

SBA's NEWLY ORGANIZED CONCERN RULE

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The Small Business Administration (“SBA”) uses an important rule, called the Newly Organized Concern Rule, when it considers protests alleging that a company is not small. The rule states that affiliation may arise where four elements are met, and explains how to rebut any affiliation:

- (1) the former officers, directors, principal stockholders, managing members or key employees of one concern organize a new concern;
- (2) the new concern is in the same or related industry or field of operation;
- (3) the persons who organized the new concern serve as the new concern’s officers, directors, principal stockholders, managing members or key employees;
- and
- (4) the one concern is furnishing or will furnish the new concern with contracts, financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities, whether for a fee or otherwise.

A concern may rebut such an affiliation determination by demonstrating a clear line or fracture between the two concerns. A “key employee” is an employee who, because of his/her position in the concern, has a critical influence in or substantive control over the operations or management of the concern.

13 C.F.R. § 121.103(g). When there is affiliation between two companies, the receipts of *both* companies is counted in determining the size of either. 13 C.F.R § 121.104. Size Appeal of Saint George Industries, LLC, SBA No. SIZ-5440 (Jan. 30, 2013) is a good example of the newly organized concern rule.

- Mr. Patrick Stallings retired from the US Army in July 2007
- Upon retirement, Mr. Stallings joined Point Blank Solutions, Inc., (“Point Blank”) a public company, where he ran Operations from Oct. 2008 to Oct. 2009.
- Mr. Stallings then worked in Product Development until May 2010, when he became executive Vice President for DOD Operations, managing military sales, business development and government programs and contracts.
- Point Blank filed for Chapter 11 bankruptcy, and Sun Capital Partners (“Sun”) purchased Point Blank’s assets on Oct. 27, 2011.
- Sun then created a new company, Point Blank Enterprises, Inc. (“PB Enterprises”) on Nov. 1, 2011 to hold the Point Blank assets purchased by Sun.
- At this time, Mr. Stallings began to work at PB Enterprises
- In mid-December 2011, Mr. Stallings was notified that he “was being involuntarily terminated from PB Enterprises as part of Sun’s reorganization plan.
- Mr. Stallings left PB Enterprises on Jan. 31, 2012.
- January 2012, either while still employed by PB Enterprises or within days after employment ceased, Mr. Stallings founded Saint George Industries, Inc. (“Saint George”).

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The protester alleged that Saint George Industries was not a small business because it was affiliated with PB Enterprises under the newly organized concern rule organized concern rule, and that PB Enterprises had provided Mr. Stallings with a commitment of work that enabled him to secure financing. The protester asserted that PB Enterprises remains in existence under Chapter 11 protection of the Bankruptcy code, however, PB Enterprises acquired the assets of Point Blank through bankruptcy proceedings.

Although the Area Office found Saint George and Point Blank to be generally affiliated based on the newly organized concern rule, SBA's appellate body, the Office of Hearings and Appeals ("OHA") concluded that the Area Office analysis was flawed or incomplete. Specifically, it was never clear that the first element of the newly organized concern was every met. Mr. Stallings alleges that he was never an officer of PB Enterprises, and could not exercise critical influence or substantive control over the company—because he worked there for only 90 days and then was involuntarily dismissed. (The Area Office had reasoned that Mr. Stallings could be considered an officer or key employee of PB Enterprises because he held such positions at Point Blank—which they stated “subsequently became PB Enterprises). Most important, however, is that the Area Office simply recited Mr. Stallings’s job titles, and made no substantive analysis of whether he was an officer or key employee of Point Blank—a critical aspect of this rule.

Finally, it was not clear from the record that Point Blank and PB Enterprises should be treated as a unified entity for purposes of the rule. Saint George had dealings only with PB Enterprises, but not Point Blank Solutions. It was not clear from the record the extent to which PB Enterprises and Point Blank solutions shared similar ownership or management—and there was no real basis to impute Mr. Stallings’s role at Point Blank to PB Enterprises. In short, OHA said that the record does not demonstrate that the Area Office fully explored whether Mr. Stallings was an officer or key employee of PB Enterprises. OHA vacated the size determination and remanded it to the Area office for further investigation.

TIPS: If you are establishing a new small business concern, using key employees or officers of one company in the same field, make sure you can demonstrate “a clear line or fracture between the two companies” as required by the rule. The old company should not furnish the new small business with contracts, financial or technical assistance, indemnification on bid or performance bonds, and/or other facilities, whether for a fee or otherwise. The two companies must be legally distinct. Physical separateness helps as well, but demonstrating a clear line of fracture is most important.