United States Small Business Administration
Office of Hearings and Appeals

IN THE MATTER OF:	
Artis Builders, Inc.	SBA No. VET-214
Appellant	Decided: April 6, 2011
Solicitation No. 1443N2011101539	

APPEARANCES

Steven L. Reed, Smith, Currie & Hancock LLP, Washington, D.C., for Artis Builders, Inc., the Appellant.

John C. Goodman, Law Offices of John C. Goodman, San Diego, California, for Kevcon, Inc., the Protestor.

Christopher R. Clarke, Office of General Counsel, Small Business Administration, Washington, D.C., for the Agency.

DECISION[1]

I. Jurisdiction

This appeal is decided under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134.

II. Issue

Did the Acting Director for Government Contracting (AD/GC) for the U.S. Small Business Administration (SBA) make a clear error of fact or law in determining that Artis Builders, Inc. (Appellant) did not meet the Service-Disabled Veteran Owned Small Business Concern (SDVO SBC) eligibility requirements at the time it submitted its proposal for Solicitation No. 1443N2011101539 (solicitation)? *See* 13 C.F.R. § 134.508.

[1] This decision was originally issued under a protective order. On April 6, 2011, I issued an order for redactions directing each party to file a request for redactions if that party desired any information redacted from the published decision. No party requested any redactions. Thus, the decision is now published in its entirety.

III. Background

A. Protest and Acting Director for Government Contracting Determination

On September 23, 2010, the Contracting Officer (CO) for the U.S. Department of the Interior, National Park Service, issued the instant solicitation seeking proposals for construction work at Lake Mead National Recreation Area. The procurement was set aside entirely for SDVO SBCs. Appellant submitted its proposal on October 27, 2010.

On December 9, 2010, Appellant was selected as the apparent successful offeror. On December 14, 2010, Kevcon, Inc. (Kevcon) protested Appellant's SDVO SBC eligibility. Kevcon alleged that Appellant is merely a "pass through shell" created by Marcon Engineering, Inc. (Marcon) for the purpose of obtaining work intended for SDVO SBCs. Protest at 1. Marcon itself is not an SDVO SBC. The CO referred Kevcon's protest to the SBA Office of Government Contracting.

On February 24, 2011, the AD/GC issued his determination, finding Appellant was not an eligible SDVO SBC at the time it submitted its proposal. The AD/GC found that Mr. Carl Frank, the President/CEO and majority owner of Appellant, is a veteran with a service-connected disability based on documentation from the U.S. Department of Veterans Affairs. The AD/GC also determined that Appellant met the ownership requirement set forth in 13 C.F.R. § 125.9 because Mr. Frank owned 51% of Appellant at the time of the proposal. The remaining 49% interest is held by Ms. Maryory Contreras, the President/CEO and sole owner of Marcon.

The AD/GC determined, however, that Appellant is not an eligible SDVO SBC because Mr. Frank does not control Appellant, as is required by 13 C.F.R. § 125.10. The AD/GC based his determination on two principal issues.

First, Appellant is a corporation with only two persons (Mr. Frank and Ms. Contreras) on its board of directors. Although Mr. Frank is a service-disabled veteran, Ms. Contreras is not. Appellant's corporate bylaws provide that "A majority of the total number of Directors shall be necessary to constitute a quorum for the transaction of business." Determination at 6 (quoting Article III, Section 8). Thus, in order to reach quorum, both Mr. Frank and Ms. Contreras must be present. Furthermore, the bylaws are silent as to how board decisions would be made in the event of disagreement among the two directors. Conceivably, then, Ms. Contreras could prevent Mr. Frank from exerting control over Appellant by voting against him at board meetings, or by refusing to attend such meetings (thereby precluding quorum).

Second, the AD/GC concluded that Mr. Frank did not control Appellant because "business relationships exist with Ms. Contreras and Marcon Engineering, Inc. which cause such dependence that [Mr. Frank] cannot exercise independent business judgment without great economic risk." Determination at 9. The AD/GC observed that Ms. Contreras, in addition to being 49% owner of Appellant and one of Appellant's two directors, is also the company's Vice President, Chief Financial Officer, and project manager for the procurement at issue, and the holder of a license from the State of California enabling Appellant to perform construction

work.[2] Appellant is a relatively new enterprise, created by Marcon in 2010, and acknowledges itself to be an "affiliate" of Marcon. Determination at 5. Appellant has no revenues, and no employees other than Mr. Frank and Ms. Contreras, who earn no salaries. Appellant therefore relies upon Marcon for office space and office equipment. Marcon personnel perform "all or nearly all of the work that is needed to run" Appellant, including "technical proposal writing, bond and insurance requests, file set-up, assistance with bid preparation, submittal and preparation of subcontractor's database, accounting, and bid delivery." Determination at 8-9. Furthermore, because Appellant has no past performance, Appellant relied upon Marcon's performance record and credentials to strengthen Appellant's proposal relative to other competing offerors. Determination at 7-8.

Based on the foregoing, the AD/GC determined that Mr. Frank does not control Appellant, and that Appellant therefore failed to satisfy the SDVO SBC eligibility requirements.

B. Appeal Petition

On March 10, 2011, Appellant filed its appeal petition with the SBA Office of Hearings and Appeals (OHA). The appeal was filed within ten business days of Appellant's receipt of the AD/GC's determination, and therefore is timely. 13 C.F.R. § 134.503. Appellant disputes the AD/GC's determination that Appellant is not controlled by a service-disabled veteran.

With regard to the AD/GC's conclusion that Ms. Contreras could potentially defeat action by Appellant's board of directors, Appellant argues that the AD/GC was required to go beyond "corporate formalities" to examine how Appellant is actually run on a day-to-day basis. According to Appellant, had the AD/GC done so, it is clear that Appellant is run entirely by Mr. Frank. Further, Appellant argues Ms. Contreras' control over Appellant's board is wholly illusory. Appellant states that Mr. Frank, by virtue of his majority ownership of the company, could unilaterally remove Ms. Contreras as a director, thereby eliminating any power she might wield over the board.

Appellant also disputes the AD/GC's conclusion that Appellant's associations with Marcon and Ms. Contreras are so extensive as to impede Mr. Frank's independent business judgment. Appellant acknowledges that "relationships do exist between [Appellant] and Marcon and those firms are affiliated."[3] Appellant insists, however, that it has maintained careful records of all assistance received from Marcon, that Appellant intends to repay Marcon "once a stream of revenue has been established," and that it is not unusual for a new construction firm to receive assistance from a more established sponsor. Further, Appellant argues that its relationship with Marcon and Ms. Contreras is similar to those discussed in *Matter of DooleyMack Government Contracting, LLC*, SBA No. VET-159 (2009) and *Matter of AWG Services, LLC*, SBA No. VET-163 (2009), which OHA found did not rise to the level of economic dependence.

[2] Appellant is incorporated in the State of California. Determination at 5.

[3] Appeal at 7. In the context of SBA regulations, firms are "affiliated" when "one [concern] controls or has the power to control the other." 13 C.F.R. § 121.103(a).

C. SBA and Kevcon Responses

SBA and Kevcon assert that the AD/GC's determination is correct. Both argue that Ms. Contreras indirectly controls Appellant's board, and that Appellant's corporate structure would prevent Mr. Frank from removing her as a director. In addition, both SBA and Kevcon maintain that Appellant is heavily dependent upon Marcon. According to Kevcon, "Without Marcon, there is no [Appellant]. [Appellant] has no work force, it relies on Marcon for that. [Appellant] has no bidding staff, it relies on Marcon for that. [Appellant] has no experience at all, it is relying on Marcon's experience.... [Appellant] has no office, no office equipment, no physical existence without Marcon. [Appellant] relies on Marcon for all these things." Kevcon Response at 8. SBA similarly emphasizes that "For all practical purposes, [Appellant] does not even exist as a company; it is merely a conduit, a pipe, an instrument for which Marcon can siphon the benefits of the SDVO SBC [program] for itself to the detriment of all eligible SDVO SBC firms, and to the integrity of the program as a whole." SBA Response at 21.

IV. Discussion

A. Standard of Review

OHA reviews the AD/GC's decision to determine whether it is "based on clear error of fact or law." 13 C.F.R. § 134.508; *see also Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 10-11 (2009) (discussing the clear error standard that is applicable to both size appeals and SDVO SBC appeals). Accordingly, the AD/GC's determination may be overturned only if Appellant proves that the AD/GC made a patent error based on the record before him. It is ultimately Appellant's burden to prove that it is an eligible SDVO SBC. *Matter of VetIndy, LLC*, SBA No. VET-175, at 4 (2010).

B. Analysis

For the reasons discussed below, I find that Appellant has not established "clear error of fact or law" in the AD/GC's decision. Therefore, the AD/GC's determination may not be disturbed.

1. Board of Directors

OHA has recognized that the regulations regarding control of 8(a) Business Development and Small Disadvantaged Business program participants can provide guidance in interpreting the control requirement of SDVO SBC eligibility. *Matter of Eason Enterprises OKC LLC, et al.*, SBA No. VET-102 (2005). In the context of 8(a) programs, 13 C.F.R. § 124.106(d)(2)(i) provides that "[p]rovisions for the establishment of a quorum cannot permit non-disadvantaged Directors to control the Board of Directors, directly or indirectly." The regulations further state that indirect control may arise "where the bylaws allow non-disadvantaged individuals effectively to prevent a quorum or block actions proposed by the disadvantaged individuals." 13 C.F.R. § 124.106(g)(1). Applying these regulations to the instant case, the AD/GC determined that the configuration of Appellant's board would enable Ms. Contreras (who is not

herself a service disabled veteran) to prevent a quorum or otherwise thwart actions by Appellant's board. I find that it was proper for the AD/GC to have conducted this analysis. Contrary to Appellant's arguments here, the corporate structure of a firm cannot be dismissed as a mere "formality." *Matter of VetIndy, LLC*, SBA No. VET-175, at 4 (2010) (rejecting argument that a company's operating agreement "should be disregarded in favor of an examination of its daily business operations").

Turning to the substance of the AD/GC's findings, Appellant's bylaws provide that "A majority of the total number of Directors shall be necessary to constitute a quorum for the transaction of business." Determination at 6. Because Appellant has only two directors, both must be in attendance for a quorum to be reached. Further, although Appellant's bylaws do not address how a tie vote between the directors would be resolved, California corporate law provides that "[t]he articles or bylaws may not provide that a lesser vote than a majority of the directors present at a meeting is the act of the board." California Corp. Code § 307. Based on these provisions, the AD/GC reasoned that Ms. Contreras could exert indirect control over Appellant's board. I see no error in this analysis.

Appellant maintains that, because Mr. Frank holds majority ownership of Appellant, he could convene a shareholders' meeting and proceed to remove Ms. Contreras. Appellant's argument is undermined, however, by its own bylaws. According to the bylaws, Directors are elected using "cumulative voting."[4] In addition, Article II Section 5 of Appellant's bylaws provides that: "A Director may not be removed if the number of votes sufficient to elect under cumulative voting votes against removal unless the entire Board is removed." Accordingly, it appears that Mr. Frank could unilaterally remove Ms. Contreras as a Director only if the entire board were removed. Further, even supposing that Mr. Frank did remove the entire board, Ms. Contreras could once again use "cumulative voting" to retain representation on the board.

Appellant maintains that "Carl Frank could then change the corporate structure to eliminate cumulative voting or to reduce the number of Directors to one." Appeal at 7. In California, however, cumulative voting is a statutory right for shareholders of privately-held corporations. California Corp. Code § 708(a). Thus, it appears doubtful that Mr. Frank could eliminate cumulative voting altogether. Moreover, OHA will not entertain arguments as to how fundamental corporate documents might, hypothetically, be revised. *See, e.g., Matter of CymSTAR LLC*, VET-123, at 7 (2007) ("whether Appellant could hypothetically amend the super-majority voting requirements in the future is irrelevant"). Rather, it is settled law that a party "must be bound by the actual language of its organizing documents." *Matter of Valor Contracting, Inc.* SBA No. VET-194, at 5 (2010) (quoting *Matter of NuGate Group*, SBA No. VET-132, at 6 (2008)). Based on the actual language of Appellant's bylaws as they are presently written, Ms. Contreras could indeed prevent quorum or block action by the board of directors. Therefore, the AD/GC correctly determined that Ms. Contreras indirectly controls Appellant's board.

[4] Article II, Section 3. "Cumulative voting" is a method designed to protect the interests of minority shareholders by allowing them to cast all their votes for a single candidate, rather than vote for a different candidate for each available seat.

2. Economic Risk

The AD/GC also based his determination on a finding that Mr. Frank could not exercise independent business judgment without severe economic risk due to Appellant's reliance upon Marcon. In the context of 8(a) programs, 13 C.F.R. § 124.106(g)(4) provides that "[b]usiness relationships…which cause such dependence that the applicant or [p]articipant cannot exercise independent business judgment without great economic risk" may preclude eligibility. Accordingly, it was appropriate for the AD/GC to consider such matters in assessing Appellant's SDVO SBC eligibility. *Matter of Eason Enterprises OKC LLC, et al.*, SBA No. VET-102 (2005).

As discussed in the AD/GC's determination, the ties between Appellant and Marcon are extensive. The AD/GC observed in his determination that Appellant is a new entity, created by and affiliated with Marcon. Determination at 5. Appellant has no revenues and therefore obtains office space and office equipment through Marcon. Furthermore, because Appellant has no employees other than Mr. Frank and Ms. Contreras, Marcon personnel perform "all or nearly all of the work that is needed to run" Appellant. Determination at 9. Ms. Contreras, who owns and controls Marcon, has several prominent posts and a large ownership stake in Appellant, and is the holder of a key license without which Appellant cannot perform work. [5] As discussed above, the AD/GC determined that Ms. Contreras exerts indirect control over Appellant's board of directors. Furthermore, Appellant relied on Marcon's performance record in its proposal for the procurement at issue.

Appellant largely concedes that the AD/GC's findings are factually accurate, but disputes whether these findings are sufficient to show economic dependence. Appellant maintains that the AD/GC's conclusion that Appellant is economically dependent upon Marcon is contrary to OHA's decisions in *Matter of DooleyMack Government Contracting, LLC*, SBA No. VET-159 (2009) and *Matter of AWG Services, LLC*, SBA No. VET-163 (2009). In each of those cases, OHA found that ties between firms did not rise to the level of economic dependence.

In *DooleyMack* the challenged firm was alleged to be dependent on a "family of companies" bearing the DooleyMack name. The firms in question worked in the same industry, and conducted business from the same location. Furthermore, the challenged firm obtained a "significant initial cash capitalization" as well as support services from another DooleyMack concern. OHA determined that, while these ties might give the other DooleyMack firms influence over the challenged firm, "[i]nfluence on business operations or managerial decisions does not amount to control." *DooleyMack* at 5. In *AWG*, the challenged firm was connected to another company through shared office space, employees, and equipment. OHA considered these ties, without more, insufficient to establish economic dependence. *AWG* at 4.

[5] In *Matter of Chevron Construction Services, LLC*, SBA No. VET-183, at 4 (2010), OHA opined that "It seems clear that if Appellant was dependent upon [another party] for necessary licenses, that would inhibit its independent business judgment."

Appellant is correct that several of the concerns identified by the AD/GC in this case are similar to issues discussed in *DooleyMack* and *AWG*. However, the AD/GC also found additional ties between Appellant and Marcon, beyond those seen in *DooleyMack* or *AWG*. In particular, the AD/GC determined that Marcon personnel perform "all or nearly all" of the work required to run Appellant. Furthermore, the AD/GC found that Ms. Contreras holds a key license without which Appellant cannot perform. Appellant has not established that these findings are factually incorrect, nor explained why these findings are not persuasive to show economic dependence. OHA has previously upheld other determinations when a firm's economic viability is shown to be inextricably linked to another. *Matter of Singleton Enterprises-GMT Mechanical, A Joint Venture*, SBA No. VET-130 (2008), *aff'd on recons.* SBA No. VET-133 (2008) (finding of economic dependence was proper when the challenged firm conducted no business and received no revenue as an independent concern). Since Marcon's involvement appears crucial to Appellant's ability to conduct business, Appellant has not shown that the AD/GC's determination is clearly erroneous.

V. Conclusion

For the reasons discussed above, the appeal is DENIED. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.515(a).

KENNETH M. HYDE
Administrative Judge