

UNITED STATES OF AMERICA
SMALL BUSINESS ADMINISTRATION
OFFICE OF HEARINGS AND APPEALS
WASHINGTON, D.C.

_____)	
IN THE MATTER OF:)	Docket No. BDPT-2006-08-21-14
)	
L.D.V., Inc.)	Decided: January 23, 2007
)	
Petitioner)	
_____)	

APPEARANCES

John Ross, Esq., Buckingham, Doolittle & Burroughs, LLP, for Petitioner L.D.V., Inc.

Joshua D. Schnell, Esq., Stephen Kong, Esq., Acting General Counsel, for Respondent Small Business Administration.

DIGEST

A personal loan to the owner of an 8(a) concern by a non-disadvantaged individual does not, without more, give the non-disadvantaged individual control or the power to control Petitioner. *See* 13 C.F.R. §§ 124.105 & 124.106.

FINAL DECISION

ARKOW, Administrative Law Judge:

Petitioner L.D.V., Inc. (Petitioner), appeals a decision by the Respondent Small Business Administration (SBA) terminating it from the 8(a) program.¹ The SBA determined Petitioner's owner failed to obtain written approval from SBA for any changes in ownership or business structure, management or control pursuant to §§ 124.105 and 124.106 because Petitioner's owner and her husband obtained a \$600,000 loan from a non-disadvantaged individual which was injected in Petitioner. The SBA determined the loan gave the non-disadvantaged individual the power to control Petitioner. Petitioner claims the SBA's determination is arbitrary, capricious, and contrary to law because the board of directors and shareholders have consistently been

¹ Small Business Act of 1958, § 8(a), as amended, 15 U.S.C. § 637(a); 13 C.F.R. Part 124. The purpose of section 8(a) is to "promote the business development of small business concerns owned and controlled by socially and economically disadvantaged individuals so that such concerns can compete on an equal basis in the American economy" 15 U.S.C. § 631(f)(2)(A).

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controlled by the disadvantaged owner and because the loan from a non-disadvantaged individual, has no effect on ownership or control. I agree with Petitioner and conclude the SBA's decision to terminate Petitioner from the 8(a) program is arbitrary, capricious, and contrary to law.

Jurisdiction

There is jurisdiction to decide this appeal. *See* 15 U.S.C. § 637(a)(9)(A), (B)(ii); 13 C.F.R. Parts 124 and 134. The appeal is timely. *See* 13 C.F.R. § 134.202(a)(1).

Issue

Whether the SBA's termination of Petitioner L.D.V., Inc., from the 8(a) program is arbitrary, capricious, or contrary to law. *See* 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b).

Facts

On June 16, 2000, Ms. Louisa Vuksanovich formed Petitioner. Administrative Record (AR), Ex. 73, at 294; Ex. 105, at 589. On January 1, 2001, Ms. Debora Carman purchased Petitioner. AR, Ex. 73, at 294 & 297. On May 25, 2002, Ms. Carman filed an application for Petitioner to gain 8(a) certification. AR, Ex. 105, at 589. On December 30, 2002, SBA notified Ms. Carman, Petitioner's president, and the individual upon whom Petitioner's 8(a) eligibility was based, that Petitioner was admitted into the 8(a) program. AR, Ex. 97, at 492. On January 21, 2003, Ms. Carman signed the 8(a) participation agreement. AR, Ex. 94, at 473-74.

On May 1, 2003, Ms. Carman and her husband borrowed \$600,000 from Ms. Vuksanovich. AR, Ex. 27, at 108. The note for the loan indicates Ms. Carman and her husband are obligated to pay three percent interest on the loan beginning on January 1, 2006, and are obligated to repay the principal over ten years beginning in 2008. *Id.* The \$600,000 was deposited into Petitioner's bank account. *Id.*, at 109. On May 30, 2003, five shares of Petitioner were transferred from Ms. Carman to Ms. Vuksanovich. AR, Ex. 28, at 114 & 117.

On March 10, 2004, Petitioner submitted an 8(a) annual update to SBA. AR, Ex. 54. Under "Other Sources of Capital," Petitioner identified Louisa Valentine² as the source for \$600,000 of Petitioner's capital. *Id.*, at 212. On April 15, 2004, SBA requested additional information regarding the \$600,000. AR, Ex. 50, at 195. On April 21, 2004, Petitioner informed SBA the funds were received in May 2003 as collateral to acquire bonding. AR, Ex. 48, at 191. Referencing the \$600,000, Petitioner stated that no formal agreements exist and at the

² There is no dispute in the record that Louisa Valentine is also known as Louisa Vuksanovich. On Petitioner's share ledger she is identified as Louisa Valentine-Vuksanovich, AR, Ex. 28, at 118; on Petitioner's share certificate, dated June 16, 2000, she is identified as Louisa D. Valentine Vuksanovich, *id.*, at 116; and on Petitioner's share certificate, dated May 30, 2003, she is identified as Louisa D. Vuksanovich, *id.*, at 114.

completion of current projects the collateral would no longer be needed. *Id.* Petitioner stressed that management and ownership remained the same. *Id.*

On January 7, 2005, SBA informed Ms. Carman that the explanation of the \$600,000 capital injection raised concerns about the control of Petitioner and SBA requested additional information. AR, Ex. 42, at 174. On January 28, 2005, Ms. Carman responded to SBA's concerns about the \$600,000. AR, Ex. 40, at 166. Ms. Carman repeatedly stated that she was in control and removal of the funds would not impact her ability to control the business. *Id.* Ms. Carman also stated that there was no formal documentation of the funds that were transferred into Petitioner's bank account. *Id.*

On April 8, 2005, SBA requested Ms. Carman identify the source of the \$600,000. AR, Ex. 37, at 146. On April 18, 2005, as she had previously indicated in her 8(a) annual update, Ms. Carman identified Louisa Valentine as the source of the capital injection. AR, Ex. 36, at 143.

SBA Determinations

On June 20, 2005, the SBA advised Ms. Carman that it intended to terminate Petitioner's 8(a) program participation. AR, Ex. 30, at 123-24 (Intent Letter). The SBA cited two grounds for termination. The first ground cited by SBA was 13 C.F.R. § 124.303(a)(4), failure by the concern to obtain prior written approval from SBA for any changes in ownership or business structure, management or control pursuant to § 124.105 and § 124.106. AR, Ex. 30, at 123-24. The second ground cited by the SBA was 13 C.F.R. § 124.303(a)(5), failure by the concern to disclose to SBA the extent to which non-disadvantaged persons or firms participate in the management of the participant business concern. AR, Ex. 30, at 123-24.

The Intent Letter stated that the SBA had concerns about (1) \$600,000 that was injected into Petitioner and (2) Petitioner's response to the SBA's inquiry about the \$600,000 that stated the money was paid in capital which reflects ownership.

The Intent Letter requested that Petitioner provide the following documentation to verify no potential for negative control by non-disadvantaged individuals exists: (1) minutes of annual shareholders meeting electing the board of directors in 2005; (2) minutes of the annual board of directors meeting electing the corporate officers in 2005; (3) documentation to verify how Petitioner obtained the \$600,000, such as copies of bank statements, sales agreements, and the consideration given by Petitioner for the \$600,000; and (4) copies of all stock certificates issued by Petitioner and a copy of the stock register.

On July 19, 2005, Petitioner timely responded to the Intent Letter. AR, Ex. 28, at 110-19. Petitioner submitted each of the documents requested by the SBA. *Id.* Petitioner stated its owner has not given up control or management of Petitioner. *Id.*

On June 27, 2006, after considering the information and evidence in Petitioner's response, the SBA advised Petitioner that the response did not overcome one of the proposed grounds for termination. AR, Ex. 1, at 1-2. Therefore, the SBA terminated Petitioner from the 8(a) program. *Id.* The reason SBA cited for termination is: 13 C.F.R. § 124.303(a)(4), failure by the concern to obtain prior written approval from SBA for any changes in ownership or business structure, management or control pursuant to § 124.105 and § 124.106. AR, Ex. 1, at 1-2. Petitioner timely appealed on August 21, 2006. Appeal Petition.

Petitioner's Position

Petitioner contends the SBA's determination to terminate its 8(a) certification is arbitrary, capricious, and contrary to law. Appeal Petition, Attachments 2, 3, & 4.

First, Petitioner argues, by owning ninety-five percent of Petitioner's stock, Ms. Carman meets the requirements of unconditional ownership set forth in 13 C.F.R. §§ 124.3 and 124.105(d). Appeal Petition, Attachments 3 & 4. Petitioner also cites that, at all times, the board of directors has been controlled by disadvantaged individuals.³ Appeal Petition, Attachments 3 & 4. Petitioner acknowledges in 2005, when Ms. Carman was reelected to the board of directors, minority shareholder Ms. Vuksanovich and Ms. Carman's daughter, Celeste Carman, were also elected to the board of directors. Appeal Petition, Attachment 3. However, Petitioner argues these changes to the board of directors do not materially alter Petitioner's ownership or business structure, management or control. Appeal Petition, Attachment 4.

Second, Petitioner states the SBA acted arbitrarily, capriciously, and contrary to law by finding an unsecured, personal loan for \$600,000 from a non-disadvantaged individual, Ms. Vuksanovich, to Petitioner's owner, Ms. Carman, and her husband constitute a change of Petitioner's ownership or business structure, management or control in violation of §§ 124.105 and 124.106. Appeal Petition, Attachments 2 & 4; Petitioner's Reply Brief, at 3-5. Petitioner argues the loan has no effect on ownership, composition, or control, and the loan has a substantial business justification. Appeal Petition, Attachments 2 & 4.

Finally, Petitioner cites the administrative record as indicative of SBA's bias toward Petitioner. Petitioner's Reply Brief, at 1-3. Petitioner argues the administrative record further demonstrates the SBA's decision is arbitrary, capricious, and an abuse of discretion. *Id.* Petitioner notes that the administrative record includes irrelevant evidence and unreliable hearsay solicited by SBA in an effort to find a reason to terminate Petitioner. *Id.*

³ Petitioner refers to disadvantaged individuals in the plural because in addition to Ms. Carman, Petitioner identifies Ms. Carman's daughter, Celeste Carman, as a disadvantaged individual. Appeal Petition, Attachment 3. However, Celeste Carman is not regarded as a disadvantaged individual under 13 C.F.R. § 124.3, since Petitioner did not rely on Celeste Carman's disadvantaged status to qualify for 8(a) program participation.

Respondent's Position

The SBA contends that its decision to terminate Petitioner from the 8(a) program is reasonable and not arbitrary, capricious, or contrary to law. Response, at 1-2, 14-28. The SBA argues that the administrative record demonstrates that the SBA's decision is reasonable, fully supported by the administrative record, and in accordance with its regulations. *Id.*

SBA argues Petitioner was lawfully terminated from the 8(a) program based on its failure to obtain prior written approval from SBA for changes in Petitioner's ownership or business structure, management or control. Response, at 14-28. SBA states Ms. Vuksanovich had actual control or the power to control Petitioner. Response, at 16-28. In support of its contention, SBA cites: (1) Ms. Vuksanovich's critical financial and bonding support which enabled Ms. Vuksanovich to directly and indirectly influence Ms. Carman and Petitioner, Response, at 18-22; (2) Ms. Vuksanovich's \$600,000 loan to Ms. Carman, Response, at 23-25; and (3) Ms. Vuksanovich's business relationship with Petitioner which prevented Ms. Carman from exercising independent business judgment, Response, at 25-28.

Oral Hearing

On October 27, 2006, Petitioner moved for an oral hearing to argue why termination of its 8(a) status was arbitrary, capricious, and an abuse of discretion. On November 6, 2006, SBA opposed Petitioner's motion for an oral hearing and argued that Petitioner failed to meet the standard for admission of evidence beyond the written administrative record because Petitioner did not show the SBA determination resulted from bad faith or improper behavior as required by 13 C.F.R. § 134.407(a). On November 8, 2006, Petitioner's motion for an oral hearing was denied.

On November 28, 2006, Petitioner moved for reconsideration of the order denying an oral hearing and alleged a pattern of bad faith in SBA's review of Petitioner's 8(a) status. On December 7, 2006, SBA opposed Petitioner's motion for reconsideration of the order denying an oral hearing and argued Petitioner failed to make a substantial showing of bad faith or improper behavior. Since I agree with Petitioner and conclude the SBA's decision terminating Petitioner from the 8(a) program is arbitrary, capricious, and contrary to law, it is unnecessary to rule on Petitioner's motion for reconsideration of the order denying an oral hearing.

Discussion

I. Standard of Review

The SBA determination must be sustained unless a review of the written administrative record demonstrates that the SBA's determination, that Petitioner should be terminated from the 8(a) program, is arbitrary, capricious, or contrary to law. As long as the SBA's decision to terminate Petitioner is reasonable, it must be upheld in this appeal. *See* 13 C.F.R. § 134.406(b).

My review of the administrative record is narrow and does not permit me to substitute my own judgment for that of the SBA. I must examine whether the SBA considered all the facts presented as well as the laws and regulations that guide the decision-making process. Then I must determine whether the SBA made a clear error of judgment in its decision. Only if it did can I find the SBA decision arbitrary, capricious, or contrary to law. *See Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

A clear error of judgment can be found if the SBA (1) fails to properly apply the law and regulations to the facts of the case; (2) fails to consider an important aspect of the problem; (3) offers an explanation for its determination that runs contrary to the evidence; or (4) provides an implausible explanation that is more than a difference between my views and those of the SBA. In sum, the SBA must articulate a satisfactory explanation for its action, including a rational connection between the facts found and its determination. *Id.*

II. Termination Requirement

The SBA may terminate an 8(a) program participant prior to completion of its program term for good cause. 13 C.F.R. § 124.303(a). The SBA alleges that it has good cause to terminate Petitioner. Good cause includes failure to obtain prior written approval from the SBA for any changes in ownership or business structure, management or control pursuant to 13 C.F.R. §§ 124.105 and 124.106. 13 C.F.R. § 124.303(a)(4).

The SBA's termination will be sustained on appeal if the administrative record establishes the SBA reasonably determined there is good cause to terminate Petitioner.

III. Analysis

SBA terminated Petitioner from the 8(a) program for failure to obtain prior written approval from the SBA for any changes in ownership or business structure, management or control pursuant to 13 C.F.R. §§ 124.105 and 124.106. *See* 13 C.F.R. § 124.303(a)(4).

Where 13 C.F.R. § 124.105 lists the requirements for unconditional ownership, 13 C.F.R. § 124.106 lists the requirements for control. Section 124.105 provides an 8(a) business must be, at a minimum, 51 percent unconditionally owned by one or more socially and economically disadvantaged individuals and the ownership must be direct. Section 124.106 requires an 8(a) participant's management and daily business operations to be conducted by one or more disadvantaged individuals (with limited exceptions not applicable to this case). Control has been defined as the ultimate authority to manage and direct daily business operations. *See Matter of Data Voice, Inc.*, SBA No. MSB-455, at 15 (1994).⁴ Influence on business operations or

⁴ *Matter of Data Voice, Inc.*, and the cases decided before 1998 apply an earlier version of the regulation. *See* 63 Fed. Reg. 35,739 (June 30, 1998). Although the regulation was redesignated in the 1998 revision (from 13 C.F.R. 124.104 to the current 13 C.F.R. 124.106), the

managerial decisions does not amount to control. *See generally Matter of Aerofab, Inc.*, SBA No. MSB-423 (1993).

SBA determined a non-disadvantaged individual, Ms. Vuksanovich, had actual control or the power to control Petitioner because she loaned \$600,000 to Ms. Carman and her husband. Thus, the critical question is whether the unsecured, personal loan of \$600,000 alters control of Petitioner or, more specifically, did the loan endow Ms. Vuksanovich, a non-disadvantaged individual, with control or power to control Petitioner. It did not.

Financial support by non-disadvantaged shareholders does not constitute control. *Aerofab, Inc.*, SBA No. MSB-423, at 3-6. Major shareholders, who are also lenders to an 8(a) business, may be determined to be in a position to influence managerial decisions, but their financial support alone, even if deemed critical to the business, does not amount to control or the power to control. *See id.* If SBA's regulations considered the power to influence a business equivalent to the power to control, virtually all 8(a) businesses would be controlled by non-disadvantaged individuals or entities—considering the influence of institutional lenders, the sway of persons or entities in a position to provide capital, and the influence of major customers. *See id.*, at 4.

In order to conclude that a non-disadvantaged individual has control or the power to control “in the very least one ought to be able to hypothesize some situation” in which the non-disadvantaged individual has control or the power to control. *Matter of Paragon Systems, Inc.*, SBA No. MSB-440, at 6 (1993) (quoting *Matter of Trans-Tel Central, Inc.*, SBA No. MSB-388 (1991)).

If Ms. Vuksanovich, the non-disadvantaged individual, attempted to rely on her loan to Ms. Carman to wield control over Petitioner, no reason exists that would force Petitioner to accede to Ms. Vuksanovich. Petitioner could simply seek to obtain funding elsewhere. *See also Paragon Systems, Inc.*, SBA No. MSB-440, at 6-7 (finding 8(a) participant was not controlled by former non-disadvantaged owner who possessed a critical license for business to operate since 8(a) participant could hire another individual with a license). Or, Petitioner could merely refuse to comply, and Ms. Vuksanovich would be powerless to impose her will.

I recognize that Ms. Vuksanovich's loan, expertise, and prior ownership provide the possibility for a measure of influence on Petitioner. In fact, as the owner of five shares and a director, she has the right and obligation to provide input and recommendations as to the business decisions of Petitioner. However, the question presented is not “whether there might” be a reason to find the non-disadvantaged individual controls or has the power to control, but if there is “a rational basis” for the SBA's conclusion that Ms. Vuksanovich's loan provides control or the power to control Petitioner. *See id.*, at 7.

substance of the relevant regulation was not altered. *See* 63 Fed. Reg. 35,729-30 (proposed revisions), and 35,739.

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There is nothing in the record to lead to the rational conclusion that Ms. Vuksanovich, due to her loan to Petitioner's owner, has the ultimate authority to administer and to manage daily business operations of Petitioner. SBA's conclusion that Ms. Vuksanovich does is not supported in the record. I am aware Ms. Vuksanovich is the former owner of Petitioner, the amount of the loan, and the various allegations within the administrative record, but the SBA's termination is based on the fact that "at any time, Ms. Vuksanovich could pull her financial support." Response, at 27.

Here, there is a legally binding promissory note payable to Ms. Vuksanovich. The note does not contain provisions that give Ms. Vuksanovich the ability to exercise control over Petitioner. In fact, the loan is not to Petitioner and there is no evidence in the record that Ms. Vuksanovich imposed any conditions on Petitioner with respect to the loan. Moreover, any opportunity Ms. Vuksanovich had for using the loan to exert leverage on Petitioner ended when Ms. Vuksanovich entered into a written and signed agreement documenting the terms of the loan. *See Aerofab, Inc.*, SBA No. MSB-423, at 6 (explaining non-disadvantaged shareholders who provided financial assistance to the 8(a) applicant could have made the financial support contingent upon power over the business, but once they signed guarantees without such requirements, the opportunity was lost). Ms. Vuksanovich cannot demand repayment, absent a default on the loan. There is nothing Ms. Vuksanovich could legally do to Ms. Carman or Petitioner to require Petitioner to make a particular business decisions.

Of course, Ms. Carman and Petitioner could choose to follow Ms. Vuksanovich's advice and recommendations. Due to Ms. Vuksanovich's experience with Petitioner, her advice could very well be beneficial to the success of Petitioner. That is desirable, since the purpose of the 8(a) program is to develop successful businesses.

The SBA's analysis and conclusion were unreasonable and contrary to the weight of the evidence in the record. SBA's rationale—Ms. Vuksanovich controls or has the power to control Petitioner due to an unsecured, personal loan to Ms. Carman and her husband—ignores that Petitioner's president and owner, Ms. Carman, a disadvantaged individual, owns ninety-five percent of Petitioner's voting stock and is on Petitioner's board of directors. Moreover, the administrative record contains no evidence of conditions tied to the loan which vest Ms. Vuksanovich with control or the power to control Petitioner.

For these reasons, after a review of the administrative record, I find the SBA's conclusion that a non-disadvantaged individual, Ms. Vuksanovich, has actual control or the power to control Petitioner because of the \$600,000 unsecured, personal loan is not supported in the record and is unreasonable. I find the SBA made a clear error of judgment in concluding Petitioner should be terminated from the 8(a) program because it failed to obtain prior written approval from the SBA for a change in control due to the loan. Accordingly, the SBA's decision is arbitrary, capricious, and contrary to law.

Conclusion

Respondent Small Business Administration's decision terminating Petitioner L.D.V., Inc., from the 8(a) program is ARBITRARY, CAPRICIOUS, AND CONTRARY TO LAW. *See* 15 U.S.C. § 637(a)(9)(C); 13 C.F.R. § 134.406(b).

Subject to 13 C.F.R. § 134.409(c), this is the final decision of the Small Business Administration. *See* 15 U.S.C. § 637(a)(9)(D); 13 C.F.R. § 134.409(a).

RICHARD S. ARKOW
Administrative Law Judge