United States Small Business Administration
Office of Hearings and Appeals

VSBC Appeal of: Snowfensive, LLC., Appellant	SBA No. VSBC-368-A Decided: July 2, 2024

APPEARANCES

Kenneth M. Bitner, Esq., Terry Jessop & Bitner, Salt Lake City, Utah, for Snowfensive, LLC

John B. Perkins, Director, Veteran Small Business Certification Program, U.S. Small Business Administration, Washington, D.C.

Edmund M. Bender, Esq., Office of General Counsel, U.S. Small Business Administration, Washington, D.C.

DECISION

I. Introduction and Jurisdiction

On April 10, 2024, Snowfensive, LLC (Appellant) appealed a decision of the U.S. Small Business Administration (SBA), denying Appellant's application for certification as a Service-Disabled Veteran-Owned Small Business (SDVOSB). SBA found that Appellant did not demonstrate that its service-disabled veteran majority owner could overcome supermajority voting requirements found in Appellant's governing documents. On appeal, Appellant maintains that the denial decision was erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse. For the reasons discussed *infra*, the appeal is denied.

OHA adjudicates SDVOSB status appeals pursuant to the Small Business Act of 1958, 15 U.S.C. §§ 631 *et seq.*, and 13 C.F.R. parts 128 and 134 subpart K. Appellant timely filed the appeal within 10 business days after receiving the denial notice on April 1, 2024. 13 C.F.R. § 134.1104(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. The Case File

Appellant is a limited liability company (LLC) formed in the state of Utah on March 28, 2016. (Case File (CF), Exh. 29.) In February 2024, Appellant applied for certification as an SDVOSB, and submitted various supporting documents to SBA. Appellant is 90% owned by Mr. John Carruthers, a service-disabled veteran. (CF, Exhs. 24, 51, and 52.) His wife, Mrs. Stephanie Carruthers, owns the remaining 10%. (*Id.*) Mrs. Carruthers is neither a veteran nor a service-disabled veteran. (*Id.*)

Appellant provided a copy of its Amended and Restated Operating Agreement (the Operating Agreement), dated February 28, 2024. (CF, Exh. 24.) The Operating Agreement reflects that Mr. and Mrs. Carruthers are Appellant's two members. (*Id.* at 1.) Appellant is a manager-managed LLC with Mr. Carruthers designated as the sole manager. (*Id.* at 2, 4.) Mr. Carruthers also holds the power of attorney for all members. (*Id.* at 13.) The Operating Agreement contains the following provision pertinent to this appeal:

> **Article XII — Amendments**
>
> **12.1 Amendments**. Amendments to this Operating Agreement or to the Articles of Organization that are of an inconsequential nature (as determined by the person holding the power of attorney granted in Article 9.1) and that do not affect the rights of the other Members in any material respect, or that are contemplated by this Operating Agreement (including without limitation those contemplated by Article 7.4), may be made by that person through the exercise of his or her power of attorney. Any other amendment to this Operating Agreement or to the Article[s] of Organization requires the unanimous consent of the Members, after notice and opportunity for discussion of the proposed amendment.

(*Id.* at 15.)

When reviewing Appellant's application, SBA expressed concern that Mr. Carruthers cannot unilaterally amend the Operating Agreement. (CF, Exh. 35.) Appellant responded that, based on Appellant's interpretation of Utah state law, the operating agreement of a manager-managed LLC may only be amended through unanimous consent of all members. (*Id.*)

B. Denial

On April 1, 2024, SBA, acting through the Director of the Office of Government Contracting (D/GC), denied Appellant's application for certification as an SDVOSB. (CF, Exh. 23.) The D/GC found that Appellant's governing documents did not enable Mr. Carruthers to overcome supermajority voting requirements. (*Id.* at 1.)

According to § 12.1 of Appellant's Operating Agreement, the person holding the power of attorney (*i.e.*, Mr. Carruthers) may unilaterally make "inconsequential" amendments to the

Operating Agreement, if such amendments "do not affect the rights of the other Members." (*Id.*) More substantive amendments, though, must be unanimously approved by all members. (*Id.*) Thus, because a service-disabled veteran cannot unilaterally amend Appellant's Operating Agreement, including in situations beyond the narrow exceptions specified at 13 C.F.R. § 128.203(j), the D/GC concluded that Mr. Carruthers does not fully control Appellant. (*Id.* at 2.)

C. Appeal

On April 10, 2024, Appellant appealed the D/GC's decision to OHA. Appellant advances three principal arguments as to why the D/GC erred in his decision. (Appeal at 2-3.)

First, Appellant's Operating Agreement adheres to the requirements for manager-managed LLCs under Utah state law. (*Id.* at 2.) Section 48-3a-407 of the Utah Revised Uniform Limited Liability Company Act specifies that:

> (3) In a manager-managed limited liability company, the following rules apply:
>
> . . .
>
> (c) The affirmative vote or consent of all members is required to:
>
> (i) approve a transaction under Part 10, Merger, Interest Exchange, Conversion, and Domestication;
>
> (ii) undertake any act outside the ordinary course of the limited liability company's activities and affairs; or
>
> (iii) amend the operating agreement.

(*Id.*, quoting Utah Code Ann. § 48-3a-407.) Therefore, Appellant reasons, under Utah law its Operating Agreement may be amended only through unanimous consent of all members. (*Id.*) Additionally, Utah's LLC Act is based upon the Revised Uniform Limited Liability Company Act, which has been adopted by more than 20 states. (*Id.*) Were OHA to uphold the D/GC's determination, "an incredible number" of manager-managed LLCs may be barred from obtaining SDVOSB certification. (*Id.*)

Appellant argues that SBA should allow more exceptions than those specifically listed in 13 C.F.R. § 128.203(j). (*Id.* at 3.) Furthermore, these exceptions should be read in context of 13 C.F.R. § 128.203(f). (*Id.*) Under the latter section, a qualifying veteran "must meet all supermajority voting requirements regarding the management and daily business operations" of the concern. (*Id.*) Since amending an operating agreement is not within the scope of a concern's management or daily business operations, amending the operating agreement should be treated as an exception under 13 C.F.R. § 128.203(j). (*Id.*)

Lastly, Appellant asserts that the managing member of an LLC owes fiduciary duties to other members. (*Id.*) These duties limit the manager's ability to amend an LLC's operating

agreement if the amendment would materially affect the interests of other members. (*Id.*) Appellant's Operating Agreement is merely structured in a way to reflect this duty. (*Id.*)

D. OHA's Request for Comments

On May 13, 2024, OHA requested that SBA submit comments on the issues presented in this appeal. More specifically, OHA asked that SBA address Appellant's contention that, for a manager-managed LLC in the state of Utah, state law requires that all members must consent to an amendment of the operating agreement. (OHA's Order at 1.) OHA also requested that SBA address Appellant's claims that failure to require unanimous consent would breach a managing-member's fiduciary duty owed to other members, and that amending an operating agreement should be considered a type of "extraordinary circumstance" within the meaning of 13 C.F.R. § 128.203(j). (*Id.*)

E. D/GC's Comments

On May 22, 2024, the D/GC submitted comments in response to OHA's request. According to the D/GC, the Utah Revised LLC Act sets forth "default rules for LLCs in cases where the operating agreement does not contain certain provisions." (D/GC Comments at 1.) If, however, an operating agreement does contain relevant provisions, the operating agreement takes precedence over the statute. (*Id.*) The Utah Revised LLC Act thus stipulates that the statute governs only "[t]o the extent the operating agreement does not provide for a matter." (*Id.*, quoting Utah Code Ann. § 48-3a-112(2).) Appellant's Operating Agreement is not silent on the question of amendments, so the Utah Revised LLC Act has no bearing on the matter. (*Id.*) Furthermore, Appellant's Operating Agreement makes clear that any substantive amendment must be approved through the unanimous agreement of all members, and one of Appellant's members — Mrs. Carruthers — is not a service-disabled veteran. (*Id.* at 2.) Accordingly, the D/GC correctly denied Appellant's application since Mr. Carruthers does not fully control this aspect of Appellant's decision-making. (*Id.*, citing *Matter of XOtech, LLC*, SBA No. VET-277 (2018).)

F. SBA's Comments

On May 28, 2024, SBA submitted comments in response to OHA's request. SBA maintains that the D/GC properly denied Appellant's application. (SBA Comments at 1.)

SBA contends that any fiduciary duty between the members of an LLC is not within the scope of the D/GC's review. (*Id.* at 2.) With regard to the Utah Revised LLC Act, SBA agrees with the D/GC that the statute only comes into play when the operating agreement is silent on a matter. (*Id.*) Appellant could have drafted its Operating Agreement in accordance with SBA regulations, yet did not do so. (*Id.* at 2-3.) Had Appellant's Operating Agreement remained silent on the question of the amendment, only then would Utah state law dictate that unanimous consent of all members was required. (*Id.* at 2.)

SBA rejects Appellant's assertion that amending an operating agreement should be deemed an extraordinary circumstance under 13 C.F.R. § 128.203(j). (*Id.* at 3.) When SBA

amended its regulations to identify these five exceptions, SBA specifically stated that the five circumstances were exclusive. (*Id.*, citing 83 Fed. Reg. 48,908, 48,909 (Sept. 28, 2018).) In 2022, SBA considered expanding this list to include amending operating agreements but ultimately declined to do so. (*Id.* at 3-4, citing 87 Fed. Reg. 73,400, 73,403 (Nov. 29, 2022).)

G. Appellant's Comments

On June 4, 2024, Appellant submitted comments in response to OHA's request. Appellant emphasizes that its Operating Agreement only requires unanimous agreement when a "proposed amendment materially affect the rights of the other member." (Appellant's Comments at 1.) Appellant reiterates that it attempted to craft this language to comport with the fiduciary duties owed by the managing member. (*Id.*) The Utah Revised LLC Act specifies that a managing member owes a duty of care to the other members of an LLC, and this duty can be eliminated only if not unconscionable or against public policy. (*Id.* at 2, citing Utah Code Ann. § 48-3a-112(4).) Appellant contends that to allow Mr. Carruthers to unilaterally amend Appellant's Operating Agreement in a manner that materially impacts Mrs. Carruthers's rights would contravene public policy. (*Id.* at 3.)

Appellant claims to have structured its Operating Agreement in an effort to avoid future litigation over any unconscionable amendments. (*Id.*) Regardless, Appellant renews its argument that amending an operating agreement should be considered an extraordinary circumstance. (*Id.*) Appellant complains that SBA is "looking for any possible way" to deny Appellant's application, rather than assisting Appellant in its efforts to obtain SDVOSB certification. (*Id.*)

III. Discussion

A. Standard of Review

When a concern seeks certification as a VOSB or SDVOSB, SBA regulations provide that:

> An Applicant's eligibility will be based on the totality of circumstances, including facts set forth in the application, supporting documentation, any information received in response to any SBA request for clarification, any independent research conducted by SBA, and any changed circumstances. The Applicant bears the burden of proof to demonstrate its eligibility as a VOSB or SDVOSB.

13 C.F.R. § 128.302(d). On appeal to OHA, Appellant has the burden of proving, by a preponderance of the evidence, that the denial decision is based upon clear error of fact or law. *Id.* § 134.1111.

B. Analysis

Appellant has not shown that the D/GC clearly erred in reaching his decision. As a result, this appeal must be denied.

Under SBA regulations, in order for an LLC to qualify as an SDVOSB, "one or more [service-disabled veterans] must serve as managing members, with control over all decisions of the [LLC]." 13 C.F.R. § 128.203(d). The regulations further require that:

> ***Supermajority requirements***. One or more [service-disabled veterans] must meet all supermajority voting requirements regarding the management and daily business operations of the concern, regardless of the legal structure of the firm.

Id. § 128.203(f). The regulations specify five "extraordinary circumstances," which need not necessarily be controlled exclusively by service-disabled veterans: (1) adding new owners, (2) dissolution of the company, (3) sale of the entire company or all assets of the company, (4) a merger of the company, and (5) declaring bankruptcy. *Id.* § 128.203(j).

Here, the D/GC denied Appellant's application because Mr. Carruthers, Appellant's service-disabled veteran majority owner, cannot unilaterally overcome a supermajority requirement pertaining to amendments of Appellant's Operating Agreement. Sections II.A and II.B, *supra*. In particular, Appellant's Operating Agreement provides that, except for amendments of an "inconsequential nature" that "do not affect the rights of the other Members in any material respect," amendments to Appellant's Operating Agreement may occur only with the unanimous agreement of all of Appellant's members. *Id.* One of Appellant's members, Mrs. Carruthers, is not a service-disabled veteran. *Id.*

On appeal, Appellant does not dispute that Mr. Carruthers cannot unilaterally amend the Operating Agreement. Sections II.C and II.G, *supra*. Appellant argues, however, that the language of its Operating Agreement is mandated by Utah state law. *Id.* This argument fails, because Utah state law in fact indicates that "the operating agreement governs . . . the means and conditions for amending the operating agreement," and that Utah state law applies only insofar as the operating agreement does not address the matter. Utah Code Ann. § 48-3a-112(1) and (2). Accordingly, since Appellant's Operating Agreement does specify how the document may be amended, it is irrelevant what Utah state law would have required if the Operating Agreement had been silent on the issue. Contrary to Appellant's claims, then, unanimous consent to amend the Operating Agreement is not required under Utah state law.

Appellant also argues that a managing member would breach his or her fiduciary duties, if the Operating Agreement could be unilaterally amended in a matter that restricted another member's rights. Sections II.C and II.G, *supra*. Appellant, though, has not persuasively shown that such a breach would necessarily occur. Notably, there are several provisions in Utah state law that allow for fiduciary duties to be waived or eliminated. Under § 48-3a-409(6), for example, "all the members of . . . a manager-managed [LLC] may authorize or ratify, after full disclosure of all material facts, a specific act or transaction that otherwise would violate the duty of loyalty." Similarly, § 48-3a-112(4)(c) states that:

> If not unconscionable or against public policy, the operating agreement may:
>
> (i) alter or eliminate the aspects of the duty of loyalty stated in Subsections 48-3a-409(2) and (9);

(ii) identify specific types or categories of activities that do not violate the duty of loyalty;

(iii) alter the duty of care, but may not authorize intentional misconduct or knowing violation of law; and

(iv) alter or eliminate any other fiduciary duty.

Accordingly, it appears that Appellant could have drafted its Operating Agreement to comply with SBA regulations without violating any fiduciary duty that Mr. Carruthers may owe to Mrs. Carruthers. Assuming Mrs. Carruthers reviewed, and agreed, to the terms of the Operating Agreement, it is unclear why it would be "unconscionable" or "against public policy" for Mrs. Carruthers to authorize Mr. Carruthers to unilaterally amend the Operating Agreement. Nor does Appellant point to any precedent whereby a court has found such a provision unconscionable or against public policy.

Appellant lastly argues that amending an operating agreement should be considered an "extraordinary circumstance," akin to those described at 13 C.F.R. § 128.203(j), under which a service-disabled veteran need not exercise full control over a concern. This argument, though, lacks support in the regulatory history. When originally promulgating the regulation, SBA made clear that "[t]hese five circumstances are exclusive, and SBA will not recognize any other facts or circumstances that would allow negative control by individuals that are not service-disabled." 83 Fed. Reg. 48,908, 48,909 (Sept. 28, 2018). Subsequently, SBA considered, and specifically rejected, a proposal to broaden the list to include amendment of an operating agreement. 87 Fed. Reg. 73,400, 73,403 (Nov. 29, 2022). It thus is clear that SBA did not intend that amendment of the operating agreement would constitute an excusable "extraordinary circumstance."

IV. Conclusion

Appellant has not established that the D/GC committed any error of fact or law in denying Appellant's application for certification. The appeal therefore is DENIED. This is the final decision of the U.S. Small Business Administration. 15 U.S.C. § 657f(f)(6)(A); 13 C.F.R. § 134.1112(d).

KENNETH M. HYDE
Administrative Judge