Cite as: *Size Appeal of The Coleman Group, Inc. d/b/a Spherion Staffing Services*, SBA No. SIZ-6026 (2019)

United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: The Coleman Group, Inc. d/b/a Spherion Staffing Services, Appellant, Appealed From Size Determination No. 3-2019-071	SBA No. SIZ-6026 Decided: September 9, 2019

APPEARANCE

Anita J. Ponder, Esq., Quintairos, Prieto, Wood & Boyer, P.A., Chicago, Illinois, for Appellant

DECISION[1]

I. Introduction and Jurisdiction

On July 2, 2019, the U.S. Small Business Administration (SBA) Office of Government Contracting - Area III (Area Office) issued Size Determination No. 3-2019-071 finding that The Coleman Group, Inc. d/b/a Spherion Staffing Services (Appellant) is not a small business due to its affiliation with its franchisor, Spherion Staffing, LLC (Spherion). Appellant maintains that the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse. For the reasons discussed *infra*, the appeal is denied and the size determination is affirmed.

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 originally issued under the confidential treatment provision of 13 C.F.R. § 134.205. OHA afforded Appellant an opportunity to file a request for redactions if desired. No redactions were requested, and OHA now issues the entire decision for public release.

II. Background

A. Franchise Agreement

Appellant, through its owner and CEO, Ms. Cheryl S. Williams, entered into a franchise agreement with Spherion on March 30, 2014. The franchise agreement explained that Spherion has developed proprietary plans, systems, procedures, and methods for recruiting and supplying personnel to provide temporary help and full-time placement services to others, and that Appellant desired to obtain a franchise from Spherion to market and provide such services. The franchise agreement contained the following provisions pertinent to this appeal:

> **1. Definitions**. As used in this Agreement:
>
> . . .
>
> (g) **"Direct Costs"** means the sum of:
>
> (1) The Temporary Employees' gross payroll and other direct labor costs with respect thereto (including, without limitation, payroll taxes, local, county, or state headcount taxes, and taxes based on sales or gross receipts which are not separately collected from customers);
>
> (2) [Spherion]'s accrued expenses (as determined by [Spherion]) relating to workers' compensation, liability, bonding or other insurance, deductibles or reserves, transportation, vacation, holiday or sick pay, profit sharing, health insurance or other fringe benefit costs and any other tax or cost which is levied on or directly measured by headcount, Sales, hours or Temporary Employee wages paid or incurred by [Spherion] with respect to any Accounting Period or Fiscal Year; and
>
> (3) the costs of any services, non-standard benefits, materials, equipment, products or other consumables Customers have agreed to pay and for which there is a separate charge on the invoice.
>
> (s) **"Temporary Employees"** means the employees of [Spherion] who are provided to Customers by [Appellant] on behalf of [Spherion] to perform any services authorized by this Agreement, irrespective of whether such employees are full-time, part-time or temporary.
>
> . . .

2. **Nature** of **Agreement**.

. . .

(d) Anything in this Agreement to the contrary notwithstanding, the parties hereto further acknowledge and agree that the Temporary Employees provided by [Appellant] pursuant to this Agreement shall be the employees of either [Spherion] or a wholly-owned subsidiary of [Spherion], full-time placement applicants shall be the applicants of either [Spherion] or a wholly-owned subsidiary of [Spherion], and the Customers to whom services are provided pursuant to this Agreement shall be Customers of either [Spherion] or a wholly-owned subsidiary of [Spherion], all at the sole option of [Spherion].

. . .

6. **Duties and Obligations** of **[Spherion]**.

In consideration of and for this Agreement, [Spherion] hereby agrees to perform all of the following, at its expense:

. . .

(e) Pay all Temporary Employee payroll, all payroll taxes, workers' compensation, general liability, bonding, fringe benefit expense and other Direct Costs as set forth in Section 1(g) of this Agreement, and provide the Management Information Services referred to in Section 8 of this Agreement.

8. Payroll/Billing and Management Information Services and Fees..

(a) Based on payroll and billing information provided to [Spherion] by [Appellant], [Spherion] shall prepare and mail all weekly invoices and periodic statements to Customers, all weekly payroll to Temporary Employees, all required payroll tax returns and insurance contribution reports, shall prepare and provide [Appellant] with [Appellant]'s monthly commission statement, and shall make available periodic copies of confidential Customer, full-time placement applicant and Temporary Employee lists, and any sale or management information reports deemed appropriate by [Spherion].

. . .

12. [Appellant's] Commission

Commissions are paid to [Appellant] as set forth in this Section 12.

. . .

(e) [Spherion] shall deduct from the aggregate gross commission payable to [Appellant]:

(1) an Accounts Receivable Funding Fee calculated by multiplying the accounts receivable over sixty (60) days from the date of the respective billing as of the end of each Accounting Period by one and one half (1/4) percentage points over the Prime Rate. . . . The Accounts Receivable Funding Fee will be charged and deducted for an entire Accounting Period notwithstanding that an account becomes more than sixty (60) days old on or before the last day of the Accounting Period, until the account receivable is deducted pursuant to Subsections (e)(2), (e)(3) or (e)(4) below;

(2) the amount of previous billing (both Temporary Sales and Full-Time Placement sales) to a Customer that are determined to be uncollectible by [Spherion] prior to two hundred and seventy (270) days from the date of such billing (a bankruptcy or equivalent proceeding filed by or against Customer shall cause all previous billing to that Customer to be automatically deemed uncollectible);

(3) the amount of previous billings to a Customer which remain uncollected two hundred and seventy (270) days from the date of such billings, regardless of any agreement or evidence as to ultimate collectability;

(4) the amount by which any Customer account receivable over ninety (90) days exceeds the credit limit established pursuant to [Spherion] procedures for such Customer by either twenty-five percent (25%) or fifty thousand dollars ($50,000). This deduction from [Appellant's commission shall be made thirty (30) days after [Spherion] provides [Appellant] with written notice of the amount to the deducted, unless the Customer account receivable is reduced to within the approved credit limit, or the credit limit is increased by [Spherion] prior to the deduction[.]

. . .

*3 **14. Assignment**..

. . .

(b) Except as provided in Section 2(b) hereof, neither [Appellant] nor any Owner shall directly or indirectly sell, assign, sublicense, grant a security interest in or otherwise transfer this Agreement, the Franchised Business, any shares or other interest in the Entity, or any right or interest granted herein, or suffer or permit any such sale, assignment, sublicense, attachment of a security interest or other transfer to occur by operation of law or otherwise, without the prior written consent of [Spherion] . . . . [Spherion] shall have sixty (60) days from its receipt of [a] purchase agreement to, in its sole discretion, either approve or disapprove

> the proposed purchaser or notify [Appellant] in writing of [Spherion]'s exercise of its first right of refusal to become the purchaser.

(Franchise Agreement §§ 1,2, 6, 8, 12, 14.)

B. Size Determination

On June 14, 2019, the Area Office received a request for a size determination from SBA's Historically Underutilized Business Zone (HUBZone) program office, challenging Appellant's size in conjunction with Appellant's application for HUBZone status. The HUBZone office expressed concern that Appellant appears to be affiliated with its franchisor, Spherion, due to the control imposed by the franchise agreement.

On July 2, 2019, the Area Office issued Size Determination No. 3-2019-071, concluding that Appellant is affiliated with Spherion. After reviewing the terms of the franchise agreement, the Area Office found that "the issue of excessive control through common management can be found in this case." (Size Determination at 5.) Pursuant to 13 C.F.R. § 121.404(b), the Area Office determined Appellant's size as of February 7, 2019, the date Appellant submitted its HUBZone application, and June 14, 2019, the date the Area Office received the size determination request from the HUBZone office. (*Id*. at 1, 7.)

The Area Office found that the franchise agreement makes clear that temporary employees and full-time placement applicants are not Appellant's own employees, but rather are employees of Spherion. (*Id*. at 5.) Further, under the franchise agreement, Spherion "pays all temporary employee wages, payroll taxes, workers' compensation, general liability, bonding, fringe benefits expense and other direct costs," and prepares and mails invoices and statements to customers. (*Id.*) Customer accounts are owned by Spherion, though Appellant is responsible for collections and bears the risk of loss from nonpayment by customers. (*Id*. at 5-6.) Additionally, Spherion may deduct the accounts receivable funding fee, past due accounts receivable, and other fees from Appellant's commission. (*Id*. at 6.)

The Area Office found that an independent business would have control over its income and expenditures, whereas, here, Spherion controls the accounts receivables and may extract deductions before remitting commission to Appellant. (*Id.*) Spherion enjoys a right of first refusal if Appellant wants to sell, assign, or otherwise transfer its interest in the business. Spherion also restricts Appellant's ability to do business with certain potential clients. The Area Office asserted that "[t]he above examples are not options but are part of a contractual agreement, which results in one firm controlling another." (*Id.*) Spherion also mails and processes the invoices and payments received, such that Appellant "has no control over its billing." (*Id.*) The franchise agreement creates excessive control by Spherion over Appellant, resulting in affiliation between the two entities.

C. Appeal

On July 17, 2019, Appellant filed the instant appeal. Appellant argues that the Area Office erred by (1) misconstruing standard provisions in the franchise agreement in the

affiliation analysis; (2) ignoring the fact that the parties are independent contractors; (3) failing to find that Appellant has the right to profit from its efforts and bears the risk of loss; and (4) disregarding the absence of common ownership, common management and/or excessive restrictions upon the sale of the franchise interest.

Appellant first contends that the Area Office failed to take into consideration Appellant's duties and obligations under the franchise agreement, which include "the recruitment, screening, testing, interviewing, hiring, training, assigning and supervising of Temporary Employees and full-time placement applicants." (Appeal at 6.) According to Appellant, Ms. Williams, Appellant's sole owner, "voluntarily agreed" that the Temporary Employees would be employees of Spherion "to prevent possible compensation and/or service issues." (*Id.*) Ms. Williams "was not forced or coerced by Spherion" to consent to this arrangement and the "critical duties" performed by Appellant demonstrate that "Spherion does not have excessive or unacceptable control" over employees under the franchise agreement. (*Id.*) Ms. Williams likewise agreed to have Spherion pay all wages, payroll taxes, workers' compensation, general liability, bonding, fringe benefits, and other direct costs. (*Id.*)

With respect to customers, Appellant acknowledges that "the customer accounts are owned by Spherion." (*Id.*) However, Ms. Williams voluntarily agreed to this provision, and the franchise agreement indicates that Appellant will solicit customers on behalf of Spherion and convey information to Spherion. (*Id*. at 6-7.) Appellant highlights that it assumes full responsibility for collecting unpaid customer accounts and bears the risk of loss resulting from nonpayment. (*Id*. at 7.) Appellant also must assist and cooperate with Spherion in defense of any claim or suit by a Temporary Employee or Customer. Appellant contends that these responsibilities "clearly demonstrate that Spherion does not have excessive or unacceptable control of the Customers of [Appellant]." (*Id.*)

Appellant next argues that the Area Office failed to consider Appellant's obligations with respect to billing under the franchise agreement. Although "Spherion has control of billing and disburses the money to [Appellant]," Appellant maintains an accounting and payroll system, provides payroll and billing information to Spherion, and pays for software, equipment and maintenance. (*Id.*) Appellant reiterates that Ms. Williams voluntarily agreed that Spherion would have control of billing and would disburse money to Appellant. Thus, Spherion does not have excessive control over billing and disbursement. (*Id.*, citing *Size Appeal of Coastal Base Services*, SBA No. 3662 (1992).)

Appellant contends that the Area Office failed to "recognize the benefit" afforded to Appellant by the commission structure described in the franchise agreement. Appellant asserts:

> Per the Franchise Agreement, Spherion pays commissions to [Appellant] each month based on the temporary sales and full-time placement sales generated by [Appellant] during that month. These commissions are considered earned by [Appellant] immediately and are recognized and paid by Spherion each month regardless of whether payment from the clients have actually been received at the time the monthly commissions are disbursed.

(*Id*. at 7-8.)

With respect to the provisions that stipulate a right of first refusal by Spherion for the sale of an interest in Appellant, Appellant argues these are standard provisions to which Ms. Williams voluntarily agreed. (*Id*. at 8.) The right of first refusal is merely "the right to meet any offer made to [Appellant]," and should not be confused with a purchase option under the ""present effect" rule, 13 C.F.R. § 121.103(d). (*Id.*) Appellant contends that a right of first refusal leads to a finding of affiliation only when there are other substantial ties between the firms. (*Id.*, citing *Size Appeal of Procurement Automation Institute, Inc*., SBA No. 4236 (1997).)

Appellant insists that it has the right to profit from its business and bears the risk of loss commensurate with its ownership. As a result, Appellant continues, the Area Office should have "look[ed] no further" in determining whether affiliation exists between Appellant and Spherion. (*Id*. at 9, citing 13 C.F.R. § 121.103(1).) According to Appellant, the Area Office "should never have considered the Franchise Agreement or any other indicia of the relationship as the basis for finding control," without first examining whether Appellant bears the risk of loss or the right to profit from its business. (*Id.*) Absent such findings, the terms of the franchise agreement are considered only in unusual circumstances. (*Id*. at 10, citing *Dani Enterprises, Inc. v. U.S. Small Bus. Admin.*, 757 F. Supp. 99 (D.D.C. 1991).)

Appellant contends that the test for right to profit is whether the franchisee is permitted to retain 75% or more of net income. (*Id.*, citing *Size Appeal of ERM-South, Inc.*, SBA No. 4085 (1995).) Appellant retains 75% of gross profits generated from the placement of temporary employees and 88% of its commissions related to direct hire placements. (*Id.*) Thus, the franchise fees are not an excessive portion of the revenue generated from Appellant's efforts. As stated in the franchise agreement, Appellant also bears 100% of the risk of loss of any uncollectible accounts. (*Id.*)

Appellant asserts that it "does not rely on the finances, resources, expertise, facilities, or equipment of Spherion or any other business." (*Id.*) Ms. Williams receives 100% of Appellant's dividends and is the sole individual guarantor of Appellant's indebtedness to Spherion. (*Id*. at 11.) Ms. Williams is responsible for Appellant's finances and has the sole authority to structure the company as its sole shareholder and CEO. (*Id.*) Ms. Williams has 35 years of business experience, including 25 years of staffing experience, and does not rely on Spherion for technical expertise. (*Id*. at 12.) Ms. Williams also manages Appellant's contract opportunities and hires, trains, and terminates all of Appellant's key personnel. Ms. Williams negotiates and executes all lease agreements on behalf of Appellant and must provide her approval for the lease or purchase of all large equipment and vehicles for Appellant. (*Id.*) Appellant concludes that these facts show that Ms. Williams alone controls Appellant, and that the size determination "lacks reason and is contradicted by the evidence in the record." (*Id*. at 13.)

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

The instant case is analogous to OHA's decisions in *Size Appeal of Garvin Enterprises, Inc. d/b/a Lloyd Staffing*, SBA No. SIZ-4544 (2003) and *Size Appeal of ETI Professionals, Inc.*, SBA No. SIZ-4603 (2004).

Garvin Enterprises involved a temporary employment agency operating under a franchise agreement. The franchise agreement provided that "[the franchisor] will be the legal employer of all temporary employees whose services [the franchisee] provides to its customers." *Garvin Enterprises*, SBA No. SIZ-4544, at 2. Further, accounts receivable and proceeds of all collected accounts belonged to the franchisor, and the franchisor would finance the payroll, process the payroll, pay the payroll taxes, pay the temporary employees, and invoice the customers. *Id.* On these facts, OHA concluded that:

> [The franchisee's] product is the temporary employees and the services they perform. These employees are [the franchisor's] employees, and [the franchisor] controls their payroll, invoices for their services, and collects the accounts receivable their services generate, turning over to [the franchisee] only those funds due it under the Franchise Agreement. This leads to the inescapable conclusion that [the franchisor] controls the core of [the franchisee's] business, and its ultimate product.

Id. at 11. Accordingly, OHA determined, "[t]he degree of control the Franchise Agreement gives [the franchisor] mandates a finding of affiliation between the firms." *Id.* at 13.

In *ETI Professionals*, OHA likewise considered whether a franchise agreement for the placement of temporary employees granted the franchisor control over the franchisee. The franchise agreement provided that all temporary employees would be employees of the franchisor rather than the franchisee; that the franchisor would administer and process the franchisee's payroll, accounts receivable, and billings; and that the franchisee could accept customers only as permitted by the franchisor. *ETI Professionals*, SBA No. SIZ-4603, at 4. Citing *Garvin Enterprises* and other OHA precedent, OHA held that "a franchise agreement containing these provisions gives the franchisor control over the franchisee, and thus the firms are affiliated." *Id.*

In the instant case, Appellant's franchise agreement contains provisions highly similar to those found to be problematic in *Garvin Enterprises* and *ETI Professionals*. The employees Appellant places are considered to be employees of the franchisor *{i.e.*, Spherion), and the ultimate customers belong exclusively to Spherion. Section II.A, *supra*. In addition, pursuant to the franchise agreement, Spherion exerts total control over Appellant's payroll, billing, and cash flow. *Id.* Thus, the Area Office reasonably determined that Spherion controls the essential elements of Appellant's business, and Appellant is affiliated with Spherion.

On appeal, Appellant does not contend that the Area Office misinterpreted the franchise agreement, nor does Appellant argue that the instant case can be distinguished from *Garvin Enterprises* and *ETI Professionals*. Rather, Appellant cites to *Size Appeal of Coastal Base Services*, SBA No. 3662 (1992) for the proposition that Spherion does not control Appellant, because Appellant voluntarily agreed to accept the restrictions in the franchise agreement. *Coastal Base*, though, was discussed at length in *Garvin Enterprises*, and OHA explained that, in *Coastal Base*, the temporary employees whose services the franchisee was providing to its customers were not the employees of the franchisor. *Garvin Enterprises*, SBA No. SIZ-4544, at 9. Apart from this distinction - which OHA deemed "vitally important" - the franchisee in *Coastal Base* had the option of either turning its payroll and billing functions over to the franchisor, or making other arrangements. *Id.* at 9-10. Conversely, in *Garvin Enterprises*, once the franchisee had entered into the franchise agreement, the franchisee ceded control over these functions to the franchisor, and no longer had any option to do otherwise. OHA found that "[the franchisee] had a choice to make, between independence and sheltering under [the franchisor's] wing. Having made the one choice, it cannot expect the benefits meant for those who choose the other." *Id.* at 13.

Here, as in *Garvin Enterprises*, Appellant's argument that Appellant chose to allow Spherion to control crucial functions such as payroll and billing is meritless. The executed franchise agreement requires that Spherion will control these functions. Section II A, *supra*. Further, Appellant entered into the franchise agreement in 2014, but Appellant's size is determined as of February 7, 2019, the date Appellant submitted its HUBZone application, and as of June 14, 2019, the date the Area Office received the size determination request from the HUBZone office. Sections II.A and II.B, *supra*. The Area Office did not err in concluding that, as of the dates to determine size, Spherion controlled core aspects of Appellant's business, notwithstanding that Appellant voluntarily agreed to enter into the franchise agreement in 2014.

Lastly, Appellant also maintains that it should not have been found affiliated with Spherion because Appellant has the right to profit from its efforts and bears a risk of loss. Again, though, OHA addressed similar arguments in *Garvin Enterprises*, and held that, while such factors may tend to support the conclusion that the franchisee is an independent business, "they are outweighed" by the terms of the franchise agreement "which establish [the franchisor's] control over [the franchisee] and mandate a finding of affiliation." *Garvin Enterprises*, SBA No. SIZ-4544, at 12. In light of the strong similarities between the franchise agreement here and those seen in *Garvin Enterprises* and *ETI Professionals*, Appellant has not shown that the Area Office erred in finding that Appellant is controlled by, and affiliated with, Spherion.

IV. Conclusion

Appellant has not established that the size determination is clearly erroneous. Accordingly, I DENY the instant appeal, and AFFIRM the size determination. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(d).

KENNETH M. HYDE
Administrative Judge