

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

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SIZE APPEAL OF:	)	
	)	
Genex Technologies, Inc.	)	Docket No. SIZ-2006-02-02-10
	)	
Appellant	)	Decided: May 24, 2006
	)	
Grant Application No. 1 R43 DE016797-01	)	
National Institute of Health	)	
Bethesda, Maryland	)	
	)	
	)	

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APPEARANCES

Joseph P. Mackin, President  
Clark Lynn, Vice President  
Genex Technologies, Inc.

DIGEST

In order to be an eligible small business for a Small Business Innovation Research (SBIR) award under 13 C.F.R. § 121.702, a business concern must have, together with its affiliates, no more than 500 employees and be either:

- (1) a concern which is at least 51% owned and controlled by individuals who are United States citizens or permanent resident aliens, or
- (2) a concern which is at least 51% owned and controlled by another business concern which in turn is at least 51% owned and controlled by individuals who are United States citizens or permanent resident aliens, or
- (3) a joint venture in which each entity meets the requirement of either (1) or (2).

A business concern which is a corporation, wholly owned by another corporation, which second corporation is in turn 93% owned by a third corporation, is not eligible for an SBIR award.

- 2 -

DECISION

HOLLEMAN, Administrative Judge:

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.

Issues

What are the size eligibility requirements for the SBIR Program.

Whether a business concern which is a corporation, wholly owned by another corporation, which second corporation is in turn 93% owned by a third corporation, may be an eligible small business for an SBIR award.

I. BACKGROUNDA. The Size Determination

On October 13, 2005, the National Institute of Dental and Craniofacial Research of the National Institute of Health of the Department of Health and Human Services (NIH) requested that the Small Business Administration (SBA) Office of Government Contracting - Area 2 (Area Office) perform a size determination on Genex Technologies, Inc. (Appellant). Appellant had a pending grant application with NIH under the Small Business Innovation Research (SBIR) program.

On October 17, 2005, the Area Office informed Appellant of the protest and requested Appellant submit a completed SBA Form 355, a response to the concerns raised by NIH, and certain other information. Appellant responded to the Area Office's request on November 2, 2005 and filed a supplemental response on December 19th.

On December 30, 2005, the Area Office issued a size determination finding Appellant other than small. Size Determination No. 2-2006-001. The Area Office found that 100% of Appellant's stock is owned by Technest, Inc. (Technest). Appellant's officers are Robert Tarini, CEO, Joseph Mackin, President, Gino Pereira, CFO, and Daniel Clevanger, Secretary. Appellant reports one affiliate, EOIR Technologies, Inc.

Technest is owned 93% by Markland Technologies, Inc. (Markland). Technest's officers include Mr. Tarini, Mr. Mackin, and Mr. Pereira. Mr. Tarini and Mr. Mackin also serve as Technest's directors.

- 3 -

Markland is a publicly-owned company with multiple stockholders. Markland's officers include Mr. Tarini, Mr. Mackin, Mr. Pereira, and Mr. Clevanger. Markland's directors are Mr. Tarini, Mr. Mackin, and Mr. Pereira. Markland reports two affiliates, Technest and Ergo Systems, Inc.

The Area Office found Appellant, together with all its affiliates named above, has less than 500 employees. However, the Area Office also found that Appellant is neither owned and controlled at least 51% by individuals who are United States citizens or permanent residents, nor owned and controlled at least 51% by a concern which is itself at least 51% owned and controlled by individuals who are United States citizens or permanent residents, but is owned by a corporation which itself is owned by another corporation. Accordingly, the Area Office found that Appellant did not meet the size standard for small businesses under the SBIR program, and thus concluded the firm was other than small.

#### B. The Appeal

Appellant received the size determination on January 6, 2006. On February 2, 2006, Appellant filed the instant appeal. Appellant asserts that its ownership was structured with two tiers of corporate ownership in order to avoid "certain contractual restrictions at the Markland level."

Appellant asserts that on February 14, 2005, Technest acquired Appellant, and Markland acquired its 93% interest in Technest. Appellant asserts that over 51% of Markland's stock is owned by individuals who are either United States citizens or permanent resident aliens. The Boards of Directors of Markland and Technest are the same, as are the executive officers.

Appellant asserts that if it were merged into Technest the resulting corporation would be an eligible small business. Appellant argues that such a merger would be a mere ministerial act, and thus Appellant's failure to comply with the regulations is merely a matter of corporate form. Appellant asserts the Area Office's application of the regulation elevates corporate formalities over the substantive intent of the regulation. Appellant asserts the Area Office applied the regulation overly formalistically and reached an absurd result by finding Appellant other than small.

Appellant further argues that the intent of the regulation is to preclude a small business owned by a large business with significant financial resources from having an unfair advantage over other small businesses. Here, however, Appellant, together with its affiliates, is clearly small. Further, Appellant argues this Office should consider the effect of the application on its business. Most of Appellant's business has been research for federal agencies funded by the SBIR program. Appellant asserts that ineligibility for the SBIR program will have a crippling effect on its business.

## II. DISCUSSION

Appellant filed the instant appeal within 30 days of receiving the size determination, and thus the appeal is timely. 13 C.F.R. § 134.304(a)(2).

Appellant has the burden of proving, by a preponderance of the evidence, all elements of its appeal. Specifically, it must prove the Area Office 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).

In order to be eligible for an SBIR award, a business concern must have, together with its affiliates, no more than 500 employees and be either:

- (1) a concern which is at least 51% owned and controlled by individuals who are United States citizens or permanent resident aliens, or
- (2) a concern which is at least 51% owned and controlled by another business concern which in turn is at least 51% owned and controlled by individuals who are United States citizens or permanent resident aliens, or
- (3) a joint venture in which each entity meets the requirement of either (1) or (2).

13 C.F.R. § 121.702.

Appellant here clearly does not qualify under the plain language of the regulation. Appellant is a corporation, owned by another corporation, which corporation is in turn 93% owned by another corporation. The regulation does not permit a concern to have two levels of corporate ownership and remain an eligible SBIR concern.

At one time, the SBIR regulation was less flexible and required that the SBIR concern itself be at least 51% owned and controlled by individuals who were United States citizens or permanent resident aliens. 13 C.F.R. § 121.702 (2004). In our cases applying this regulation, this Office has carefully reviewed the legislative history of the SBIR program, and construed the regulation strictly, finding that "individuals" meant only natural persons, not corporations, and declined to find concerns with any form of ownership other than that permitted by the regulation eligible under the size regulations as SBIR concerns. *See Size Appeal of Diversa Corporation*, SBA No. SIZ-4672 (2004); *Size Appeal of Aspect Medical Systems, Inc.*, SBA No. SIZ-4567 (2003); *Size Appeal of Cognetix, Inc.*, SBA No. SIZ-4560 (2003); *Size Appeal of CBR Laboratories, Inc.*, SBA No. SIZ-4423 (2001).

In 2004, SBA amended the regulation to read as it does today, permitting ownership of an SBIR concern by another concern. 69 Fed. Reg. 70,180 (Dec. 3, 2004). SBA considered, and specifically rejected, comments which argued for a more liberal construction of the ownership requirements, and rejected the proposal that an SBIR firm could be owned by more than one firm. *Id.* at 70,181. This Office has also considered and specifically rejected the argument that holdings by institutional investors should be treated as if owned by the individual investors in the

institutions. *Aspect Medical Systems*, SBA No. SIZ-4567 at 3; *Cognetix*, SBA No. SIZ-4560 at 5. It is thus clear that Appellant's argument is meritless.

Appellant attempts to dismiss as excessive formalism simple application of the regulation as written, in the manner the Agency clearly expected it would be applied at the time the regulation was promulgated. Appellant's long experience with the SBIR program diminishes Appellant's argument, as it has long known, or should have known, what the requirements for SBIR eligibility were and elected to ignore those requirements when Technest purchased it. A corporate merger between Genex and Technest would not be a mere ministerial act, as Appellant argues, but an act with real legal consequences, resulting in the complete absorption of one corporation by the other. 19 AM. JUR. 2D *Corporations* § 2168 (2005).

SBA has carefully considered the issue of the ownership structure of SBIR concerns and crafted a regulation meant to allow flexibility yet still limit the program to those concerns which Congress intended to receive awards. Appellant has chosen a different form of corporate organization than that permitted by the regulation.

The regulatory requirements for eligibility as an SBIR concern are clear, and it is equally clear Appellant has failed to meet them. Appellant has thus failed to establish any error of law or fact in the size determination, and this Office must deny its appeal.

### III. CONCLUSION

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

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

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CHRISTOPHER HOLLEMAN  
Administrative Judge