

**Testimony of Mark Leazer, Forms & Supply, Inc.
on Behalf of the National Office Products Alliance
Committee on Small Business, U.S. House of Representatives**

**Hearing on Impact of Emerging Procurement
Methods on Small Business Contractors
Thursday, March 6, 2008**

Madam Chairwoman and members of the Committee, I am Mark Leazer, Director of Sales Technology for Forms and Supply, Inc. a small, independent WOSB office products and furniture dealer based in Charlotte, NC. I am testifying today on behalf of NOPA – the National Office Products Alliance – a not-for-profit trade association established in 1904 that represents and serves more than 700 small independent dealers nationwide, along with their key suppliers.

NOPA appreciates the opportunity to speak to the Committee about a serious, growing problem facing small office product dealers who have government business: Small Business “Fronts”, also known as pass-throughs. This problem directly affects our 200-plus members who serve federal government customers in offices around the country, as well as in the Washington, DC metro area. NOPA members range in size from \$1 million to \$90 million in sales per year. Further pertinent industry background is provided at the end of this prepared statement for the hearing record.

Small Business “Fronts” – What Are They?

Last April, an industry colleague, Grady Taylor, representing the TriMega Purchasing Association, provided an overview of the various obstacles facing small businesses in the office products industry when they seek federal government business.

He touched on one obstacle – Small Business Pass Throughs or “Fronts” – which has become a large, growing problem and is particularly damaging and unfair to legitimate independent small dealers in our industry and others. Today, I would like to concentrate on this problem, which requires special congressional attention and focused legislative and regulatory remedies to be addressed effectively.

Just what are “pass-throughs” or small business “fronts”? In the simplest terms, these are situations in which a large national company approaches a small business and proposes to create a “mentoring” relationship for the sole purpose of gaining improper access to contracts set aside for small business.

Let me emphasize that these “fronts” are NOT the same thing as legitimate small business mentoring program relationships. In that case, the small firm plays a commercially useful subcontracting role.

The abuses, which are associated with the small business “fronts” problem, occur when:

- The small business has little or no prior experience as a reseller of office products, particularly to government customers, and little or no ability to itself support such business;
- The large company offers to performs most or all of the selling, order processing, customer service, product delivery, and invoicing and payments processing for the contract on behalf of the “pass-through” dealer “partner;”
- The small business performs few if any commercially useful functions once the contract award is made, beyond providing an entry point through its website to the full operating infrastructure of the large corporation; and
- The small business typically receives a commission for its willingness to serve as the “front” for this business, which is “passed through” to the large corporation.

Members of the National Office Products Alliance (NOPA) urgently need help from this Committee and Congress as a whole to end the large, growing use of small business “fronts” by large national chain stores. This practice allows them to improperly capture federal government contracts set aside for small businesses in our industry and others. It appears to be unethical and totally inconsistent with congressional intent to create a level playing field for legitimate small businesses in government contracting.

Congress has encountered and dealt with a similar issue in the form of Federal Prison Industries, through which purchasing preferences aimed at enhancing the work skills of federal prisoners often led to “drive-by manufacturing.” In reality, prisoners were paid below minimum wage and received little or no training in the higher-level skills associated with production of office furniture or other products.

Congress has consistently voiced its disapproval of such practices by passing legislation to end them. NOPA asks that Congress now turn its attention to the urgent, comparable problem of small business fronts.

Negative Impact of “Fronts” on Legitimate Small Businesses

The known direct loss of federal business experienced by legitimate independent dealers already totals tens of millions of dollars annually. This loss will grow as these office products dealers continue to unfairly lose access to future multi-year federal, state and local government office products contracts as a result of the small business “fronts” problem. Conservatively, these total losses already have reached more than 100 million dollars per year on a national basis, including federal and state government contracts.

In FY 2006 federal agencies spent between \$322 million and \$540 million on office supplies, according to FederalTimes.com. Estimates are imprecise, because of incomplete government data collection. These data also exclude the large volume of business done through the government’s credit card program.

Regrettably, this “pass-through” problem also is causing significant losses of current business and future opportunities for small office product dealers at the state and local government level and in institutional and commercial markets nation-wide.

How Small Business “Fronts” Work

NOPA has conducted research into a variety of small business “front” situations. This research shows a common pattern of unethical and misleading contracting behavior, which in most cases may not be illegal due to loopholes in present federal laws.

Appendix 1 compares the legitimate independent dealer to the “pass-through” dealer. Pass-through situations typically work as follows:

- 1) The large office products corporation identifies a small business owner with socio-economic preferential selling status and some business experience – sometimes in a different industry – to serve as its “front” to gain access to government set-aside contracts for small business.
- 2) The large corporation offers to help the small business enter the office products industry with the understanding that the major company will handle all or virtually all of the value-added sales, order placement and processing, product delivery, customer service, quality assurance and even billing functions. In exchange for a commission, the smaller company agrees to serve as a mentored partner “front” through which orders are passed to the major corporate “partner”.
- 3) Government orders placed with the small business “front” are usually captured by the website/customer management computer system of the major corporation, and the order management, customer service and fulfillment processes are then fully administered by employees of the major corporation.
- 4) Payments may even be handled through “lock boxes” established in the name of the “front”, but with the major corporation making the actual payment collection. The commission is then paid to the “front” to close out the transaction.

NOPA believes that GSA and many federal agencies are trying to provide more opportunities for legitimate small businesses to compete on a level playing field for federal contracts. However, we do not believe they fully understand the “pass-through” phenomenon. The current Army Blanket Purchase Agreement (BPA) and a recent multi-agency strategic sourcing initiative contract awards that include small office product dealers are positive signals. But even those awards appear to include some potential pass-throughs.

Small Business Fronts Harm Government Customers

Small business “fronts” harm not only legitimate, independent small business dealers, but also the federal government as an office products buyer. Federal customers are injured by the steady erosion of effective competition for federal contracts as legitimate small

dealers are less willing and able to pursue new government business. Regular, ongoing competition involving multiple alternative office product suppliers – the best way to ensure best price and value – erodes and in some cases no longer occurs.

Pending legislation in the U.S. Senate (S. 2300) would require the General Accountability Office (GAO) to study the small business “fronts” problem at the federal level. Presumably, this study would address the issue of impact on competition for federal government contracts. However, NOPA notes that there already is strong hard evidence of the negative effects of reduced competition for state government office product contracts in several states. In several cases, state contracts that allow a large prime contractor to work with small business “fronts” have had significant problems and anticipated cost savings to governments in those states have not been realized.

In North Carolina, the state purchasing authority awarded a multi-year sole-source contract in 2006 to one of the large national office product chains. Over the prior 5-10 years, the state steadily eliminated the participation of independent, full-service dealers in this contract despite their long-standing, superior performance records. Competition suffered as a result.

Within a year after the sole-source contract was awarded, the Inspector General for the Department of Administration in North Carolina found significant examples of unauthorized product substitutions and incorrect (usually higher) pricing on a large number of contracted “core” office products, where charged prices did not match the awarded bid prices. The large office product chain was forced to make restitution, but was not removed from the state contract.

In Georgia, a similar audit found even more widespread product substitutions and overcharges by the large national chain. In February 2008, the State terminated its contract with the large national chain and has reopened office products business to all qualified suppliers, including independent dealers.

In the Georgia situation, the large national chain was awarded the state office products contract with the understanding that it would work with a consortia of small dealers in the State as “subcontractors”. Most if not all of the small dealers chosen to participate by the national chain were small business “fronts”, with little or no prior office products industry experience and little role in contract fulfillment.

A similar state contract arrangement with one of the national office product chains prevails in California, with 8 of 9 small business consortia members having no apparent significant prior experience in the office supplies business. That situation too has recently come under closer legislative and administration scrutiny, particularly after violations of contract terms by one of the national chains in 8 California counties.

NOPA believes that similar situations would be discovered if individual agencies conducted thorough audits of actual versus bid pricing and the scope of unauthorized product substitutions under federal office product contracts. In recent years, a growing

number of federal office product contracts have been awarded to one of the large national office product chains on a multi-year basis and/or to their small dealer “fronts”.

These “fronts” are expanding as vehicles for large corporations to “demonstrate” a commitment to small business subcontracting, and specifically to providing “assistance” to disadvantaged or under-represented socio-economic groups. Unfortunately, the reality does not match the image shown.

Federal Legislation Essential to End Small Business “Fronts”

NOPA and its members greatly appreciate the exceptional efforts this Committee has made, particularly in the past 12-18 months, to assist small businesses in our industry and others. The results have been legislation to:

- 1) Require more complete and accurate government accounting of purchases from small businesses;
- 2) Create better standards for determining which federal contracts are appropriate for “bundling,” a growing federal contracting practice that has taken new form under GSA’s “Strategic Sourcing Initiative; and
- 3) Encourage increased government-wide contracting opportunities for small businesses through closer congressional oversight and more ambitious agency-level goal setting, monitoring and reporting to Congress.

None of these reforms, however, have become law as yet. And none will directly address the small business fronts problem, which can only be curbed or eliminated through more specific legislative and regulatory reforms.

Small Business “Fronts” Inconsistent with Recent Reform Legislation

Pending government contracting reform legislation in the House (H.R. 1873, passed in May 2007) and Senate (S. 2300) provide a foundation upon which additional reforms to eliminate small business “fronts” could be built. There are three elements of the “fronts” problem, each of which must be addressed:

- 1) Federal agencies should not receive credit for small business awards when the work done under a given contract is largely performed by employees of a large corporation;
- 2) Small business “fronts” should not be allowed to gain access to set-aside government contracts when they effectively serve as brokers that receive a commission from large companies, and when they add little or no value added to the contracted work; and

- 3) Large national companies should not improperly gain a larger piece of the federal market through sham mentoring programs.

In stark contrast, legitimate independent office product dealers typically perform a high percentage of the service work associated with government contracts. Appendix 1 provides a visual comparison of the typical functions performed by independent small office products dealers versus small business “fronts”. One such “front”, Faison, was recently determined by the Small Business Administration to be “other than small.” And this decision was upheld on appeal (Appendix 2).

Independent dealers meet long-standing FAR requirements for government service subcontractors (50% minimum value-added rule) operating under set-aside contracts for small business. They also meet relevant state procurement requirements, such as the “commercially useful function” criteria used in California. A copy of those standards appears in Appendix 3.

Because there are no specific criteria in current U.S. law or the Federal Acquisition Regulation (FAR), small business “fronts” may be not be illegal and federal agencies have either not seen or tolerated the practice, despite reservations about it.

With new requirements in place to more accurately measure and report federal small business contracting and pending legislation to reform small business contracting in general, it is time to address small business fronts, which are one of the most glaring and widespread unfair federal contracting problems our industry faces.

Specifically, NOPA asks the Committee and Congress to draft and approve legislation to:

- 1) Establish strict bid evaluation and post-award review criteria to ensure that federal contracts set aside for small business are not awarded to companies that play only minimal roles in servicing such contracts;
- 2) Require federal agencies to ensure that all bidders on small business set-aside contracts fully disclose and certify the functional roles they will play in contract fulfillment, as well as the specific functions their primary suppliers and subcontractors, if any, will perform;
- 3) Require each federal agency to report annually to the appropriate committees of jurisdiction in the U.S. House of Representatives and the U.S. Senate regarding their implementation of these provisions to end the use of small business “fronts” in federal contracting; and
- 4) Establish meaningful penalties for companies found in violation of the proposed new legislative and FAR provisions aimed at elimination of “fronts”.

Office Products Industry Background

Government and commercial customers typically buy office products from small independent dealers or from one of the four large national corporations that operate in this market. The same manufacturers and wholesalers sell to both dealers and the large national chains.

A few dealer-owned purchasing cooperatives negotiate direct purchasing agreements with manufacturers to buy large quantities of the highest-volume office products to help their independent dealer members stay cost-competitive with the major national office product specialist chains. For lower-volume products, both independent dealers and the national chains rely heavily on wholesalers to supply them.

With similar costs for goods they sell, the main differences between independent office product dealers and the national chains is their size and how they operate. Dealers are entrepreneurial businesses focused on government, institutional and commercial delivery accounts and are known for their flexibility and exceptional customer service. They usually are not retailers. The large national chains are mixed retailers and commercial resellers. Not surprisingly, their strategies for serving customers are quite different from those of independent dealers.

To serve government and commercial customers in multiple locations – especially for large national contracts, independent dealers often participate in special “teaming arrangements”. My company, Forms and Supply, is an active participant in one of them: the American Office Products Distributors (AOPD), which has operated successfully since the 1970s.

For these reasons, “subcontracting” is not necessary and generally has not been used in the office products industry, except in the context of the collaborative teams of independents I just mentioned. Independent dealers and large national chains are competitors who do not work well together, and have different operating strategies and philosophies. As a standard industry practice, the legitimate independent dealer has the sole responsibility to negotiate contracts with its supporting business partners as well as government customers, and remains legally liable for the performance of any and all functions to be performed under those contracts. In known pass-through situations, this is not typically the case, with the larger company playing the central role in bid development and negotiations with supporting vendors and the government customer.

On behalf of NOPA and its members, I thank you for opportunity to testify before this Committee about one of the most damaging and unfair practices that often prevents independent office product dealers from competing on a level playing field for federal government contracts.

For Further Information Contact: Paul Miller, Miller Wenhold Capitol Strategies (703/934-0219) or Chris Bates, President, National Office Products Alliance (NOPA) at 703/549-9040, x 100).

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

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SIZE APPEAL OF:)	
)	
Faison Office Products, LLC)	Docket Nos. SIZ-2006-11-09-68 (RMD)
)	SIZ-2006-06-26-46
Appellant)	
)	
Solicitation No. LC-2621-606150)	
Jet Propulsion Laboratory)	Decided: January 26, 2007
California Institute of Technology)	
Pasadena, California)	
)	
_____)	

APPEARANCE

John G. Stafford, Jr., Esq., Greenberg Traurig, LLP, McLean, VA, for Appellant, Faison Office Products, LLC.

DECISION

PENDER, Administrative Judge:

Introduction and Jurisdiction

This appeal arises from a subcontract under a prime contract between the California Institute of Technology's Jet Propulsion Laboratory (JPL) in Pasadena, California, and the National Aeronautics and Space Administration.

On June 8, 2006, the Area Office issued Size Determination No. 05-2006-018 (size determination I or the first size determination), finding Faison Office Products, LLC (Appellant or Faison), to be other than a small business under North American Industry Classification System (NAICS) code 424120, Stationery and Office Supplies Merchant Wholesalers. Appellant appealed size determination I, and on September 27, 2006, I issued *Size Appeal of Faison Office Products, LLC*, SBA No. SIZ-4812 (2006) (the Remand Order), remanding the matter to the Area Office for a new size determination. Subsequently, JPL made award to Catalog Stationery, and the JPL contract is currently being performed by that company. On October 24, 2006, the Area Office issued its size determination on remand (size determination), again concluding that Appellant was "other than small for the subject size standard due to its

affiliation with Corporate Express, Inc., a large business.” On November 9, 2006, Appellant timely appealed the size determination.

The U.S. Small Business Administration Office of Hearings and Appeals (OHA) decides size determination appeals under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134. Accordingly, this matter is properly before OHA for decision.

Issues

Whether the Area Office made a clear error of fact or law when it determined that Appellant was economically dependent, and thus affiliated under the identity of interest rule at 13 C.F.R. § 121.103(f), with a large concern because Appellant derived 70% of its revenue from the large concern and had a strategic alliance with the large concern.

Whether the Area Office made a clear error of fact or law when it determined the totality of the circumstances (13 C.F.R. § 121.103(a)(5)) between Appellant and a large concern caused them to be affiliated.

Whether the Area Office made a clear error of fact or law when it determined Appellant to be other than small due to its affiliation with another concern based upon findings that (1) the large concern was to perform primary and vital requirements of the solicitation; and (2) Appellant was unduly reliant upon the large concern. 13 C.F.R. § 121.103(h)(4).

Facts

The Remand Order contains the detailed facts of the case, including the following:

1. The Jet Propulsion Laboratory (JPL) Contracting Officer (CO) issued Request for Proposals (RFP) LC-2621-606150 on November 18, 2005. The RFP was a 100% small business set-aside. The RFP identified NAICS code 424120, Stationery and Office Supplies Merchant Wholesalers, with a 500 employee size standard as being applicable.¹ Proposals were due on January 11, 2006.
2. On March 17, 2006, JPL notified an unsuccessful offeror, Office Solutions, that Appellant was the apparent successful offeror. Office Solutions submitted a size protest to the CO on April 18, 2006. On April 25, 2006, the U.S. Small Business

¹ The size standard for NAICS code 424120 is listed as 100 employees in 13 C.F.R. § 121. However, in the acquisition of commercial items, the Federal Acquisition Regulation (FAR) provides a 500 employee size standard for a business which submits an offer in its own name, but which proposes to furnish an item which it did not itself manufacture. 48 C.F.R. §§ 12.301, 52.212-1(a); *see also Size Appeal of GC Micro*, SBA No. SIZ-4365 (1999).

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Administration, Office of Government Contracting, Area V (Area Office) dismissed the size protest as untimely.

3. On April 25, 2006, the Area Office notified Appellant that Office Solutions had filed an untimely protest regarding Appellant's size. The Area Office informed Appellant that even though the Area Office had denied Office Solution's protest, the Area Director had decided to initiate a size protest based on the information provided by Office Solutions.

4. Appellant's President and Chief Executive Officer, Mr. Jared D. Casey, Jr., owns 55% of Appellant's stock. Corporate Express owns the remaining 45% of Appellant's stock.

5. Appellant had an average of thirty-three employees for the 2005 calendar year. Appellant, without consideration for any potential affiliates of Appellant, meets the size standard for NAICS 424120.

6. Appellant has a corporate Advisory Board that makes recommendations about the furtherance of its business. Corporate Express has one member on this board.

7. Appellant admits that Corporate Express is responsible for generating "an approximate average of seventy percent" (70%) of Appellant's revenue over the past five years.

8. Appellant and Corporate Express share six common locations.

9. Corporate Express is the prime contractor for the University of Colorado (UC) and University of Northern Colorado (UNC) contracts referred to in the Record.

10. Appellant states that it has a "strategic alliance partnership" with Corporate Express (Appeal Petition at 14). This is consistent with representations contained in Appellant's website and its May 5, 2005 letter to the Area Office. In addition, the State of Colorado Basic Ordering Agreement (BOA) shows award was made to "Corporate Express dba Faison/Corporate Express," and is signed by Gail Morgan of "Faison/Corporate Express."

11. On June 8, 2006, the Area Office issued a size determination finding Appellant to be affiliated with Corporate Express, one of the world's largest office products suppliers with over 200 facilities, 38 distribution centers, and 10,775 employees. Based on affiliation with Corporate Express, Appellant was deemed other than small under NAICS code 424120.

12. Appellant filed an appeal on June 26, 2006. On September 27, 2006, I issued *Size Appeal of Faison Office Products, LLC*, SBA No. SIZ-4812 (2006), remanding the matter

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to the Area Office for a new size determination. Subsequently, JPL made award to Catalog Stationery, who is currently performing the JPL contract. On October 24, 2006, the Area Office issued its size determination on remand, again concluding that Appellant was “other than small for the subject size standard due to its affiliation with Corporate Express, Inc., a large business.” On November 9, 2006, Appellant appealed this size determination.

The Remand Order

In my September 27, 2006 Remand Order, I held that the Area Office’s finding of affiliation based upon the totality of the circumstances was based upon three clear errors of fact or law. Specifically, the Area Office: (1) Incorrectly found facts regarding the Advisory Board; (2) Found facts concerning the RFP without it being part of the Record; and (3) Misunderstood the significance of the UC and UNC contracts. I vacated and remanded the June 8, 2006 size determination for the Area Office to make a size determination that: (1) Properly considers the RFP; (2) Makes correct findings, if any, concerning the Advisory Board; and (3) Makes correct findings, if any, concerning the UC and UNC contracts. I also strongly recommended the Area Office consider whether it believes an identity of interest under 13 C.F.R. § 121.103(f) exists in recasting its decision upon remand.

SBA Determination Upon Remand

In its October 25, 2006 size determination (size determination), the Area Office provided its clarification of the following three areas specified in the Remand Order:

1. The Area Office clarified that even if Corporate Express had no members on Appellant’s Advisory Board and none ever attended any Board meetings, it would still have found affiliation based on other factors, including totality of the circumstances;
2. Its finding of affiliation was not dependent on Appellant’s UC and UNC contracts. However, upon review of additional evidence supplied to OHA, it determined that while Corporate Express may have chased the contract, the ultimate award was made to “Faison/Corporate Express.” In addition, the Area Office mentioned that “per conversations with UC and UNC, some of the customers ordering off this BOA are counting partial awards to a minority owned firm”;
3. The RFP placed weighted importance on management and technical factors and the Area Office found that Appellant was reliant upon Corporate Express to equip it with the vast majority of these factors including: the Oracle iProcurement technology, e-Way, VANS, order fulfillment software, delivery, packaging, its business continuity plan, and four of the seven key personnel positions. Accordingly, the Area Office noted there was sufficient evidence to justify a finding that Appellant violated the ostensible subcontractor rule since Appellant was unusually reliant upon Corporate Express and because Corporate Express was performing primary and vital requirements of the contract as per 13 C.F.R. § 121.103(h)(4).

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The Area Office found Appellant and Corporate Express affiliated under the identity of interest rule as provided in 13 C.F.R. § 121.103(f). Among the factors that convinced the Area Office an identity of interest existed between Appellant and Corporate Express were:

1. Appellant derives approximately 70% of its income through its relationship with Corporate Express;
2. Corporate Express represents it has an ongoing collaboration or “strategic alliance” with Appellant that permits customers to say they are awarding contracts to a minority firm by ordering from the Corporate Express/Faison strategic alliance;
3. Corporate Express owns 45% of Appellant’s stock; and
4. Appellant is co-located with and relies heavily upon Corporate Express to perform contracts.

Appellant’s Allegations Upon Appeal

In its November 9, 2006 Appeal Petition, Appellant makes several arguments why the size determination is clearly in error. Before stating its arguments, Appellant offered the following introductory paragraph:

In its Order Remanding Size Determination, this Office guided the Area Office to review Faison’s proposal for the JPL contract to determine whether, in fact, the Area Office’s determination that Faison’s services are ancillary to Corporate Express’s [sic] for that contract is supported by the evidence, and to consider in greater detail whether an “identity of interest” under 13 C.F.R. § 121.103(f) arose between Faison and Corporate Express, so that, under a totality of the circumstances test, Faison and Corporate Express could be found to be affiliated. Each of these elements is discussed below.

(Appeal Petition at 4).

The other “elements” Appellant referenced include:

1. The Area Office mischaracterizes the State of Colorado contract to support its finding of identity of interest affiliation. For example, the Area Office continually refers to the contract as a “Faison contract” and “erroneously relies also upon the ‘fact’ that some State of Colorado customers ordering from the contract are counting partial awards to a minority owned firm. The...contract was not bid, however, as a SDB set aside.” Furthermore, Appellant should not be penalized for the actions of third parties, such as State of Colorado customers, over whom Appellant has no control (Appeal Petition at 5);

2. The Area Office shows a clear and prejudicial predisposition to rule against Appellant because:

- a. A Size Specialist informed Appellant that a small business performing at the national level raises “an automatic red flag for the Area Office”(Appeal Petition at 6); and
- b. The size determination implies that national contracts “cannot be held by small businesses without dependence upon a large business to such an extent that it rises to the level of affiliation.” *Id.*

Appellant asserts that these beliefs are in “direct conflict with Section 2 of the Small Business Act reflecting the express will of Congress that small businesses be given a fair proportion of Government sales with no mention whatever of limitation to local or regional markets....” *Id.*

3. The Area Office makes clear errors of fact with regard to the RFP and Appellant’s proposal by:

- a. Mischaracterizing Appellant’s services as “ancillary” and Corporate Express’s services as “core”;
- b. Inaccurately portraying Corporate Express as supplying order fulfillment services when these services are “sometimes performed by Corporate Express and sometimes contracted to other third party distributors”(Appeal Petition at 7);
- c. Utilizing the RFP’s proposal evaluation weighting scheme to establish that Appellant’s services are ancillary when the weighting criteria were not intended to indicate core versus ancillary services;
- d. Ignoring the fact that “JPL issued its solicitation as a small business set-aside knowing that small business offerors likely would team with a large business to meet the [Oracle] iProcurement requirements, which were assigned the most weight for evaluation purposes by the JPL.” Therefore, by concluding that Corporate Express is performing the core iProcurement functions and this core function must be performed by a small business, the Area Office ignores that “no small business would likely be qualified to perform the JPL contract” (Appeal Petition at 9);
- e. Mischaracterizing Appellant and Corporate Express’s “partnering initiative” as a joint venture (*See* 4a-c, below);
- f. Erroneously inferring that either Appellant failed to incorporate its own safeguarding procedures or inappropriately relied upon Corporate Express’s safeguarding procedures. However, since Corporate Express was responsible for the iProcurement function, only Corporate Express was required to provide safeguarding procedures for confidential

information; and

g. Drawing erroneous conclusions from Appellant's list of key personnel in its proposal when the law does not require that all key personnel be employed by the prime contractor.

4. The Area Office makes a clear error of fact and law in finding an identity of interest between Appellant and Corporate Express by:

a. Concluding that a joint venture relationship exists because (1) Appellant has employees working at Corporate Express offices, when only six of Appellant's employees occupy Corporate Express offices; (2) Appellant "relies upon the infrastructure of Corporate Express (inventory, warehousing, delivery vehicles)," when "Corporate Express does not always provide warehousing and delivery services"; and (3) Appellant and Corporate Express's State of Colorado contract was awarded to "Faison/Corporate Express," when the status of this contract as a Corporate Express contract has already been addressed by OHA (Appeal Petition at 11-12);

b. Reiterating eight facts bearing on Appellant and Corporate Express' relationship despite the fact that OHA found these facts did not result in affiliation based on the totality of the circumstances (Appeal Petition at 15);

c. Erroneously concluding a joint venture relationship exists when Appellant and Corporate Express have a "strategic alliance relationship that is long-term for many opportunities...extend[ing] beyond the limited definition of a joint venture in 13 C.F.R. § 121.103(h)" (Appeal Petition at 14);

d. Relying upon *Size Appeal of Team Contracting, Inc.*, SBA No. SIZ-3875 (1994) when the facts are distinguishable. Specifically, Appellant and Corporate Express do not have a joint venture agreement and neither party enjoys management rights in the other party (Appeal Petition at 14-15);

e. Applying the wrong criteria, instead of the regulatory criteria at 13 C.F.R. § 121.103(f). First, the Area Office relies upon the fact that Appellant and Corporate Express are in the same line of business when that is only relevant to the newly organized concern rule at 13 C.F.R. § 121.103(g). Second, the Area Office places too much weight on the fact that Appellant and Corporate Express work together to promote the economic interests of each other, when teaming agreements are common in government solicitations and not indicative of identical business interests. Third, Appellant is not economically dependent upon Corporate Express but simply teams with them for specific projects. Appellant asserts that it "receives approximately 30% of its revenue from contracts outside the Corporate Express strategic alliance" and "there is no evidence that [Appellant] would cease to do business" if it could no longer team with Corporate Express (Appeal Petition at 16-17).

Discussion

I. Introduction

The Record in this Appeal supports the Area Office's determination that Appellant is other than small because of its identity of interest with Corporate Express (13 C.F.R. § 121.103(f)). In particular, the evidence that Appellant derives 70% of its revenue from its relationship with Corporate Express and that Corporate Express represents its ongoing relationship with Appellant as a "strategic alliance" is strong evidence of an identity of interest.

There is also sufficient evidence to support the Area Office's determination that Appellant and Corporate Express are affiliated under the totality of the circumstances (13 C.F.R. § 121.103(a)(5)). For example, although not establishing affiliation in isolation, the fact that Corporate Express owns 45% of Appellant, has an employee that serves on Appellant's Advisory Board, and shares common locations with Appellant can reasonably be viewed as affording Corporate Express the power to control Appellant through the totality of the circumstances, especially when considered with the evidence establishing identity of interest.

The Record also supports the Area Office's determination that Appellant's relationship with Corporate Express in submitting its offer under the instant procurement triggers the ostensible subcontractor rule (13 C.F.R. § 121.103(h)(4)). The Area Office's careful analysis of the requirements of the solicitation and its finding that Corporate Express is performing primary and vital requirements of the solicitation is supported by the Record. In addition, the Record supports the Area Office's finding that Appellant was unusually reliant upon Corporate Express in submitting its offer.

In addition, in the introductory paragraph to its arguments in its Appeal Petition, Appellant seemingly fails to recognize that since 2004² there is a difference between identity of interest and totality of the circumstances. Specifically, Appellant argued that I had directed the Area Office to determine whether an identity of interest under 13 C.F.R. § 121.103(f) arose between Appellant and Corporate Express "so that, under a totality of the circumstances test, [Appellant] and Corporate Express could be found to be affiliated" (Appeal Petition at 4). This argument is contrary to law and the Remand Order, for as I plainly explained, affiliation under 13 C.F.R. § 121.103(f) (identity of interest) is distinct from affiliation based upon the totality of the circumstances (13 C.F.R. § 121.103(a)(5)) and not a necessary predicate to finding affiliation under the totality of the circumstances (Remand Order at 8 - 10). *See Size Appeal of Lance Bailey and Associates*, SBA No. SIZ-4817, at 13-14 (*Lance Bailey*).

² 69 Fed. Reg. 29192, 29202 (May 21, 2004).

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II. Applicable Law

A. Timeliness

Appeals must be filed within 15 days of receipt of a size determination. 13 C.F.R. § 134.304(a)(1).

B. Standard of Review

It is undisputed that Appellant's size is below the size standard, but if found to be affiliated with Corporate Express, one of the largest businesses in the office product industry, Appellant will exceed the subject size standard. Thus, OHA must review whether the Area Office made a clear error of fact or law when it determined Appellant to be other than a small business due to its affiliation with Corporate Express. 13 C.F.R. § 134.314. In evaluating whether there is a clear error of fact or law, OHA does not consider Appellant's size *de novo*. Rather, OHA reviews the record to determine whether the Area Office based its size determination upon a clear error of fact or law. *See Size Appeal of Taylor Consulting, Inc.*, SBA No. SIZ-4775 (2006). Thus, I will only disturb an area office's size determination if I determine the area office clearly made key findings of law or fact that are mistaken.

C. Identity of Interest

SBA's size regulations recognize affiliation can occur in several specific instances. Under the facts of this appeal, the relevant regulation is 13 C.F.R. § 121.103(f) (identity of interest), which provides:

Affiliation based on identity of interest. Affiliation may arise among two or more persons with an identity of interest. Individuals or firms that have identical or substantially identical business or economic interests (such as family members, individuals or firms with common investments, or firms that are economically dependent through contractual or other relationships) may be treated as one party with such interests aggregated. 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.

The relevant portion of this regulation is "economically dependent through contractual or other relationships." Before SBA promulgated 13 C.F.R. § 121.103(f) in 2004, OHA recognized affiliation based on economic dependence in the context of the totality of the circumstances, which OHA found because facts suggested dependence by one or both concerns upon the other. OHA affirmed determinations based upon economic dependence when two concerns have identical or nearly identical business or economic interests, *e.g.*, when one or both of the concerns depends upon the other for a high percentage of its revenues. *See Size Appeal of Pointe Precision, LLC*, SBA No. SIZ-4466, at 9-10 (2001); *Size Appeal of J & R Logging*, SBA No. SIZ-4426 (2001) (an example of extreme dependency); *Size Appeal of Kansas City LLC d/b/a*

Best Harvest Bakeries, SBA No. SIZ-4574 (2003) (another example of extreme dependency); *Size Appeal of Wireless Technology Equipment Co., Inc.*, SBA No. SIZ-4204 (1996) (*Wireless Technology*); *Size Appeal of Supreme-Technology, Inc.*, SBA No. SIZ-4092 (1995).

OHA's past practice is consistent with the plain meaning of 13 C.F.R. § 121.103(f). Accordingly, if an area office finds a concern depends on another concern for a high percentage of its revenue, then the area office can reasonably determine the two concerns are affiliated because of economic dependence, *i.e.*, that they share an identity of interest. In making this holding, I am not fixing a certain percentage of revenue as being sufficient to prove economic dependence, for it could be as low as 30% or 40%, based upon the facts. However, I do hold, as a matter of law, that when one concern depends on another for 70% or more of its revenue, that the concern is economically dependent on the other. Given the high probative value of this kind of evidence, the only exception to this holding would be if the dependent concern could prove, by clear and convincing evidence, that its interests are separate from the other concern.

I note that there are other facts that strengthen a determination of economic dependence and bear on whether there is an affiliation based upon an identity of interest. For economic dependence, it is relevant whether the two concerns are involved in the same line of business as it is relevant whether the larger concern owns a portion of the smaller or retains some degree of influence within the smaller concern. *See Size Appeal of National Welders Supply Co., Inc.*, SBA No. SIZ-4315 (1998). This could consist of financing, a seat on the Board of Directors, contracts for exclusive dealings, existing subcontractor relationships, supply of raw materials, co-location, claims of a continuing commercial or strategic relationship, or an ownership stake. While all of these factors are plainly relevant to a totality of the circumstances determination, they are also relevant to an economic dependency determination. The key is whether the facts imply dependence. If a reasonable person could conclude there is economic dependence, I would not have a definite and firm conviction that the area office made a clear error of fact or law.

It remains relevant that the protested concern retains the burden of proving its size. 13 C.F.R. § 121.1009(c). The protested concern must do this when submitting its SBA Form 355 to an area office and answering subsequent requests for information. That is the path to rebutting any possible determination of economic dependency by an area office under 13 C.F.R. § 121.103(f).

D. Totality of the Circumstances

As mentioned above, affiliation through the totality of the circumstances provides an independent basis for an area office to determine affiliation from, amongst other things, affiliation based on identity of interest. *Lance Bailey*, at 13-14. Authorization for finding affiliation based upon totality of the circumstances is found at 13 C.F.R. § 121.103(a)(5). However, to comprehend affiliation through totality of the circumstances, it is necessary to read all the text in 13 C.F.R. § 121.103 before subparagraph (a)(5), as well as the text of (a)(5). This text states:

(a) General Principles of Affiliation. (1) Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control exists.

(2) SBA considers factors such as ownership, management, previous relationships with or ties to another concern, and contractual relationships, in determining whether affiliation exists.

(3) Control may be affirmative or negative. Negative control includes, but is not limited to, instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

(4) Affiliation may be found where an individual, concern, or entity exercises control indirectly through a third party.

(5) *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.*

(emphasis added).

As explained in *Lance Bailey*, the specific independent bases of affiliation, *i.e.*, those described in 13 C.F.R. § 121.103(c), (d), (e), (f), (g), and (h) can form a non-exclusive basis or “nucleus” of a finding of affiliation through the totality of the circumstances. Thus, while the evidence in the record may not establish affiliation under one of the specific factors enumerated in 13 C.F.R. § 121.103 or under other indicia of control, an area office’s review of the totality of the circumstances arising from proof relevant to various factors may convince the area office that one concern has the power to control another and, thus, both are affiliated.

Based upon 13 C.F.R. § 121.103(a)(5), if an area office concludes that it is more likely than not that various facts give one concern the power to control another concern, it may find affiliation under the totality of the circumstances. In applying the totality of the circumstances standard for determining affiliation, area offices necessarily must exercise sound discretion. In exercising that discretion, an area office must find facts and explain why those facts caused it to determine one concern had the power to control the other.

An area office can consider facts it considered to be insufficient under an independent basis for affiliation and conclude affiliation exists under the totality of the circumstances. Similarly, an area office may aggregate facts that it found support one or more of the independent factors and conclude on a separate basis, that affiliation under the totality of the circumstances is warranted. However, as stated in *Lance Bailey*, our preference remains that an area office first evaluate whether affiliation should be found under the independent grounds described in 13 C.F.R. § 121.103(c), (d), (e), (f), (g), and (h).

E. The Ostensible Subcontractor Rule

SBA predicates its affiliation regulations upon the power of one concern to control another. 13 C.F.R. § 121.103(a). One independent basis of control area offices must consider is the ostensible subcontractor rule. 13 C.F.R. § 121.103(h)(4). The purpose of the rule is to prevent other than small firms from forming relationships with small firms to evade SBA's size requirements. The ostensible subcontractor rule permits the Area Office to determine a subcontractor and a prime have formed a joint venture (and are thus affiliates) for determining size. An ostensible subcontractor is a subcontractor that performs primary and vital requirements of a contract or a subcontractor upon which the prime contractor is unusually reliant. 13 C.F.R. § 121.103(h)(4).

The ostensible subcontractor rule provides:

A contractor and its ostensible subcontractor are treated as joint venturers, and therefore affiliates, for size determination purposes. An ostensible subcontractor is a subcontractor that performs primary and vital requirements of a contract, or of an order under a multiple award schedule contract, or a subcontractor upon which the prime contractor is unusually reliant. All aspects of the relationship between the prime and subcontractor are considered, including, but not limited to, the terms of the proposal (such as contract management, technical responsibilities, and the percentage of subcontracted work), agreements between the prime and subcontractor (such as bonding assistance or the teaming agreement), and whether the subcontractor is the incumbent contractor and is ineligible to submit a proposal because it exceeds the applicable size standard for that solicitation.

13 C.F.R. § 121.103(h)(4).

The relationship between the prime and its putative subcontractor as reflected in the proposal can trigger the ostensible subcontractor rule. If the proposal shows the subcontractor is performing primary and vital requirements of the solicitation, then an area office is correct to find affiliation. Similarly, if the proposal shows the prime is unusually reliant upon the subcontractor, then an area office is correct to find affiliation.

OHA has interpreted the ostensible subcontractor rule many times. However, as explained in *Lance Bailey*, what is relevant in one decision is not necessarily relevant in the next, for these determinations usually turn on the unique facts presented in an individual RFP and proposal. *Lance Bailey*, at 16. Still, OHA has often affirmed size determinations where an area office determined that key personnel were subcontractor employees or that key tasks were to be performed by subcontractor employees. See *Size Appeal of BAMA Company*, SBA No. SIZ-4819 (2006), at 7-8; *Size Appeal of B&M Construction, Inc.*, SBA No. SIZ-4805 (2006), at 15-17.

F. Improper Predisposition

Appellant has accused the Area Office of a predisposition to rule against small businesses competing for very large contracts. This necessarily suggests improper conduct by the Area Office. In evaluating this kind of accusation, I note that SBA does not permit its employees to act upon factors extraneous to the evidence in the record when processing size protests. If a party can show an SBA employee acted out of personal animus, prejudice, or bad faith, that is sufficient to prove a clear error of fact or law. Hence, OHA would take appropriate action in such circumstances.

However, before even reaching the question of improper action by an SBA employee, parties must recognize that OHA presumes all SBA employees act in good faith in the performance of their duties. I hold the presumption that SBA acted in good faith in issuing a size determination can only be overcome by clear and convincing evidence of personal animus, prejudice, or other irregular conduct.

The reason I hold the clear and convincing evidence standard is applicable in this instance is because the Court of Appeals for the Federal Circuit held the clear and convincing evidence standard “most appropriately describes the burden of proof applicable to the presumption of the government’s good faith.” *Am-Pro Protective Agency, Inc. v. U.S.*, 281 F.3d 1234, 1239 (Fed. Cir. 2002). This burden of proof is appropriate, for Appellant is essentially accusing the Area Office of acting in bad faith in issuing the size determination.

III. Analysis

A. Timeliness

Appellant appealed the size determination within 15 days of receiving it. Therefore, Appellant's appeal is timely. 13 C.F.R. § 134.304(a)(1).

B. Does Appellant Have an Identity of Interest with Corporate Express?

The evidence of an identity of interest due to Appellant’s economic reliance upon Corporate Express is overwhelming. In addition to Appellant depending on Corporate Express for 70% of its revenue (which is sufficient to support a determination of economic dependence by itself), the record shows that: (1) Corporate Express claims Appellant and it have a strategic alliance; (2) Appellant is co-located with Corporate Express at several locations; and (3) Appellant relies upon Corporate Express infrastructure for its ability to perform large contracts. This evidence is precisely the kind of evidence of economic dependence anticipated by the plain meaning of 13 C.F.R. § 121.103(f) and most closely akin to the types of situations OHA addressed in its economic dependency decisions.

Appellant has not challenged or rebutted these facts by proving they are clearly in error as required by 13 C.F.R. § 134.314. Rather, I find that Appellant generally failed to contest

economic dependence beyond arguing that since 30% of its revenue was unrelated to Corporate Express, it would not go out of business if it ceased doing business with Corporate Express. Besides being insufficient to prove a clear error of fact, I hold that Appellant's argument is an admission of the facts found by the Area Office. Since I have held that a concern that depends upon another for 70% of its business is economically dependent upon the other concern for finding an identity of interest, I hold the Area Office made no clear error of fact or law in finding Appellant to be affiliated with Corporate Express on the basis of an identity of interest.

C. Is There Sufficient Evidence to Find Affiliation through
Operation of the Ostensible Subcontractor Rule?

I find the Area Office expended significant effort to investigate the ostensible subcontractor rule as it applied to the relationship between Appellant and Corporate Express in Appellant's proposal. Not only did the Area Office carefully review and analyze the RFP, it also compared the RFP's requirements to Appellant's proposal. In its analysis, the Area Office chose to designate functions as "ancillary to the core services of the RFP" to indicate the opposite of the words "primary and vital," used in 13 C.F.R. § 121.103(h)(4).

In the size determination, the Area Office first recited the Technical Management criteria given the most weight by the RFP. It then identified whether the proposal stated Appellant or Corporate Express would be performing the services that related to each RFP factor. As the result of this analysis, the Area Office concluded Appellant would be performing ancillary tasks and thus found Corporate Express was to perform primary and vital services under the RFP.

The Area Office found that Corporate Express, either acting individually or as part of its strategic alliance with Appellant, would perform all the highest weighted Technical Management requirements of the RFP. For example, in quoting from Appellant's proposal, the Area Office found Corporate Express was to perform the iProcurement requirements, fulfill orders, and report activities. In addition, Appellant's proposal made it clear that it was Corporate Express that would be making the majority of the required deliveries as its strategic alliance partner. According to its proposal, Appellant was to manage the contract, provide customer service and sales support, and perform marketing functions, none of which were weighted factors in the RFP's Technical and Management criteria.

In addition, the Area Office recited language from Appellant's proposal emphasizing the importance of Corporate Express (Size Determination at 4). More specifically, Appellant attributed much of the capability needed to perform the contract, such as managing servers, operating delivery vehicles, utilizing warehouse replenishment software, and operating a Business Continuity Plan (safeguarding assets and maintaining accurate books)³ to Corporate Express.

The Area Office completed its analysis of Appellant's proposal by assessing the source of

³ I recognize that Appellant avers this pertains to iProcurement, but find it irrelevant.

key personnel for the performance of the contract arising under the RFP. The Area Office found that four of the seven individuals identified in the “Key Personnel Positions” portion of the RFP were current Corporate Express employees.

The Area Office found that the services Appellant would be performing were ancillary to the core services required by the RFP. It concluded that while Appellant would be performing various administrative functions, such as providing sales representatives, customer service, and account management, Corporate Express was the concern enabling the office products to be stored, available, packaged, and delivered. Accordingly, given the weight placed on various factors by the RFP, Appellant’s role was less important than the role Corporate Express was to perform.

Appellant’s response to the Area Office’s findings on the ostensible subcontractor issue is sparse. Moreover, its primary argument is more of an admission than a rebuttal. Specifically, Appellant argues that “JPL issued its solicitation as a small business set-aside knowing that small business offerors likely would team with a large business to meet the [Oracle] iProcurement requirements, which were assigned the most weight for evaluation purposes by the JPL.” (Appeal Petition at 9). Accordingly, Appellant argues that the Area Office’s finding that Corporate Express was performing the core iProcurement functions and this core function must be performed by a small business, ignores that no small business would be likely to be qualified to perform the JPL contract.” *Id.*

Appellant’s logic is flawed. The Area Office did not determine that a small business must perform the iProcurement function. Rather, it found that Corporate Express’ performance of this function, along with the “vast majority” of the factors given weighted importance in the RFP, including delivery, packaging and order fulfillment, meant Corporate Express was performing primary and vital (core) requirements of the JPL contract.

In addition, although merely asserted and not proven by Appellant, it is irrelevant that JPL knew small business offerors would team with large businesses to meet the iProcurement requirements of the RFP. This is because whatever JPL intended, Appellant still must comply with SBA’s size regulations. That is, Appellant could not assign so much of the primary and vital work evaluated under the RFP’s Technical Management factors to an other than small concern and still comply with 13 C.F.R. § 121.103(h)(4).

The Record proves that the basis of Appellant’s qualifications to perform the work required by the RFP were actually the qualifications and experience of Corporate Express, with whom it has a “strategic alliance.” That is, Appellant’s proposal largely attributed qualifications relevant to the RFP Management Technical factors (Operational Approach, Related Experience, and Management Approach) to Corporate Express. I hold this is sufficient to sustain a finding that Appellant is unusually reliant upon Corporate Express to both qualify for and perform the RFP’s requirements.

D. Do the Totality of the Circumstances Support a Finding
of Affiliation between Appellant and Corporate Express?

The Area Office considered many facts before determining that Appellant and Corporate Express are affiliated under the totality of the circumstances. In addition to the matters relevant to its identity of interest and ostensible subcontractor determinations, the Area Office cited other facts relevant to the relationship between Appellant and Corporate Express.

For example, the Area Office also further investigated the relationship between Appellant and Corporate Express as it related to the UC and UNC BOA. From its investigation, the Area Office found that although the contract listed Corporate Express as the contractor, the ordering information on file reflected that the company was listed as “Company: Corporate Express” and “Does Business As: Faison/Corporate Express.” In addition, UC and UNC indicated that some customers ordering off of the contract are counting partial awards to a minority owned firm (Appellant).

After reciting clarifications to its original size determination, the Area Office also found eleven (11) facts. While I have already discussed some of these facts in analyzing the identity of interest and ostensible subcontractor issues, these facts do support the Area Office’s finding of affiliation through the totality of the circumstances. They are:

1. Appellant’s President and CEO owns 55% of Appellant and Corporate Express owns 45% of Appellant;
2. Corporate Express is a large business;
3. Appellant has an average of 33 employees, six of whom share Corporate Express space;
4. Appellant and Corporate Express are in the same line of business (providing office supplies);
5. Appellant repeatedly terms and promotes Corporate Express as its “strategic partner” (since 1994);
6. One Corporate Express employee serves as a member on Appellant’s Advisory Board;
7. Approximately 70% of Appellant’s revenue over the past five years was generated as a result of its “strategic partnering” with Corporate Express;
8. Appellant and Corporate Express share six common locations;
9. In multiple states, Appellant has its employees in the Corporate Express office to

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provide “customer care and sales reps” along with Corporate Express staff;

10. For its large contracts, Appellant relies upon the infrastructure of Corporate Express (inventory, warehousing, delivery vehicles); and

11. A contract pursued and won by Corporate Express was awarded to “Faison/Corporate Express.”

In addition to these eleven (11) facts, the Area Office noted that Appellant uses Corporate Express as a “subcontractor” in other contracts, including one for Pepsi-Cola advertising.

These eleven (11) facts, plus any independent facts arising under the Area Office’s identity of interest and ostensible subcontractor findings, are extensive and material. For example, Corporate Express is not a spectator to Appellant’s operation, for it owns 45% of Appellant, has an employee on its advisory board, transports Appellant’s orders on its trucks, and accounts for 70% of Appellant’s revenue. What is more, its “strategic alliance” with Appellant formed the basis of Appellant’s ability to submit an offer under the RFP. In the aggregate, these facts show a very substantial, dependent, and enduring relationship between Appellant and Corporate Express. Moreover, these facts show the entity with the power to control the relationship is Corporate Express.

When I vacated and remanded the Area Office’s June 8, 2006 size determination, I stated that since the Area Office based its totality of the circumstances determination upon some incorrect or undeveloped facts, I had to vacate the size determination. I remanded because the Area Office did not determine there was affiliation under the independent factors in 13 C.F.R. § 121.103 (whereupon I recommended it consider 13 C.F.R. § 121.103(f) upon remand) and because I could not tell whether the Area Office would have determined there was affiliation had it known some of the facts it recited were incorrect. Regardless, I did not say the remaining true facts were insufficient to justify a determination of affiliation under the totality of the circumstances.

The Area Office corrected the deficiencies of the June 8, 2006 size determination. For example, through further investigation, it developed additional and relevant facts concerning the UC and UNC contract. The Area Office also examined the RFP and Appellant’s proposal in detail. On the whole, its attention to the requirements of the Remand Order was complete.

I hold that Appellant has both failed to identify any material errors of fact or prove there are any clear errors of fact applicable to the facts underlying the size determination. Moreover, I hold the most relevant or probative evidence of affiliation under the totality of the circumstances is so overwhelming that even if the Area Office did make an error of fact, it is very likely to be harmless.

Considering the foregoing, I cannot hold that the Area Office made a clear error of fact or law in concluding that Appellant and Corporate Express are affiliated under the totality of the

circumstances.

E. Was the Area Office Improperly Predisposed to Find
Appellant was Affiliated with a Large Concern?

The Record contains no evidence of personal animus, prejudice, or bad faith. Arguably, the only suggestion of improper conduct comes from Appellant's statement in its Appeal Petition that the Area Office explained that small businesses attempting to do business on a large or nationwide scale "raises an automatic red flag" (Appeal Petition at 6).

Notwithstanding Appellant's failure to offer clear and convincing evidence of a predisposition by the Area Office, I find that explaining that certain business arrangements "raise a red flag" cannot constitute personal animus, prejudice, or bad faith (predisposition). Rather, I hold that mentioning the existence of a red flag is merely a recitation of what experience has taught area offices over time. Moreover, I take notice that size specialists in area offices are expected to be knowledgeable and are trained to spot various factors or "red flags." *See* 13 C.F.R. § 121.1009(b).

I also hold that the size determination does not imply or suggest that national contracts cannot be held by small businesses unless they are affiliated with a large business. Rather, I hold this size determination is supported by the Record.

F. Summary

The facts in the Record are probative of Appellant's economic dependence upon Corporate Express. The Record also shows that Corporate Express would be performing primary and vital requirements under the RFP and that Appellant was unusually reliant upon Corporate Express to qualify for the RFP and thus violated the ostensible subcontractor rule. Finally, the totality of the circumstances show a very strong and deliberate relationship between Appellant and Corporate Express that gives Corporate Express the power to control Appellant through that relationship.

Conclusion

I have considered Appellant's Petition and the Record. The Record shows the Area Office did not base its size determination upon a clear error of fact or law when it determined:

- a. Appellant is an other than small concern because it is economically dependent upon and thus has an identity of interest with Corporate Express;
- b. The relationship between Appellant and Corporate Express for the work required by the RFP constitutes a violation of the ostensible subcontractor rule; and
- c. Appellant is affiliated with Corporate Express under the totality of the

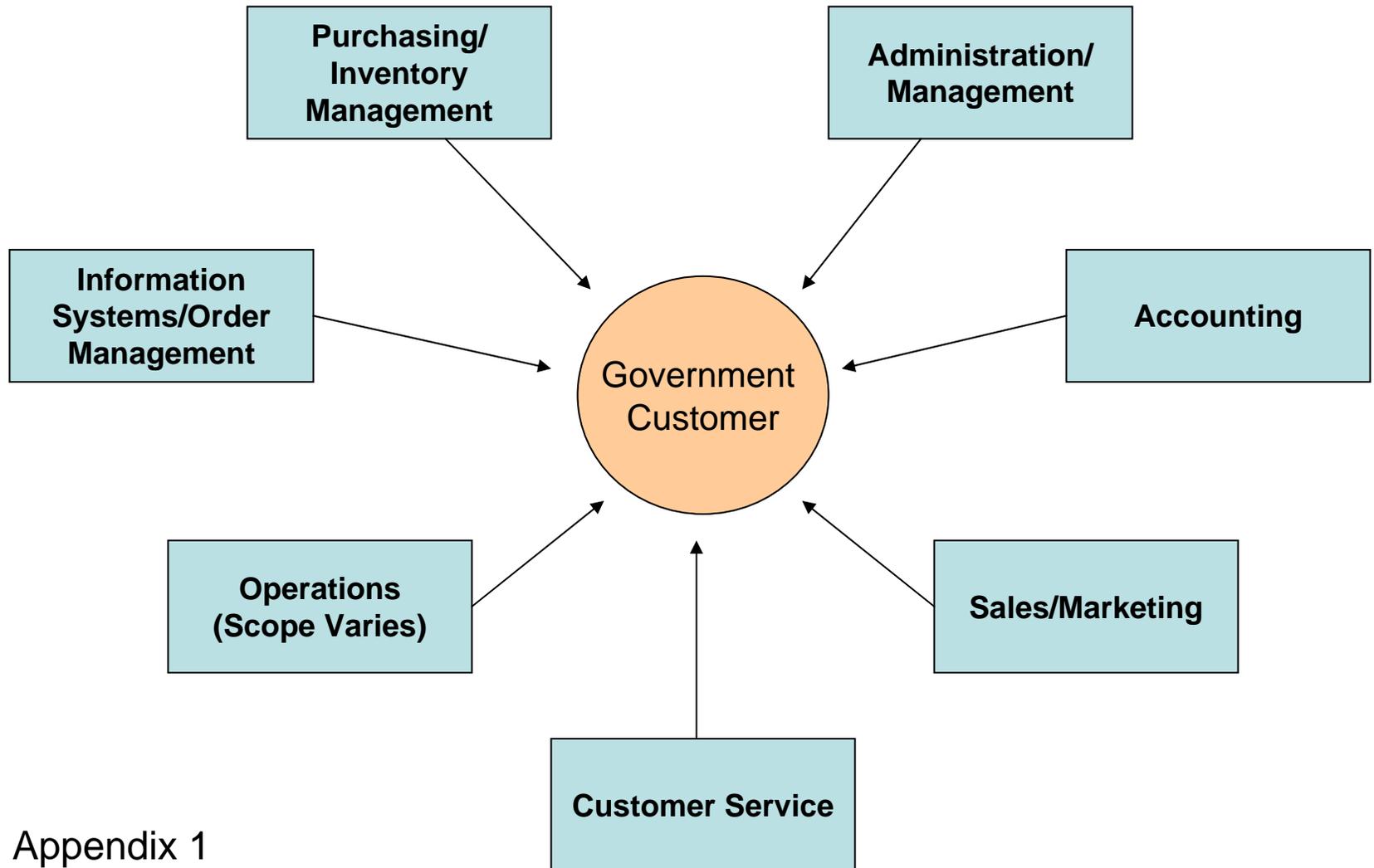
circumstances.

Therefore, the size determination is **AFFIRMED**.

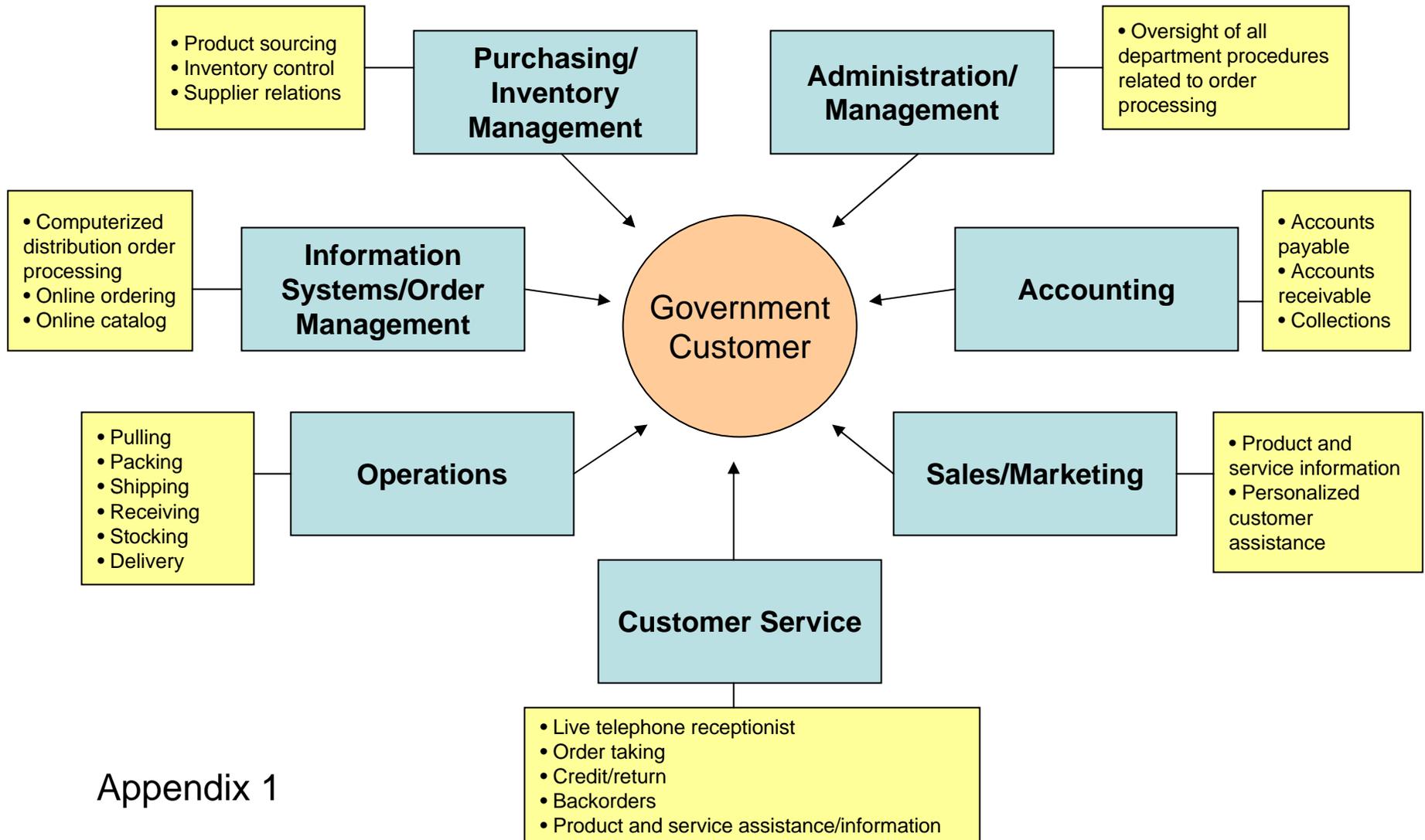
This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(b).

THOMAS B. PENDER
Administrative Judge

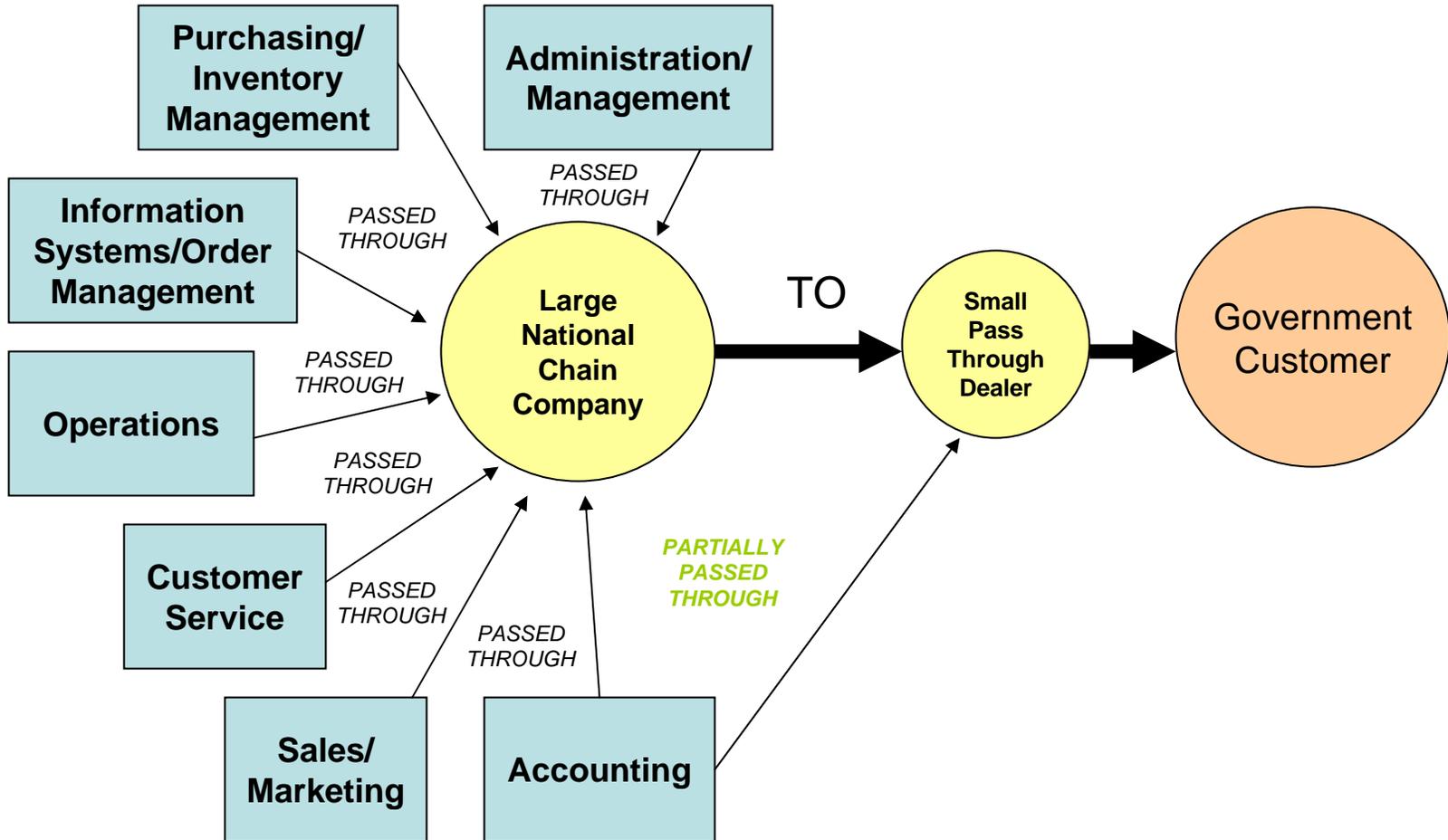
Independent Small Dealer Business Functions for Customers



Independent Small Dealer Business Functions for Customers (Detail)



Large Company Business Functions Passed Through Small Business “Front” to Customer



Questions: Pass-Through Issue

- 1) The pass-through situation you reference in your testimony, can you tell me exactly how the process works?

A large business seeking to gain access to a contract or a portion of a contract that is “set aside” or intended for a small or otherwise disadvantaged business, partners with a business of that type. Typically, the small business provides some small percentage of the total work to serve as a representative on the account, so that the small business status can be claimed per that company’s socioeconomic status.

For that business “entrée” and a minimal percentage of work, the small business typically gets some type of commission payment from the large business or perhaps gets to service a small local portion of that account’s business. However, the vast majority of the work and service infrastructure is provided by the large company, ranging from internet ordering systems to product inventory shipped, to delivery on their own vehicles. In many cases even the billing, accounting, and reporting requirements are handled by the large business.

- 2) Can you tell me what a small business gets out of this relationship?

Typically, a commission of some sort or in some cases the opportunity to service a small percentage of the customer’s business, usually in close proximity to their own office. Think of the small business as a “broker” of a sort for the large business, though in most cases, the large company develops the business relationship the government agency and maintains it.

- 3) Are there any current cases where this type of relationship has been investigated?

There is one confirmed pass-through case – Faison, which served as a “front” for one of the major Office Supplies companies. NOPA has identified similar cases of probable pass-throughs, but those have not yet been reviewed by SBA.

- 4) If so, what was the outcome of the investigation?

Faison, a minority company with HQ offices in CO, long suspected of being a “front” for a large OS company, was recently held to be “other than small” by an ALJ ruling in Orange County, CA. That determination was confirmed upon legal appeal.

- 5) When agencies award contracts to these small businesses do they typically know that the large corporate company is doing the work?

Some do and some don't. I was recently involved in a bid for a facility managed by a private contractor for DOE, which was to be a small business set aside. When questioned about a suspected bidder being a pass-through, the response from the customer was “I can't control with whom our vendors partner and it is not illegal.” My response: “No it isn't illegal “YET”, but what happens to the spirit of the set aside, when the primary beneficiary of the award is a large business?”

- 6) Do you have a sense of how much business is lost to small businesses by these partnerships?

NOPA's research has identified the number to now be in the “tens of millions” just in the federal government sector and growing. State and local government and commercial have been estimated to be “tens of millions” as well.

- 7) Have you contacted the SBA about this situation? If so, what has been their response?

SBA investigated and made a size determination ruling in the Faison case. Another probable pass-through situation was brought to SBA's attention, but they did not issue a ruling.

- 8) Could SBA play a bigger role in fixing this problem if they were to investigate these small businesses as they did in the Faison case you described?

I would certainly think so, since SBA has authority to make size determinations with respect to small business contracting matters. Generally, this has been a “self-certification” system, unless a protest is filed, in which case an official investigation is undertaken and a ruling is made.

It is our impression that SBA, with its limited resources, has not moved forward proactively in this area. The lack of clear legal standards defining “pass throughs” may have constrained SBA in determining that a small business is not eligible to participate in a set-aside contract opportunity.

- 9) Are you aware of recent contracts that have been awarded to these pass-through company's?

Yes. The Faison case was a clear example. NOPA also submitted background information with respect to another probable “pass through” company, but SBA did not move forward in the same way. There are several additional small companies that have federal contracts that NOPA believes are probably “pass throughs.”

- 10) If so, can you provide us with a list?

We would be willing to share NOPA's research with the Committee staff to further its own review of this problem.

11) If Congress is to act, what is that we can do to close this loophole?

Please see NOPA's written testimony, page 6, for our general proposals. For quick reference, here they are:

Specifically, NOPA asks the Committee and Congress to draft and approve legislation to:

- 1) Establish strict bid evaluation and post-award review criteria to ensure that federal contracts set aside for small business are not awarded to companies that play only minimal roles in servicing such contracts;**
- 2) Require federal agencies to ensure that all bidders on small business set-aside contracts fully disclose and certify the functional roles they will play in contract fulfillment, as well as the specific functions their primary suppliers and subcontractors, if any, will perform;**
- 3) Require each federal agency to report annually to the appropriate committees of jurisdiction in the U.S. House of Representatives and the U.S. Senate regarding their implementation of these provisions to end the use of small business "fronts" in federal contracting; and**
- 4) Establish meaningful penalties for companies found in violation of the proposed new legislative and FAR provisions aimed at elimination of "fronts".**

- 12) Does the industry oppose legitimate mentoring relationships (answer is no)?

No, not at all. Legitimate “mentoring” relationships should be just what the term implies – a larger business assisting a small or fledgling business concern in developing best practices, its own infrastructure and expertise, so the small business can be successful and grow IN ITS OWN RIGHT.

My view would be that a true mentoring relationship would not be for the sole purpose of allowing large companies “access” to “brokered” business that is intended to go to “legitimate” small businesses.

- 13) If not, how does the situation you describe differ?

See #12 above. Also, you might refer to Appendix 1 which has charts comparing legitimate dealers to those that are “pass-throughs”.

- 14) Do agencies that award contracts to these small business pass-throughs get small business credit for doing so?

That is my understanding.

- 15) If Congress does implement legislation to correct this problem, do you see it having a negative impact on legitimate partnerships in industries where small businesses team with large businesses on government contracts?

No, I do not. NOPA recognizes that there are many industries, especially manufacturing, where it is an absolute necessity for large businesses to partner with small businesses simply to meet the required need. This is legitimate “subcontracting”.

Fortunately, in the office products industry, at least on the dealer/distributor side, there are plenty of legitimate small businesses with the buying power, technical and reporting capability and the national distribution capability through small business teaming arrangements to meet the requirements of large government and commercial accounts without the need to team with a large national/international concern.

Unfortunately, our four large national competitors continue to find ways to capture business not intended for them. Without some type of action, the negative impact will continue to be to the thousands of hard-working, technically capable, legitimate small businesses in our industry that could be creating thousands of jobs and providing exemplary service.

- 16) If not, why not? **See above.**