

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

REDACTED VERSION FOR PUBLIC RELEASE

SIZE APPEAL OF:

Southern Contracting Solutions III, LLC,

Appellant,

Appealed From

Size Determination No. 03-2018-047

SBA No. SIZ-5956

Decided: August 30, 2018

APPEARANCES

Steven Koprince, Esq., Matthew T. Schoonover, Esq., Matthew P. Moriarty, Esq., Shane J. McCall, Esq., Stephan L. Skepnek, Esq., of Koprince Law, LLC, Lawrence, Kansas, for Appellant

Peter B. Ford, Esq., Patrick T. Rothwell, Esq., Michelle E. Litteken, Esq., Meghan F. Leemon, Esq., Timothy F. Valley, Esq., of PilieroMazza PLLC, Washington, District of Columbia, for Government Contracting Resources, Inc.

DECISION¹

I. Introduction and Jurisdiction

On June 1, 2018, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area III (Area Office) issued Size Determination No. 03-2018-047 finding that Southern Contracting Solutions III, LLC (Appellant) is not a small business under the size standard associated with the subject procurement. Appellant maintains the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse or remand. For the reasons discussed *infra*, the appeal is granted; the size determination is vacated, and remanded to the Area Office for a new size determination.

¹ This decision was initially issued under a protective order. Pursuant to 13 C.F.R. § 134.205, OHA 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

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.

II. Background

A. Solicitation and Protest

On January 19, 2018, the United States Department of the Navy, Naval Facilities Engineering Command Southeast, Jacksonville, FL (Navy) issued Request for Proposals (RFP) No. N69450-18-R-1735 for multi — function support services for facility investment, pest control, integrated solid waste management, grounds maintenance, landscaping, and environmental services. The RFP stated that the Navy planned to award a single Indefinite Delivery/Indefinite Quantity (ID/IQ) contract. The Contracting Officer (CO) set the procurement aside entirely for Service-Disabled Veteran-Owned Small Business Concerns (SDVO SBCs) and assigned North American Industry Classification System (NAICS) code 561210, Facilities Support Services, with a corresponding \$38.5 million annual receipts size standard. Proposals were due on February 23, 2018.

On April 19, 2018, the CO notified unsuccessful offerors Appellant was the apparent successful offeror. On April 26, 2018, Government Contracting Resources, Inc. (GCR), filed a protest alleging that Appellant is not a small business. Appellant is a joint venture (JV) comprised of Electronic Metrology Laboratory, LLC (EML) and Emerald Resource, LLC (Emerald), an SDVO SBC.

In its protest, GCR alleged, “EML's SAM.gov certifications strongly suggest that EML's average annual receipts for the period of measurement exceed \$38.5 million.” (Protest, at 3.) GCR also contended that EML is a member of at least five other JVs, which creates a substantial likelihood that EML's average annual receipts exceed the size standard once the receipts of EML and its affiliates are aggregated. (*Id.*) GCR also argued the revenues from EML and Emerald's previous JVs must be included in the calculation of each company's receipts. (*Id.*)

GCR claimed that EML and Emerald are affiliated due to their “longstanding inter-relationship and contractual dependence” because of their history of previous JVs. Further, Emerald is dependent on EML because “a significant share” of Emerald's receipts are attributed to its JVs with EML. (*Id.* at 4.) Emerald has never been awarded a contract under the NAICS code for the instant procurement, which further shows Emerald's reliance on EML. (*Id.* at 5.) Additionally, no representatives of Emerald attended the site visit for the instant procurement. Instead, a member of EML attended on behalf of Appellant. (*Id.*) Thus, GCR argued that EML and Emerald are affiliated and ineligible for the instant award. (*Id.*) The CO forwarded the protest to the Area Office for a size determination.

B. Size Determination

On June 1, 2018, the Area Office issued Size Determination No. 03-2018-047 finding Appellant to be an other than small business for the \$38.5 million size standard. Specifically, the Area Office found that the exception to affiliation among JV partners did not apply because EML was found to be affiliated with Group 23, LLC (Group 23) and Bluegrass Developing Group, LLC (Bluegrass) due to common ownership. (Size Determination, at 8.)

In reviewing the record, the Area Office found that Emerald owns 51% of Appellant and EML owns 49% of Appellant. Emerald is the managing venturer of Appellant and designated XXXXX of Emerald as the project manager and Ms. Michelle Perry as President of Appellant. (*Id.* at 4.) Emerald is 100% owned by Ms. Perry, who has no other ownership interests and does not hold a director, officer, or manager position in any other entity except for Appellant. (*Id.* at 4-5.) EML is owned 51% by Mr. Sammy Isbell and 49% by Mr. Scott Barlow. Mr. Barlow is the President of EML. Mr. Isbell and Mr. Barlow are not related by blood, marriage, civil union, or adoption, and do not share ownership interest in any other entity together. (*Id.* at 5.)

In its size determination, the Area Office analyzed EML's Operating Agreement, specifically Section 3.5² titled, "Major Decisions" which states that "[n]o act shall be taken, sum expended or obligation incurred by the Company except by the unanimous written consent of all Members with respect to a matter within the scope of any of the major decisions enumerated below." (Operating Agreement, at 7) (emphasis original). In reviewing the actions listed under Section 3.5 of the Operating Agreement, the Area Office determined that Mr. Barlow has negative control over EML because the actions relate to the daily operations of the business. (Size Determination, at 5.) Furthermore, under the Operating Agreement, Mr. Barlow has "broad powers to block major decisions that provide for changing the strategic direction of the company which may include the establishment of new goals for the business, [and] amend the Articles of Organization to change the method by which the company is managed which clearly affects the pool of individuals who are authorized to manage the daily operations of the business." (*Id.* at 5-6.)

Specifically, the Area Office views Section 3.5's requirement for unanimous written consent of all Members for the mortgage or encumbrance of all or substantially all of EML's assets affects the firm's ability to obtain financing, "which is a part of the daily operations of the business." (*Id.* at 6.) Further, the unanimous consent provisions of Section 3.5 of the Operating Agreement give minority shareholders the power to block actions enumerated under Section 3.6 of the Operating Agreement, titled "General Powers of Members," which includes the lending and borrowing of money, as well as buying, owning, managing, selling, leasing, mortgaging, pledging, or otherwise acquiring or disposing of company property. (*Id.*) The Area Office stated that a company's operating agreement or articles of incorporation, that include a requirement of a minority shareholder's consent to amend it, is grounds for finding that the minority shareholder has negative control of the concern. (*Id.*; citing to *Size Appeal of Carntribe-Clement 8AJV # 1*,

² The Area Office cited to "Section 3.2" of the Operating Agreement, which is "Outside Activities/Member Qualifications," but the correct citation to the Operating Agreement is Section 3.5, captioned "Major Decisions."

LLC, SBA No. SIZ-5357 (2012).) Mr. Barlow has the “power to block fundamental actions needed to operate a business” and both Mr. Barlow and Mr. Isbell have the power to control EML. (*Id.*) Thus, the companies in which Mr. Barlow has minority holdings that are approximately equal in size to the other minority holdings (namely Group 23 and Bluegrass) are considered affiliated with EML due to common ownership. (*Id.*)

EML and Emerald are JV partners for Southern Contracting Solutions, LLC, which has received two contracts, and Southern Contracting Solutions, LLC II, which has not received a contract. Therefore, EML and Emerald are not deemed affiliated based on the number of awards received by the JV over the two-year time period. (*Id.* at 7, *see* 13 C.F.R. § 121.103(h).) EML and BMAR & Associates, LLC (BMAR) formed seven JV entities and were awarded seven contracts together. The EML/BMAR JV has not been awarded a contract since 2010 and there is one outstanding contract that will end on January 21, 2019. Hence, the Area Office concluded there is no long-term relationship between EML and BMAR and the companies are not affiliated. (*Id.*)

The Area Office added EML's proportionate shares of the receipts of all EML JV entities to EML's annual receipts, and Emerald's proportionate shares of the receipts of all Emerald JV entities were added to Emerald's revenues to calculate Appellant's annual receipts. (*Id.* at 8, *see Size Appeal of Alpha Protective Services, Inc.*, SBA No. SIZ-5035 (2009).) Because Bluegrass was formed in November 18, 2015, its receipts were calculated in accordance with the regulatory standard for an entity which has been in business for less than three complete fiscal years. (*Id.*, *see* 13 C.F.R. § 121.104(b)(2).)

The Area Office found that Emerald's annual receipts do not exceed the \$38.5 million size standard. (*Id.*) However, EML's annual receipts, when combined with the annual receipts of its affiliates, Bluegrass and Group 23, do exceed the \$38.5 million size standard. Because EML is not a small business for the instant procurement, the exception to finding affiliation among joint venturers does not apply. (*See* 13 C.F.R. § 121.103(h)(3).) Thus, EML and Emerald are affiliates and, as a result, their JV, Appellant, is other than small for this procurement. (*Id.*)

C. EML's Operating Agreement

EML's Operating Agreement was made and entered into on January 22, 2001. The Operating Agreement lists Mr. Sam A. Isbell, Jr. as a Member and Chief Operating Officer and Scott Barlow as a Member and President of EML. Section 3.5 of the Operating Agreement lists the following actions as “Major Decisions” that require unanimous written consent of all Members:

- (i) the sale of all or substantially all assets of the Company;
- (ii) a mortgage or encumbrance upon all or substantially all assets of the Company;
- (iii) any matter which could result in a change in the amount or character of the Company's contributions to capital;

- (iv) a change in the character of the business of the Company;
- (v) a false or erroneous statement in the Articles of Organization;
- (vi) disposal of the goodwill of the Company;
- (vii) submission of claim of the Company to arbitration;
- (viii) confession of a judgment;
- (ix) commission of any act which would make it impossible for the Company to carry on its ordinary course of business;
- (x) contravention of this Operating Agreement;
- (xi) amendment of this Operating Agreement; or
- (xii) amendment of the Articles of Organization to change the management of the Company from the member to managers or from managers to members.

Section 3.6, “General Powers of Member” allows all members to engage in the following activities unless otherwise expressly provided in the Operating Agreement:

- (i) the right to enter into and carry out legal contracts;
- (ii) to employ employees, agents, consultants and advisors to act for the benefit and on behalf of the Company;
- (iii) to lend or borrow money to issue evidences of indebtedness;
- (iv) to bring and defend actions in law or at equity; and
- (v) to buy, own, manage, sell, lease, mortgage, pledge or otherwise acquire or dispose of Company property.

D. Appeal Petition

On June 18, 2018, Appellant filed the instant appeal. Appellant argues the Area Office erred as a matter of fact and law in determining that Mr. Barlow has negative control over EML's daily operations. (Appeal, at 6.) Specifically, the size determination includes “flawed interpretations of the EML Operating Agreement and incorrectly applies OHA precedent to the actions listed in the EML Operating Agreement requiring minority-owner consent.” (*Id.* at 6-7.) Further, the Area Office clearly erred by not providing Appellant with due process regarding the issue of negative control. (*Id.* at 7.)

Appellant argues Scott Barlow has “no say” over EML's daily operations. (*Id.*) Appellant believes the central question in determining whether negative control exists turns on “whether such control impedes or otherwise inhibits the ordinary actions essential to operating the company.” (*Id.*, citing to *Size Appeal of Carntribe-Clement 8AJV #1*, SBA No. SIZ-5357 (2012).) Appellant rejects the Area Office's reliance on *Carntribe*, as OHA reversed the Area Office's determination in that matter. Furthermore, the decision supports the appeal with respect to activities that constitute daily operations. (*Id.*) For example, OHA held adding new members and dissolving the company were both extraordinary events, and a minority member's veto power to prevent such change was designed to preserve his investment. (*Id.*) Should either event occur, it could pose a serious threat to that minority-holder, and such veto power in those instances did not establish negative control. (*Id.*)

The Area Office clearly erred by misinterpreting the Operating Agreement's Section 3.5, “Major Decisions,” as giving minority shareholders negative control over the powers enumerated in Section 3.6, “General Powers of Member.” (*Id.* at 9.) Appellant contends OHA has held that an LLC operating agreement that requires minority consent to carry out actions that contravene an operating agreement does not require a finding of negative control, because these provisions are included to protect the interests of investors. (*Id.*; citing to *Size Appeal of McLendon Acres, Inc.*, SBA No. SIZ-5222 (2011).) Section 3.5 identifies “Major Decisions” which require the unanimous written consent of all Members. Section 3.6 enumerates the “General Powers” of EML's Members, exercised via majority rule. Appellant argues acting in contravention of the Operating Agreement requires unanimous consent because the examples of ordinary actions that are provided in Section 3.6 of the Operating Agreement are actions permitted by the Operating Agreement, not contravened by it. (*Id.* at 10.) These are actions that require only majority vote under Section 3.6 and can be undertaken by Mr. Isbell under the “majority-rules” provisions of the Operating Agreement, as Mr. Barlow is a minority holder with only 49% control of the company. (*Id.*)

Appellant argues the Area Office erred when it concluded that Mr. Barlow had control over the “strategic direction” and creation of “new goals” of EML without providing a description of which actions under Section 3.6 of the Operating Agreement would qualify for such authority. (*Id.* at 12.) Further, OHA has held that veto power over the decision to enter into a substantially different business does not constitute negative control, because this is an extraordinary action. (*Id.* at 13, citing to *Size Appeal of BR Constr., LLC*, SBA No. SIZ-5303 (2011).) Appellant also contends a minority-member having veto rights over amending a concern's articles of organization to change the company from member-managed or to manager-managed is the same as a decision to enter into a new business, e.g., an extraordinary action. (*Id.* 13-14, citing to *Size Appeal of Dooleymack Gov't Contracting, LLC*, SBA No. SIZ-5086 (2009) and *Size Appeal of DHS Sys., LLC*, SBA No. SIZ-5211 (2011).)

The Area Office clearly erred in concluding that the provision requiring unanimous consent of the members to mortgage or encumber all or substantially all of the concern's assets affects EML's ability to obtain financing and carry out the daily operations of business. (*Id.* at 14.) Appellant emphasizes that the provision pertains to the mortgaging and encumbering of all of EML's assets, which are extraordinary actions, and the Area Office's reading is “far too broad and demonstrates clear factual error.” (*Id.*, citing *McLendon Acres, Inc.*, SBA No. SIZ-5222

(2011).) Appellant also argues against the Area Office's findings that the submission of a claim by EML for arbitration is a daily operation, as it is an extraordinary action. (*Id.* at 16-17.)

Lastly, Appellant argues it was deprived of due process because the Area Office never informed Appellant it was investigating the issue of negative control. (*Id.* at 18, citing to *Size Appeal of Alutiiq Int'l Sols., LLC*, SBA No. SIZ-5069 (2009).) The Area Office did not mention that it was looking into the subject of negative control even after Appellant asked if there were any additional questions regarding the control of EML. (*Id.*) If Appellant was given notice that the Area Office was investigating negative control, “it would have provided a factual and legal response.” (*Id.*) Further, the Area Office reviewed Appellant's Operating Agreement in a previous size determination and found that Mr. Isbell, not Mr. Barlow, was in sole control of Appellant. (*Id.* at 19-20, *see* Size Determination No. 03-2013-099.)

E. Motion to Admit New Evidence

Along with its appeal, Appellant seeks to admit new evidence that Appellant argues would have been submitted to the Area Office had the issue of negative control been raised with Appellant. (Motion for New Evidence, at 1.) Appellant seeks to introduce a statement from Mr. Barlow regarding his power to control EML and a 2013 size determination. Appellant argues that these documents are relevant and do not enlarge the issues on appeal, as they pertain specifically to the issues raised by the Area Office regarding Mr. Barlow's control over Appellant. (*Id.* at 2.)

F. GCR's Response to the Appeal

On July 16, 2018, GCR filed its response to the appeal. In its response, GCR argues the Operating Agreement makes it clear that Appellant has negative control over EML. (Response to Appeal, at 1.)³ Further, Appellant was not deprived of due process because it was fully aware the Area Office was analyzing Mr. Barlow's control over EML and other entities he owns. With respect to the documents Appellant attempts to admit into evidence, GCR argues that the 2013 Size Determination was already made a part of the record and is superfluous. (*Id.* at 4.) Additionally, there is no reason why Mr. Barlow's declaration could not have been submitted to the Area Office during its investigation, so OHA should deny Appellant's Motion to Admit New Evidence. (*Id.*)

GCR concedes that the Area Office misinterpreted EML's Operating Agreement and committed clear legal error because some of the actions described in Section 3.5 of the Operating Agreement constitute extraordinary actions that protect the investor and do not result in negative control. (*Id.* at 5.) Though some of the actions listed as “Major Decisions” are indeed extraordinary actions, at least four of the twelve actions listed pertain to the daily operations of a business, which could lead to a finding that Mr. Barlow does have negative control over EML. (*Id.* at 6.) GCR argues that the requirement of unanimous consent to (1) confess a judgment, (2)

³ GCR also raises the issue of common management between EML and the other entities in which Scott Barlow has an interest. However, the issue of common management was not addressed in the size determination, was not raised in the appeal, and therefore is not now before OHA. 13 C.F.R. § 134.316(c).

submit a claim for arbitration, (3) effect a change in the character of the business of EML, and (4) encumber or mortgage all or substantially all of EML's assets are all ordinary business actions. (*Id.* at 6-7.)

GCR argues that the Operating Agreement requires unanimous consent to confess a judgment and submit a claim for arbitration, but finds it inconsistent that unanimous consent is not required to bring forth or defend a legal dispute. (*Id.* at 6) (citing to *In the Matter of Apex Ventures, LLC*, SBA No. VET-219 (2011).) Because GCR does not recognize a difference in the aforementioned actions, requiring unanimous consent to confess a judgment and submit a claim for arbitration are not extraordinary acts that give Mr. Barlow negative control over EML. (*Id.*) GCR argues the provision in the Operating Agreement which requires unanimous consent regarding the change in character of the business of EML is like the provision in *Size Appeal of EA Eng'g.*, where OHA held that permitting a minority investor to block changes in the “strategic direction or lines of business . . .” constituted negative control. (*Id.* at 7, *EA Eng'g., Sci., & Tech., Inc.*, SBA No. SIZ-4973 (2008).) GCR finds it inconsistent and “patently ambiguous” that the Operating Agreement requires unanimous consent to encumber and/or mortgage all of EML's assets while it does not require unanimous consent to borrow money and create debt securities, which are ordinary daily actions. (*Id.* at 8; citing to *Carntribe-Clement 8AJV #1*, SBA No. SIZ-5357 (2012).)

GCR highlights that, although not addressed in the size determination, Section 6.2 of the Operating Agreement states that a member cannot “assign, convey, sell, encumber or in any way alienate all or any part of his or her interest in the Company without the prior written consent of all other Members.” (*Id.* at 9.) (emphasis original) GCR believes this limitation is not necessary to protect Mr. Barlow's interests as it equates to Mr. Isbell not being able to assign, convey, sell, encumber, or alienate “even a small portion” of his interest without Mr. Barlow's consent. (*Id.*) Therefore, this provision creates negative control of Mr. Barlow over EML. (*Id.*)

GCR believes Appellant's argument regarding a lack of due process is unfounded as Appellant was well aware of the issues surrounding the size protest and the Area Office's investigation. (*Id.* at 15.) “The onus was on [Appellant] (and EML) to prove that both Emerald and EML are small.” (*Id.*) Further, the Area Office noted in its communications with Appellant that control could be affirmative or negative, and included the entirety of 13 C.F.R. § 121.103(c), which addresses the issue of “Affiliation Based on Stock Ownership.” (*Id.* at 16, *see* May 1, 2018 Notice to Appellant of Size Protest, 1-2.) The Area Office specifically requested information pertaining to Mr. Barlow's interests in Bluegrass and Group 23. In response to this request, Appellant stated, “[w]ith respect to Group 23[] and Bluegrass[], please note that these entities have no bearing on [EML] as Scott Barlow is not the majority owner and is not in control of [EML].” (*Id.* at 18.) Thus, it is clear from the correspondence between the Area Office and Appellant that Appellant knew the Area Office was investigating EML's size and whether it had any affiliates. (*Id.*) Appellant had the opportunity to clarify who controls EML and EML's relationship with all of its possible affiliates as it explained that Mr. Barlow does not control EML due to his minority interest. (*Id.* at 19.)

G. Appellant's Response to GCR

On July 23, 2018, Appellant submitted a Motion to Strike or a Motion to Extend the Close of Record and File a Reply to certain portions of GCR's response in the alternative. (Appellant's July 23, 2018 Motion, at 1.) Appellant sought to address the issue of (1) whether confessing a judgment is an ordinary action, (2) whether assigning or conveying an LLC membership interest in EML is an ordinary action, and (3) whether Scott Barlow has affirmative control over EML as President of EML. OHA granted the Motion to Strike in part, finding that the issue of Scott Barlow's affirmative control was a new issue on appeal and not properly before OHA. (OHA's July 25, 2018 Order). OHA gave Appellant until July 31, 2018, to respond to the issues of whether confessing a judgment and assigning or conveying an LLC membership interest in EML is an ordinary action.

On July 31, 2018, Appellant submitted its reply to GCR's Response to the Appeal stating that “the Area Office knew these provisions were a part of the [O]perating [A]greement, considered them, and reasonably concluded that these provisions so clearly did not create negative control that it did not bother to mention them in its determination.” (Appellant's Response, at 1-2.) Additionally, Appellant acknowledged GCR's footnote questioning whether correcting a false or erroneous statement in the Articles of Organization is an extraordinary action. (*Id.* at 1.)

Appellant argues that each action is extraordinary. The assignment or conveyance of an LLC membership interest is extraordinary because a “a sale or conveyance of the membership interest of Sam Isbell, EML's majority owner, would bring new members into the LLC and have a large impact on the ownership interest of the LLC.” (*Id.* at 3.) Similar actions have been deemed extraordinary by OHA. (*Id.* at 4; citing to *Dooleymack Government Contracting, LLC*, SBA No. SIZ-5086 (2009); *DHS Systems, LLC*, SBA No. SIZ-5211 (2011); *Carntribe-Clement 8AJV #1, LLC*, SBA No. SIZ-5357 (2012); and *EA Eng'g., Sci., Tech., Inc.*, SBA No. SIZ-4973 (2008).) Confessing a judgment is not an ordinary action because doing so is not similar to bringing or defending a lawsuit since it ends litigation and puts a judgment on the record. (*Id.* at 6.) Furthermore, confessing a judgment leaves the party subject to collection by the creditor to whom the judgment is confessed. (*Id.*) (citing to Tenn. Code Ann. § 26-1-103.) Correcting a false statement in the Articles of Organization is an extraordinary action, as these documents are foundational to the creation of an LLC. (*Id.* at 7.) Also, a false or misleading statement in the Articles of Organization “would be a serious matter that could affect the liability of the LLC to do business and exist as an LLC.” (*Id.*) Appellant also sought to introduce an additional declaration from Scott Barlow regarding the frequency of the actions addressed in its response actually occurring.

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. New Evidence

OHA's review is based upon the evidence in the record at the time the Area Office made its determination. 13 C.F.R. § 134.308 (a). Consequently, evidence not previously presented to the Area Office is generally not admissible and will not be considered by OHA. *E.g.*, *Size Appeal of Maximum Demolition, Inc.*, SBA No. SIZ-5073, at 2 (2009). New evidence may be admitted on appeal at the discretion of the administrative judge following a motion that establishes good cause for the admission of new evidence. 13 C.F.R. § 134.308(a). In its motion, the movant must demonstrate that “the new evidence is relevant to the issues on appeal, does not unduly enlarge the issues, and clarifies the facts on the issues on appeal.” *Size Appeal of Vazquez Commercial Contracting, LLC*, SBA No. SIZ-5803 (2017), quoting *Size Appeal of Vista Eng'g. Techs., LLC*, SBA No. SIZ-5041, at 4 (2009).

Here, Appellant seeks to submit new evidence that could have been submitted to the Area Office. The issue of EML's size, and therefore its potential affiliation with firms in which its members had an ownership interest was squarely before the Area Office. These included questions of negative control. It was foreseeable that such issues would arise in the examination of Appellant and EML, especially given the provisions of Section 3.5 providing certain power to minority members. Appellant was represented by counsel who should have appreciated the need to clarify Appellant's relationship with all its possible affiliates. The Area Office had the power to go beyond the specific grounds raised in the protest, so Appellant's argument that the question of negative control was untimely raised is meritless. *Size Appeal of DHS Systems, Inc.*, SBA No. SIZ-5211, at 6 (2011); 13 C.F.R. § 121.1009(b). Accordingly, Appellant's proffered evidence should have been submitted to the Area Office, and it is too late to do so now. I DENY Appellant's motion for the submission of new evidence.

C. Analysis

Appellant is a JV between EML and Emerald. The general rule is that parties to a joint venture are affiliated. 13 C.F.R. § 121.103(h)(1). An exception to this rule is that a joint venture of two or more business concerns may submit an offer as a small business for a Federal procurement as long as each firm is small under the size standard corresponding to the NAICS code assigned to the contract. 13 C.F.R. § 121.103(h)(3)(i). The issue here is whether EML is a small business. To determine whether EML is a small business, the question is, whether Mr. Scott, a minority member of EML, has negative control over EML, which would mean EML is affiliated with other firms Mr. Scott has the power to control, through common ownership. 13 C.F.R. § 121.103(c)(2).

Negative control exists when a minority owner can block ordinary actions essential to operating the company. *Size Appeal Eagle Pharmaceuticals, Inc.*, SBA No. SIZ-5023, at 10 (2009). A party with a minority interest in a concern may have negative control over that concern if the concern's operating agreement gives that party the power to block action by the concern's

management or majority members. 13 C.F.R. § 121.103(a)(3). However, OHA has held that a concern giving minority owners the ability to block certain extraordinary actions of the concern has not provided negative control to the minority members, if those supermajority provisions are crafted to protect the investment of the minority shareholders, and not to impede the majority's ability to control the concern's operations or to conduct the concern's business as it chooses. *Size Appeal EA Eng'g., Sci. and Tech., Inc.*, SBA No. SIZ-4973, at 8-9 (2008), *Size Appeal of Carntribe-Clement 8AJV # 1, LLC*, SBA No. SIZ-5357 (2012).

In reviewing cases on this issue, OHA has held that there are a number of extraordinary actions which a minority member may be given the power to block, without resulting in a finding of negative control. Adding new members and dissolving the concern has been found to be an extraordinary action. *Size Appeal of Carntribe-Clement 8AJV # 1, LLC*, SBA No. SIZ-5357 (2012). Amending the Bylaws, issuing additional capital stock, and entering into any substantially different business are all extraordinary actions where a minority shareholder's veto power does not constitute negative control. *Id.*; *EA Eng'g, Sci. and Tech., Inc.*, SBA No. SIZ-4973 (2008). OHA held that the requirement for a minority shareholder's consent to: sell all or substantially all of a firm's assets; mortgage or encumber all or substantially all of a concern's assets; commit any act that could result in a change in the amount or character of the concern's contribution to capital; cause a change in the character or business of the concern; commit any act that would make it impossible to carry on ordinary business; or commit any act in contravention of the operating agreement does not suggest negative control, as these actions are extraordinary and not part of the normal course of business. *Size Appeal of McLendon Acres, Inc.*, SBA No. SIZ-5222 (2011). A minority member's power to approve the addition of any new members or the withdrawal of any old members, to increase or decrease the size of the Board, to increase or decrease the number of authorized interests, or to reclassify interests is designed to protect a minority owner's investment and does not establish negative control. *Size Appeal of DHS Systems, LLC*, SBA No. SIZ-5211 (2011). Also, selling or otherwise disposing of all of the firm's assets, admitting new members, amending the operating agreement in any manner that materially alters the rights of existing members, or filing for bankruptcy all constitute extraordinary actions that may require the minority shareholder's input, but do not create negative control. *Size Appeal of Dooleymack Government Contracting, LLC*, SBA No. SIZ-5086 (2009).

OHA has also characterized a number of actions as essential to the daily operation of the company, and therefore granting a minority owner the power to block such an action constitutes negative control. A minority member who has control over the budget, has the power to hire and fire officers, and sets employee compensation has control over the daily operations of a concern. *See Size Appeal of Team Waste Gulf Coast, LLC*, SBA No. SIZ-5864 (2017); *see also Carntribe-Clement 8AJV # 1, LLC*, SBA No. SIZ-5357 (2012); *see also DHS Systems, LLC*, SBA No. SIZ-5211 (2011). Borrowing money is also an action essential to the daily operation of a company. *Carntribe-Clement*, SBA No. SIZ-5357 (2012); *Size Appeal of BR Construction, LLC*, SBA No. SIZ-5303 (2011); *McLendon Acres, Inc.*, SBA No. SIZ-5222 (2011). Other essential actions include purchasing equipment, making changes to a budget, and incurring expenses over \$5,000. *Carntribe-Clement*, SBA No. SIZ-5357 (2012); *BR Construction, LLC*, SBA No. SIZ-5303 (2011). The creation of debt and the payment of dividends count as actions essential to operating a company. *See Team Waste Gulf Coast, LLC*, SBA No. SIZ-5864 (2017); *see also Carntribe-*

Clement, SBA No. SIZ-5357 (2012); *see also Size Appeal of Eagle Pharmaceuticals, Inc.*, SBA No. SIZ-5023 (2009). Amending or terminating leases and encumbering assets are considered ordinary actions. *Carntribe-Clement*, SBA No. SIZ-5357. A requirement that all actions taken to manage the company require a vote of 75% of the members confers negative control on the minority. *Size Appeal of Potomac River Group, Inc.*, SBA No. SIZ-5689 (2015).

Here, Section 3.6 of EML's Operating Agreement permits each of EML's Members to carry out the purposes of the Company, including entering into contracts, hiring employees and advisors, borrowing money, bringing lawsuits, buying, owning, managing, mortgaging or otherwise disposing of company property, and maintaining the company records. None of these actions require unanimous consent, and they are all essential to the daily operations of any company. *See* Section II.C., *supra*. Mr. Barlow cannot block any of them, and thus does not have negative control as to these actions.

It is Section 3.5 of the Operating Agreement that enumerates certain actions that require the unanimous consent of the members and Mr. Barlow could block. A number of them are actions which OHA has already held are extraordinary actions, where a minority member may have the power to block while avoiding a finding of negative control. These include Section 3.5(i) the sale of all or substantially all of the assets of the company; Section 3.5(ii) a mortgage or encumbrance upon all or substantially all of the assets of the company; Section 3.5(iii) any matter which could result in a change in amount or character of EML's contributions to capital; Section 3.5(iv) a change in the character of EML's business; Section 3.5(ix) the commission of any act which would make it impossible for EML to carry on its ordinary course of business; and Section 3.5(x) any act in contravention of the Operating Agreement. *See* Section II.C., *supra*; *see also McLendon Acres, Inc.*, SBA No. SIZ-5222, 2-6 (2011) (holding the aforementioned limitations on actions to be “for the protection of investors” and not an indication of negative control).⁴

The remaining actions enumerated in Section 3.5 are of a similar nature — they are not essential to the daily operation of the concern, but are actions which could have a severe impact upon the company. Accordingly, the minority member has the opportunity to block them in order to protect his investment. A false statement in the Articles of Incorporation (Section 3.5(v)), would be a very serious matter for the concern. This document brings EML into existence, and a false statement could affect the concern's ability to do business. Similarly, an amendment of the Articles of Incorporation (Section 3.5(xii)) or the Operating Agreement (Section 3.5(xi)) would have the potential to completely restructure the concern and seriously harm Mr. Barlow's interests. Disposal of a concern's goodwill (Section 3.5(vi)) is arguably synonymous to the sale of all or substantially all of a concern's assets and usually occurs at the point of sale of a company.

The submission of a claim to arbitration (Section 3.5(vii)) and confession of a judgment (Section 3.5(viii)) puts EML at risk of having to pay a potentially large claim. As Appellant

⁴ Indeed, it is difficult to avoid a suspicion that the attorney for the challenged concern in McLendon Acres and EML's attorney may have relied upon similar resources in drafting the respective operating agreements.

notes, confession of a judgment concludes litigation, and will put a judgment on record for which the subject concern will be liable. Of all the actions enumerated in Section 3.5, none pertain to EML's daily operations, but they do provide Mr. Barlow with the opportunity to block certain extraordinary actions to protect his investment as a minority shareholder in the concern.

Accordingly, I conclude that the Area Office erred in finding that Mr. Barlow had negative control over EML, and by extension, that EML was affiliated with Group 23 and Bluegrass because of Mr. Barlow's interest in those concerns. Therefore, I must grant the instant appeal, vacate the size determination, and remand the matter to the Area Office.

Nevertheless, I also note that Mr. Barlow is EML's President, and a member of EML's management. In this position he has critical influence or the ability to exercise substantive control over the concern. Hence, the issue of whether EML is affiliated through common management with other concerns over which Mr. Barlow has critical influence or the ability to exercise substantive control is an important one to address here, and the Area Office failed to do so. 13 C.F.R. § 121.103(e); *Size Appeal of Audioeye, Inc.*, SBA No. SIZ-5477 (2013).

For the reasons stated above, I conclude that I must vacate the instant size determination and remand the matter to the Area Office for a new size determination, that will not find Mr. Barlow to have negative control over EML, but will consider whether EML is affiliated with any concerns Mr. Barlow controls under the common management regulation.

IV. Conclusion

Appellant has established that the size determination is clearly erroneous. Accordingly, the appeal is GRANTED, the size determination is VACATED, and the matter is REMANDED to the Area Office for further review and investigation.⁵

CHRISTOPHER HOLLEMAN
Administrative Judge

⁵ As there is a related status case currently before OHA, I am directing the Area Office to serve OHA with a copy of the size determination upon its conclusion.