United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: eTouch Federal Systems, LLC Appellant, Appealed From Size Determination No. 6-2011-099	SBA No. SIZ-5280 Decided: September 2, 2011

APPEARANCES

John S. Pachter, Esq., Jonathan D. Shaffer, Esq., and Mary Pat Buckenmeyer, Esq., Smith Pachter McWhorter, PLC, Vienna, Virginia, for Appellant

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. Issues

Whether there was clear error of fact or law in the Area Office's determination that Appellant is affiliated with a large concern under the newly organized concern and identity of interest rules. *See* 13 C.F.R. § 134.314.

III. Background

A. The Solicitation and Protest

On December 4, 2009, the National Aeronautics and Space Administration (NASA Goddard Space Flight Center) issued Solicitation No. NNH09274133R for web services with agency-wide capability to create, maintain and manage public web sites, primarily www.nasa.gov and ancillary services as a total small business set-aside. The designated North

[1] Appellant requested confidential treatment to protect its sensitive business information. *See* 13 C.F.R. § 134.205. On issuance of the original Decision, I ordered Appellant to note which portions it wanted me to consider redacting from the published Decision. I now issue the redacted version of the Decision for public release.

American Industry Classification System (NAICS) code was 541519, Other Computer Related Services, with a corresponding $25 million annual receipts size standard. Proposals were due on February 5, 2010. On June 13, 2011, NASA notified the unsuccessful offerors that the apparent successful offeror was eTouch Federal Systems, LLC (Appellant).

Also on June 13, 2011, NASA protested Appellant's small business size status, after Appellant informed NASA it had been found to be an other than small business in Size Determination No. 6-2011-059. On June 16, 2011, the Small Business Administration (SBA) Office of Government Contracting - Area VI (Area Office) informed Appellant of the protest, and requested that Appellant file a response to the protest, together with a completed SBA Form 355 and certain other information. On June 27, 2011, Appellant responded to the Area Office request, including a completed SBA Form 355 and the Declaration of David Valliere, Appellant's Managing Partner and CEO.

B. The Size Determination

On July 12, 2011, the Area Office issued Size Determination No. 6-2011-099 (Size Determination) concluding Appellant was other than small because it is affiliated with eTouch Systems Corporation (Systems), an other than small firm.

The Area Office determined that Appellant is affiliated with Systems on three grounds: the newly organized concern rule, identity of interest due to economic dependence, and the totality of the circumstances.

The Area Office referred to its Size Determination No. 6-2011-59, which came to the same conclusion. The Area Office noted that in the earlier case, Appellant had certified its size as of April 2, 2010. The Area Office then concluded that, because Appellant's fiscal year ended December 31st, the Area Office would use the same time period to determine Appellant's size as in Size Determination No. 6-2011-59.

The Area Office found that Aniruddha Gadre is the sole shareholder of Systems. On June 25, 2009, he formed Appellant, a wholly-owned subsidiary of Systems. Mr. Gadre wished to separate his commercial and Government contract work. David Valliere worked as a project manager for Systems on its NASA contract.

On January 15, 2010, through the Asset Transfer Agreement, Systems transferred its two Federal Government contracts to Appellant. These were (1) National Aeronautics and Space Administration (NASA) Task Order No. NNH05CC35D (the NASA contract) for migrating all of NASA's public web sites, and (2) General Services Administration Schedule 70 Contract No. GS-35-0627P (the GSA contract) (together “the Contracts”). Appellant also acquired computer hardware, software, and the right to use the “eTouch” name in connection with the operation of its Government business.

Section 1.3 of the Asset Transfer Agreement provides:

> [T]he parties acknowledge that the assignment, transfer, and conveyance of the [Contracts] require the authorization, approval, and consent by the United States Government through the execution and delivery of a Novation Agreement by the United States Government as required by law ("Novation Agreement"). Notwithstanding the fact that an executed Novation Agreement has not been received by the United States Government, the consummation of the sale, assignment, transfer and conveyance of Assets shall proceed as of the date hereof, and the parties shall use reasonable efforts and cooperate with each other to obtain promptly an executed Novation Agreement from the United States Government.

Accompanying the Asset Transfer Agreement is Mr. Gadre's Officer's Certificate stating that Systems "is entering into with the United States Government a Novation Agreement that will permit the transfer of the Contracts" from Systems to Appellant. There is also the corresponding Action by Written Consent of Systems' Board. Nowhere in the Area Office file is there an executed Novation Agreement.

On February 5, 2010, the same day offers were due on the instant procurement, Mr. Valliere acquired a [majority][2] interest in Appellant and became its sole Manager. Systems retained a [substantial minority] interest in Appellant. According to Appellant's Amended and Restated LLC Agreement, Appellant has two members, Mr. Valliere and Systems, and the powers of the company will be exercised by a single Manager.

The Area Office determined that the annual receipts for Appellant alone are within the size standard. Those of Systems exceed the size standard.

The Area Office found that, on the date of Appellant's self-certification, the two contracts Systems assigned to Appellant accounted for [a large percentage][3] of its revenues. (As of December 31, 2010, over [a large percentage] of Appellant's revenues came from the NASA contract.) Systems formed Appellant and remains its [substantial] minority member. Mr. Gadre is Systems' sole shareholder. Both firms are in related Information Technology (IT) industries. The Area Office concluded there was no clear fracture between the concerns, and that Appellant was affiliated with Systems based on the newly organized concern rule.

The Area Office further concluded, because Appellant was dependent for such a large proportion of its revenues on contracts transferred to it by Systems, Systems owned a minority interest in Appellant, and the firms were in the same line of business, that Appellant was economically dependent upon Systems, and thus affiliated under the identity of interest rule.

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[2] Appellant requested the exact ownership percentages be redacted. The decisionally-significant facts are that Mr. Valliere has the majority interest in Appellant, and that Systems has a substantial minority interest.

[3] Appellant requested the exact percentages of its receipts derived from these two contracts be redacted. The decisionally-significant facts are that Appellant derives a large percentage of its receipts from these two contracts.

Finally, the Area Office found that, based upon all the factors discussed above, Appellant and Systems were affiliated based upon the totality of the circumstances rule.

C. The Appeal

Appellant filed the instant appeal with the SBA Office of Hearings and Appeals (OHA) on July 27, 2011.[4] Appellant also moves to submit additional evidence, a Declaration of Jeanne M. Holm.

In its Appeal Petition, Appellant asserts it is not affiliated with Systems under the newly organized concern rule, the identity of interest - economic dependence rule, or the totality of the circumstances rule. In making its affiliation determinations, the Area Office ignored the facts showing clear fracture and lack of economic dependence. As relief, Appellant requests the Size Determination be reversed or remanded to the Area Office.

By way of background, Appellant notes it was formed to divide Systems' Government contract work from its commercial work. These are different types of work, requiring distinctive work forces and timetables. Systems employees working on the NASA contract were dissatisfied with Systems, and a decision was reached for Systems to cease the Government contract work. Appellant was created to perform this work. Mr. Valliere later purchased a majority interest in Appellant. Appellant argues that while the NASA and GSA contracts were originally Systems' contracts, Systems transferred them to Appellant and they are now Appellant's contracts with NASA and GSA. The contracts were about to terminate, and with Systems' divestiture of Appellant, these contracts were not terminated, but continued with Appellant. Systems assigned its NASA and GSA contracts to Appellant.

Appellant argues that its formation and Mr. Valliere's purchase of a majority interest create a clear fracture between itself and Systems which the Area Office erred in failing to recognize.

Appellant asserts that Systems has no control or power to control Appellant. Mr. Valliere has the controlling interest in Appellant, and as Manager has the sole power to control the management of the concern. Mr. Valliere was never a key employee of Systems. Systems originally retained Mr. Valliere as a contract consultant on the NASA project. He never served in any position involving critical influence or substantive control over operations and management, and had no access to financial records or tax returns. Further, Mr. Valliere did not have and does not have any ownership interest in Systems. In addition, Systems provides no ongoing contracts to Federal.

Appellant further argues that it has no subcontract or teaming agreement with Systems. Appellant argues that although Systems has “nominal involvement” in the GSA and NASA

[4] Appellant requested that a Protective Order be issued in this case. Because there is no Intervenor, I decided that a Protective Order was not necessary. I am issuing this decision under confidential treatment, and only a redacted copy will be released to the public.

contracts, it has legally transferred all its rights to Appellant. Appellant asserts that it and Systems agreed to sever all existing subcontracts and vendor agreements. Appellant is the new party to these agreements, unless the agreement cannot be transferred. In those cases, Appellant will reimburse Systems for payments made under those agreements.

Appellant further asserts that it and Systems do not operate in the same business segment. Appellant argues that it and Systems operate in different geographic locations, and have different work products, customers, contract durations, required skill sets and capabilities. Systems operates in a commercial market in the San Francisco Bay Area, and performs no Government contracts, while Appellant markets to the Federal Government throughout the country. Appellant sells fully managed outsourced services exclusively to the Federal government in long-term contracts. Systems sells a narrower range of services to high tech commercial firms.[5]

Appellant asserts it did not receive any economic assistance from Systems when it purchased the NASA and GSA contracts. Appellant asserts the buyout was an arm's-length transaction financed by Mr. Valliere.

Appellant further asserts that it is an independent and viable concern, and it alone will perform the work on the NASA contract.

Appellant also asserts it is not affiliated with Systems based upon economic dependence. Appellant asserts that the NASA contract is an asset of Appellant and Appellant alone, and that there are no contractual ties between the two firms.

Appellant asserts the Area Office erred in finding it affiliated with Systems under the totality of the circumstances. Appellant asserts that: Mr. Valliere "was instrumental" in forming Appellant; the fracture of the firms was competed through the Asset Transfer Agreement; and Appellant alone performs the work on the contracts. Appellant asserts it and Systems have no common management and no power or control over each other. Mr. Gadre and Systems have no voting rights in Appellant.

IV. Discussion

A. Timeliness, New Evidence, and Standard of Review

Appellant filed the instant appeal within 15 days of receiving the Size Determination, and thus the appeal is timely. 13 C.F.R. § 134.304(a).

I DENY Appellant's motion to admit new evidence. Evidence not considered by the Area Office is not to be admitted absent a motion establishing good cause. 13 C.F.R. § 134.308(a)(2). Here, the proffered new evidence adds nothing new to the record, and fails to address the vital issue of novation.

[5] Appellant identifies a number of Federal contracts or subcontracts on Federal contracts it now holds, but these apparently postdate its self-certification as a small business, and thus cannot be considered here.

Appellant has the burden of proving, by a preponderance of the evidence, all elements of its appeal. Specifically, Appellant must prove the Size Determination is based on a clear error of fact or law. 13 C.F.R. § 134.314; *Size Appeal of Procedyne Corp.*, SBA No. SIZ-4354, at 4-5 (1999). OHA will disturb the Size Determination only if the Judge, after reviewing the record and pleadings, has a definite and firm conviction 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. The Merits of the Appeal

The instant appeal has the same challenged concern and Appellant, the same issues, covers the same fiscal years, and has largely the same facts in evidence as *Size Appeal of eTouch Federal Systems, LLC*, SBA No. SIZ-5271 (2011), which adjudicated the appeal of Size Determination No. 6-2011-59. Accordingly, my reasoning and conclusions are the same.

1. The Newly Organized Concern Rule

The newly organized concern rule provides that concerns are affiliated where four conditions are met: (a) Former officers, directors, principal stockholders, managing members or key employees of one concern organize a new concern; and (b) The new concern is in the same or related industry or field of operation; and (c) The individuals who organized the new concern serve as the new concern's officers, directors, principal stockholders, managing members or key employees; and (d) The one concern is furnishing or will furnish the new concern with contracts, financial or technical assistance, indemnification on bid or performance bonds, and or other facilities, whether for a fee or otherwise. 13 C.F.R. § 121.103(g). A key employee is one who, because of their position in the concern, has a critical influence or substantive control over the operation or management of the concern. *Id.* A concern may rebut such an affiliation determination by demonstrating that there is a clear line of fracture between the two concerns. *Id.*

Here, Appellant was originally formed and organized as a concern by Systems as its wholly-owned subsidiary. This case then, deals with a concern that was not merely formed by individual officers or shareholders of its alleged affiliate, but by the alleged affiliate itself. The rule looks to the person or entity who organized the new concern initially. Here, that was Systems itself. That Mr. Valliere was “instrumental” in forming Appellant is not enough. Systems actually formed Appellant, created the concern and endowed it with contracts. Appellant was organized as a wholly-owned subsidiary of Systems, and thus meets the first condition of the newly organized concern rule.

Next, I must reject Appellant's contention that the two concerns are not in the same or related industry. Appellant attempts to argue the fine distinction between the areas of Information Technology the two concerns operate in. Nevertheless, the regulation does not draw so fine a distinction. The newly organized concern rule requires only that the concerns are in *related* industries. There is no question that Appellant and Systems are both in the field of Information Technology, and Appellant was formed by splitting a portion of Systems' business. I find that there is no question that Systems and Appellant are in related industries, because they are both involved in providing services in the field of Information Technology.

Third, it is clear that Systems initially continued to control Appellant, as its sole owner, and Mr. Gadre managed the concern.

There is also no question that Systems furnished Appellant with two important assets, in the form of assigning to it its obligations and rights of payment (see below) under the NASA and GSA contracts, which comprised the greater portion of Appellant's receipts, both at its formation and as of February 5, 2010, the date as of which Appellant's size must be determined. (13 C.F.R. § 121.404(a)). The fact that Mr. Valliere later paid for his interest in Appellant is irrelevant. The regulation clearly includes instances where the assistance is furnished for a fee.

It is thus clear that Appellant meets the first four conditions of the newly organized concern rule. The next question is whether Mr. Valliere's purchase of a majority interest in Appellant created a clear fracture between the two concerns, so that the rule is not applicable.

Mr. Valliere has a majority interest in Appellant, and as Managing Member has the ability to run the concern. Neither Mr. Gadre nor any current Systems employee has any documented role in Appellant's management.

On the other hand, Systems retains a [substantial minority] interest in Appellant. This factor alone would establish that there is no clear fracture between the two firms. *Size Appeal of Eastburn Services, Inc.*, SBA No. SIZ-3144 (1989). The fact that Systems retains a substantial minority interest in Appellant means that the interests of the two concerns are not separate.

Further, there can be no clear fracture between Appellant and Systems because the NASA and GSA contracts upon whose revenue Appellant depends are not in fact contracts between the Government and Appellant, but between the Government and Systems. Nothing in the record indicates that these Federal contracts have been novated.[6] Appellant has never denied that the contracts have not been novated. Therefore, it is clear that the contracts have never been novated to Appellant. The fact is, Systems has far more than “nominal” involvement with these contracts. It is still the contractor of record. Appellant argues that its agreements with Systems transferring the contracts to Appellant have divested Systems of any control over these contracts and, therefore, of Appellant. However, without a formal novation, these arguments are meritless.

A Government contract may not be transferred to a third party. 41 U.S.C. § 15. The Government may, when in its interest, recognize a third party as the successor in interest to Government, when the third party's interest in the contract arises out of the transfer of all of the contractor's assets or the entire portion of the contractor's assets involved in performing the contract. FAR 42.1204(a). The Government is not obligated to novate a contract. When the Government concludes it is not in its interest to novate the contract, it may decline to do so and hold the original contractor liable for performance. FAR 42.1204(c). If the original contractor does not perform, the Government may terminate the contract for default. *Id.*

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[6] I find it worth noting that even now, GSA's website lists Systems as GSA's contractor. https://www.gsaadvantage.gov/ref_text/GS35F0627P/0HPUNP.2500CL_GS-35F-0627P_ETOUCHTHRU62814.PDF

Therefore, because there have been no novations of the NASA and GSA contracts, Systems remains the contractor of record. Regardless of the agreements between Appellant and Systems, the Government views Systems as the contractor, and holds Systems liable for performance. Systems is, in effect, a guarantor of Appellant's work on the NASA and GSA contracts. Regardless of the agreement between the firms, absent a novation, Appellant is really no more than a subcontractor, performing work Systems is obligated to perform, and receiving payment from Systems when Systems receives payment from the Government.

Accordingly, I conclude that the Area Office did not err when it found that there was no clear fracture between Appellant and Systems, because on the two contracts which comprise the great majority of Appellant's revenues as of the date on which size is determined, Systems remains the contractor of record and, in effect a guarantor of Appellant's performance. Appellant is affiliated with Systems under the newly organized concern rule, and thus other than small.

2. Identity of Interest due to Economic Dependence

Affiliation may arise between concerns that have identical or substantially identical business interests such as concerns that are economically dependent upon each other through contractual relationships. 13 C.F.R. § 121.103(f). Further, where SBA determines that such interests should be aggregated, an individual or firm may rebut that determination with evidence showing that the interests deemed to be one are in fact separate. *Id.*

Here, Appellant is economically dependent upon the NASA and GSA contracts, which provide it with the lion's share of its revenue. *Size Appeal of Incisive Technology, Inc.*, SBA No. SIZ-5122, at 4 (2010). I have already established that due to the lack of novation, Appellant is, in effect, Systems' subcontractor on these contracts, and Systems is, in effect, the guarantor of Appellant's performance. Appellant's argument that these contracts are independent of Systems is meritless. Further, because Systems owns [substantial minority] of Appellant, Appellant cannot show that Systems' interests are separate from its own. They run together. The Area Office did not err in finding Appellant affiliated with Systems due to identity of interest and thus, other than small.

3. The Totality of the Circumstances

Concerns are affiliated when one concern controls or has the power to control the other, or a third party controls or has the power to control both. 13 C.F.R. § 121.103(a)(1) (emphasis added). In determining whether affiliation exists, SBA will consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation. 13 C.F.R. § 121.103(a)(5). OHA has held that an area office should find affiliation based on the totality of the circumstances only when it is unable to establish affiliation under any of the other specific affiliation rules, yet the relationship between the parties taken as a whole is indicative of affiliation. *Size Appeal of LOGMET, LLC*, SBA No. SIZ-5155, at 10 (2010).

Here, affiliation between Appellant and Systems is clearly established under the newly

organized concern and identity of interest rules. Thus, there is no need to consider affiliation under the totality of the circumstances, and I need not reach that issue here.

V. Conclusion

Accordingly, I find that the Area Office did not err when it found Appellant affiliated with Systems under the newly organized concern and identity of interest rules, and thus determined that Appellant was other than small. Appellant has failed to meet its burden of establishing clear error in the Size Determination and I must deny its appeal.

For the above reasons, I DENY the instant appeal and AFFIRM the Area Office's Size Determination.

This is the final decision of the Small Business Administration. 13 C.F.R. § 134.316(d).

CHRISTOPHER HOLLEMAN
Administrative Judge