, because the adverse inference was clearly improper and the record otherwise demonstrates that Appellant is a small business.

E. SDI Response

On March 11, 2014, SDI responded to the appeal. SDI argues that the Area Office properly drew an adverse inference against Appellant based on Appellant's failure to provide requested information regarding Mr. Barkley's other business interests; that the new evidence Appellant seeks to introduce on appeal is inadmissible; and that Appellant's March 10, 2014 letter requesting reversal of the size determination should be rejected.

SDI asserts the Area Office correctly determined Appellant to be other than small based on application of the adverse inference rule, 13 C.F.R §§ 121.1008(d) and 121.1009(d). SDI explains that the Area Office properly concluded that Mr. Barkley had the power to control SEKTYR based on his majority ownership, and the Area Office consequently needed to review Mr. Barkley's other holdings to determine other possible affiliates and to calculate Appellant's size. (SDI Response at 4-5.) Rather than comply, Appellant attempted to evade the request and failed to provide the requested information. (*Id.* at 15-16.) Appellant cites OHA case law to emphasize that "'[t]he purpose of the adverse inference rule is to provide a negative consequence to those who fail to timely respond to a request for information by SBA during the size determination process."' (*Id.* at 9, quoting *Size Appeal of Log In Systems, Inc.*, SBA No. SIZ-5130 (2010).)

Due to Appellant's failure to furnish the requested information, SDI argues that the Area Office correctly applied the adverse inference rule to find Appellant other than small. (*Id.* at 8-9.) SDI recites OHA's three-part test for review of an adverse inference and argues that each element is met here. According to SDI, the requested information is relevant; there is a level of connection between Appellant, SEKTYR, and Mr. Barkley; and the Area Office's request was specific. SDI offers lengthy quotes from the Area Office's emails of February 5, 2014 and February 11, 2014. (*Id.* at 14-15.)

In addition to supporting the adverse inference, SDI also argues that OHA should refuse to consider any new evidence proffered for the first time on appeal. SDI asserts that Appellant has not established good cause to admit this evidence because the new evidence could, and should, have been presented to the Area Office during the size review. (*Id.*17-18 (citing *Size Appeal of Canal Wood, LLC*, SBA No. SIZ-4852 (2007).)

Finally, SDI urges OHA to exclude Appellant's March 10, 2014 letter requesting reversal of the size determination. SDI argues that Appellant's letter is improper and contrary to OHA's rules of procedure, which do not ordinarily permit a reply or a supplemental appeal. (*Id.* at 28-29.)

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 that 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

As SDI correctly observes in its response to the appeal, the bulk of Appellant's arguments in this case are undermined by the fact that the Area Office based its findings on information provided by Appellant itself during the size review, although Appellant now asserts that portions of this information were incorrect. In particular, Appellant concedes that Appellant informed the Area Office that Mr. Barkley owned [XX]% of SEKTYR, but asserts on appeal that Mr. Barkley's actual interest in SEKTYR is far smaller, only [XX]%. Similarly, Appellant's sworn SBA Form 355 represented that Mr. LaChance is one of three officers of Appellant, and Mr. LaChance signed the document on Appellant's behalf using the title "CFO." Appellant now argues on appeal, however, that Mr. LaChance is not in fact Appellant's CFO or even an officer of the company.

I must agree with SDI that, insofar as Appellant attempts to blame the Area Office for "errors" in the size determination, which resulted from Appellant's own mistakes or negligence in submitting inaccurate information to the Area Office, this appeal has no merit. Pursuant to 13 C.F.R. § 121.1009(c), it was Appellant's responsibility to convince the Area Office that Appellant is a small business. On appeal, OHA does not conduct a new investigation into the size of a challenged firm. Rather, OHA ascertains whether the area office committed any clear error of fact or law, based on the contemporaneous record available to the area office. 13 C.F.R. § 134.314. For this reason, OHA will not entertain new evidence or arguments that were not first presented to the area office for consideration. 13 C.F.R. §§ 134.308(a) and 134.316(c). Similarly, OHA has held that an area office cannot have "erred" by failing to address information or arguments that were never presented to it in the first instance. *E.g., Size Appeal of EASTCO Building Svcs., Inc.*, SBA No. SIZ-5437, at 7 (2013) (recognizing that a challenged firm "may not now argue on appeal what it should have argued to the Area Office"); *Size Appeal of J.M. Waller Assocs., Inc.*, SBA No. SIZ-5108, at 4 n.1 (2010) (denying appeal because the challenged firm "seeks to charge the Area Office with error for not considering an argument [the challenged firm] never made and that was not apparent from the face of the documentation [the challenged firm] presented."). In this case, then, Appellant's mistaken submission of incorrect data to the Area Office does not constitute valid grounds to disturb the size determination, because the Area Office did not err in relying upon such data.

Appellant does, however, raise a compelling argument that the Area Office unjustifiably applied an adverse inference against Appellant. The record demonstrates that the Area Office drew an adverse inference solely because Appellant did not produce information about Mr. Barkley's other business interests. The Area Office initially requested this information on February 5, 2014, and Appellant's counsel promptly replied the next day in an effort to persuade the Area Office that such information was not relevant. *See* Section II.B, *supra*. On February 7, 2014, Appellant's counsel emailed the Area Office and attempted to confirm that "any issues relating to Mr. Barkley are resolved." *Id.* Although there were further communications between

the Area Office and Appellant over the ensuing days, including requests for additional information, the Area Office never again raised the issue of Mr. Barkley's holdings. Nor did the Area Office dispute Appellant's assertion that the Barkley inquiry was resolved. *Id.* Under the circumstances, then, it was reasonable for Appellant to conclude that the Area Office had abandoned or withdrawn its request for information about Mr. Barkley's other business interests. Appellant's understanding was made even more plausible by the fact that Mr. Barkley and SEKTYR have no connection to the ostensible subcontractor allegations which formed the basis for SDI's protest. In prior cases, OHA has recognized that an adverse inference may be overturned when a request for information is not clearly communicated to, or received by, the challenged firm. *Size Appeal of T/J Techs., Inc.*, SBA No. SIZ-4832 (2007) (adverse inference improper because challenged firm did not receive requests for information due to area office transmission errors and technical difficulties); *Size Appeal of Addison Construction & Maintenance Corp.*, SBA No. SIZ-4418 (2000). Similarly, in the instant case, Appellant did not refuse to cooperate with the Area Office, but appears to have been unaware, based on communications with the Area Office, that the Area Office still expected information about Mr. Barkley's other business interests. As a result, the Area Office erred in applying the adverse inference.

SDI cites a number of cases in which OHA has affirmed the use of an adverse inference, but none of these cases is apposite to the situation presented here. In *Size Appeal of Temp Systems, Inc.*, SBA No. SIZ-4802 (2006), the area office requested information by a particular date, and applied an adverse inference after the deadline passed. On appeal, the challenged firm argued that it had attempted to comply with the deadline but mistakenly made a typographical error in the delivery address. OHA affirmed the size determination, concluding that the late submission of information was attributable to the challenged firm's own error. By contrast, in the instant case, Appellant was not primarily responsible for the miscommunication regarding the Barkley request. In *Size Appeal of Canal Wood, LLC*, SBA No. SIZ-4852 (2007), the challenged firm had multiple offices in the state of South Carolina, and failed to respond to an area office's requests because it assumed that such correspondence would be directed to its Conway, South Carolina office. OHA denied the appeal, explaining that "[t]he rest of the world cannot be on notice of [the challenged firm's] internal directions as to which of its offices performs which function." *Canal Wood*, SBA No. SIZ-4852, at 4. In the instant case, though, Appellant made no unilateral assumptions, but instead attempted to verify that the Barkley inquiry had been resolved, and received no contrary instructions from the Area Office. In *Size Appeal of Log In Systems, Inc.*, SBA No. SIZ-5130 (2010), OHA dismissed an appeal as untimely and procedurally defective. OHA remarked, however, that even if the challenged firm had argued that it required more time to respond to a size protest, such an argument would fail because the challenged firm did not seek or obtain an extension. Here, Appellant does not complain that it had inadequate time to respond to the Barkley request. Moreover, while it is true that Appellant did not request an extension from the Area Office, there would have been no logical reason for Appellant to do so given that Appellant understood the Barkley request to have been resolved or withdrawn.

Lastly, I agree with SDI that this appeal may not simply be reversed but rather must be remanded to the Area Office. The Area Office has not yet had an opportunity to examine Appellant's new evidence and arguments, and it is possible that that the Area Office may identify

other issues that have yet to be explored. SDI observes, for example, that the amended common stock ledger submitted by Appellant on appeal indicates that Mr. Barkley is one of two large shareholders of SEKTYR, which may be grounds to find that Appellant is affiliated not only with Mr. Barkley but also with the other large shareholder. (SDI Response at 27-28.)

IV. Conclusion

For the above reasons, the appeal is GRANTED, the size determination is VACATED, and the matter is REMANDED to the Area Office for further review. In light of this outcome, it is unnecessary to rule upon Appellant's motion to introduce new evidence on appeal. *Size Appeal of Patriot Constr., Inc.*, SBA No. SIZ-5439, at 5 (2013) (recognizing that the proponent "may submit [the new] information to the Area Office for consideration as part of the remand process"); *Size Appeal of Hardie's Fruit & Vegetable Co. South, LP*, SBA No. SIZ-5347, at 15 (2012).

KENNETH M. HYDE
Administrative Judge