Cite as: *Size Appeal of Diverse Construction Group, LLC*, SBA No. SIZ-5112 (2010)

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United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF:	
Diverse Construction Group, LLC	SBA No. SIZ-5112
Appellant	Decided: February 2, 2010
Appealed from Size Determination No. 1-SD-2010-007	

APPEARANCES

Michael J. Schaengold, Esq., Patton Boggs, LLP, for Appellant Diverse Construction Group, LLC.

Walter G. Breakell, Esq., Breakell Law Firm, P.C., for Con Tech Building Systems, Inc.

DECISION

I. Jurisdiction

This appeal is decided under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134.

II. Issue

Whether the Area Office's determination Appellant was affiliated with another firm due to contractual relations was based upon clear error of fact or law. *See* 13 C.F.R. § 134.314.

III. Background

A. The Solicitation and Protest

On August 11, 2009, the Departments of the Army and the Air Force, National Guard Bureau, issued the subject Solicitation No. W912PQ-09-B-0004 for construction projects at Fort Drum, New York. The Contracting Officer (CO) set the solicitation totally aside for Historically Underutilized Business Zone (HUBZone) small business concerns. The CO designated North American Industry Classification System (NAICS) code 236220, Commercial and Institutional

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Building Construction, with a corresponding $33.5 million annual receipts size standard, as the appropriate NACIS code for this procurement.[1] Offers were due on September 29, 2009.

At bid opening the low bidder was The Diverse Construction Group, LLC (Appellant). An unsuccessful offeror, Con Tech Building Systems, Inc. (ConTech) filed a timely HUBZone protest. Although this protest was dismissed, it raised points that led the CO to request a formal size determination by the Small Business Administration (SBA) Office of Government Contracting - Area I in New York, New York (Area Office) on October 19, 2009. On that same day, the Area Office initiated the size determination process, notified Appellant of the protest, and requested it to submit a response, together with a completed SBA Form 355 and certain other information.

B. Size Determination No. 1-SD-2010-007

On November 5, 2009, the Area Office issued a size determination finding Appellant other than small.

The Area Office first examined Appellant's proposal for the instant procurement, analyzing its relationships with its subcontractors. The Area Office concluded Appellant was not affiliated with any of its subcontractors under the ostensible subcontractor rule.

The Area Office then found Appellant was 51% owned by Mr. Hunter Grimes and 49% owned by seven other individuals. These seven individuals are all employees of Northland Associates, Inc. (Northland) Appellant's alleged affiliate and a large business. However, none of the seven is a shareholder, officer, director, or key employee of Northland. One is a first cousin of Northland's president. The other minority shareholders have no family or personal relationship with Northland's shareholders. Further, under Appellant's Operating Agreement Mr. Grimes is Appellant's Manager, and has sole and exclusive right to manage the firm's business. Mr. Grimes has never been an officer, director, principal stockholder, managing member, or key employee of Northland. Accordingly, there is no common ownership or common management between the two firms, nor have they common facilities, equipment or employees. Further, Northland has not furnished Appellant with financial assistance, indemnification on bid or performance bonds, and the two firms have never entered into a Joint Venture or Teaming Agreement.

The focus of the Area Office's analysis was the contractual relationships between Appellant and Northland. The Area Office stated there is a rebuttable presumption that firms having identical or substantially identical business or economic interests through contractual or other relationships are affiliated. The presumption may be rebutted with evidence showing that the interests deemed to be one are in fact separate.

[1] The solicitation erroneously listed the size standard as $34 million, but the SBA Area Office applied the correct $33.5 million size standard, using its authority to correct a size standard in a solicitation. 13 C.F.R. §§ 121.201, 121.402(d).

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The Area Office found Appellant, as prime contractor, had entered into two subcontracts with Northland for the Department of Veterans Affairs (VA). These subcontracts represented 48.1% and 37.4% of the contract value of these two contracts, for a total of $[REDACTED] of subcontracts to Northland from Appellant.

The Area Office further found Northland entered into two subcontracts with Appellant in December 2007, totaling $[REDACTED]. Appellant had no receipts for 2007. Approximately 33% of Appellant's 2008 receipts were derived from Northland. The remainder of Appellant's 2008 receipts were from the VA contracts described above. Thus, all of Appellant's 2008 receipts came from contracts where Northland was Appellant's subcontractor, or Appellant was Northland's subcontractor. Over 50% of Appellant's 2008 receipts not derived from Northland subcontracts were paid to Northland in its capacity as Appellant's subcontractor.

The Area Office found that for 2009 (January 1 to September 30) Appellant had received 5.3% of its total receipts as a subcontractor for Northland. Appellant, acting as a prime has paid 46.8% of its remaining receipts to Northland.

The Area Office found that since its establishment in November, 2007, Appellant has received a total of five contracts. Two of these are subcontracts from Northland and the remaining three are prime contracts from VA. Northland was a subcontractor on two of the VA contracts, and was presented as part of the proposal on one of them. The Area Office concluded that approximately 99% of Appellant's receipts involved Northland, either as prime contractor or subcontractor.

The Area Office concluded that the continuing contractual relationships between Appellant and Northland rendered Appellant dependent upon Northland. Appellant produced no evidence to demonstrate a clear fracture between itself and Northland to rebut the presumption of an identity of interest. The Area Office noted that the two firms were in the same line of business, and seven of Northland's employees held together 49% of Appellant's stock. The Area Office determined, based on the totality of the circumstances, that Appellant was affiliated with Northland, and thus other than small, citing *Size Appeal of Pointe Precision, LLC*, SBA No. SIZ-4466 (2001).

C. The Appeal

On November 24, 2009, Appellant filed the instant appeal. Appellant filed a motion to admit as new evidence a supplemental declaration from Mr. Grimes, arguing that Appellant did not know in advance the specific statistics the Area Office would rely upon, and that the supplemental declaration addresses these statistics. Appellant also requests a protective order and an expedited appeal.

Appellant asserts it is not controlled by Northland, receives no financial or other assistance from Northland, is in no way reliant upon Northland, and is not controlled by

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Northland. There is no common ownership or management, and the firms share no employees. Mr. Grimes has never been employed by Northland.

Appellant has been Northland's subcontractor on two contracts with the General Services Administration (GSA). Appellant's total receipts on these two contracts are $[REDACTED] against Appellant's total receipts from its establishment to September 30, 2009 of $[REDACTED]. Thus, Appellant's receipts from Northland represents less 9.5% of its total receipts since the company's inception.

In 2008, Appellant received approximately 33% of its income from Northland subcontracts. The proportion of Appellant's receipts derived from Northland for 2009 is only 5.3%, and it will decline further after that. Appellant's own prime contracts with the VA account for more than 90% of its receipts. While Appellant has used Northland as a subcontractor, it did so in arm's length transactions and was not required to do so. Appellant asserts that by the end of 2009, all the contracts where it is participating with Northland as either a prime or subcontractor will have been performed, and there will be no ongoing work or revenues exchanged between the two concerns. Appellant argues that a challenged firm dependent upon another firm for such a small proportion of its receipts is not affiliated with the other firm due to contractual relations, citing *Size Appeal of Neal R. Gross & Co.*, SBA No, SIZ-3888 (1994).

Appellant asserts the size determination is based upon factual errors. The Area Office stated that approximately 99% of Appellant's receipts were either from Northland or indirectly involved Northland as a subcontractor. Appellant asserts the correct percentage for 2009 is 50.1%, at most, and this will reach 0% by the end of the year. Appellant asserts the size determination erroneously asserted Appellant subcontracted 50.1% of its second VA contract to Northland, when the true figure was 37.4%. On its second prime contract, Appellant dramatically reduced the amount of work it contracted to Northland. The size determination also errs by failing to take into account that Appellant has a number of other first-tier subcontractors in addition to Northland.

While there are a number of cases finding firms affiliated through contractual relationships, in these cases the firms were dependent upon the alleged affiliate for the majority of their receipts, which Appellant is not. Further, in cases such as *Pointe Precision*, there were many more ties between the firms in addition to the contractual relationships.

D. ConTech's Response

On December 9, 2009, ConTech responded to the appeal. ConTech argues that Mr. Grimes's Supplemental Declaration should be excluded, because it contains no new evidence not previously submitted and is merely an attempt to reargue before OHA the case it should have presented to the Area Office. ConTech asserts that of five contracts Appellant has received since its business began, only one, representing approximately 9.5% of its receipts, did not involve Northland as either a prime or a subcontractor. The fact that Northland's share of

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Appellant's receipts is decreasing is irrelevant, as its size must be determined as of the date of its initial offer, including price.

ConTech asserts Appellant has failed to demonstrate a clear fracture between itself and Northland. ConTech further asserts that Appellant is affiliated with Northland due to its contractual relationships. Further, the continuous contractual relationships between Appellant and Northland demonstrate that Appellant is affiliated with Northland under the totality of the circumstances.

IV. Discussion

A. Timeliness

Appellant filed its appeal within 15 days of receiving the size determination. Thus, the appeal is timely. 13 C.F.R. § 134.304(a)(1).

B. Standard of Review

The standard of review for this appeal is whether the Area Office based its size determination upon clear error of fact or law. 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 Consultants, Inc.*, SBA No. SIZ-4775 (2006), for a full discussion of the clear error standard of review. Consequently, I will disturb the Area Office's size determination only if I have a definite and firm conviction the Area Office made key findings of law or fact that are mistaken.

C. Appellant's Motions

Appellant's motion for a Protective Order was GRANTED on January 12, 2010. Appellant's motion for an expedited hearing is DENIED, because Appellant failed to offer compelling reasons for placing its case ahead of other pending appeals, which are similarly situated. As to Appellant's motion to admit new evidence, a review of the Grimes Declaration reveals it is not new evidence as much as argument based on the existing record. It is Mr. Grimes's calculations on the proportion of Appellant's receipts that are dependent upon Northland. As argument, this submission is ADMITTED.

D. The Merits

The issue here is whether Appellant is affiliated with Northland. Seven Northland employees together own a 49% interest in Appellant, although none of them are key employees of Northland, or own an interest in that firm. The two firms have no common ownership, management, employees, equipment, or facilities. Thus, there can be no finding of affiliation between the two firms based upon these grounds.

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The Area Office based its finding of an identity of interest between Appellant and Northland upon the contractual relationships between them. Firms that are economically dependent through contractual relationships may be held to be affiliated. 13 C.F.R. § 121.103(f). However, Appellant has received only two subcontracts from Northland, and these accounted for only 9.5% of Appellant's receipts over the life of the company from 2007 to 2009. The heart of the Area Office's finding is that Appellant's granting subcontracts to Northland on two large contracts where it was the prime contractor created an identity of interest. Based upon this finding, the Area Office finds an identity of interest between the two firms and then finds Appellant has been unable to rebut this identity of interest with evidence of a clear fracture.

It is worth noting that our cases finding affiliation based upon contractual relationships find affiliation based upon a challenged firm's reliance upon its receipt of subcontracts or other receipts from an alleged affiliate. *See, e.g., Size Appeal of L & S Indus. & Marine, Inc.*, SBA No. SIZ-4978 (2008); *Size Appeal of Faison Office Prods., LLC*, SBA No. SIZ-4812 (2006); *Size Appeal of J & R Logging*, SBA No. SIZ-4426 (2001). Further, in these cases, the challenged firms were reliant upon the alleged affiliates for the large majority of their receipts.

In *Size Appeal of Pointe Precision*, SBA No. SIZ-4466 (2001), upon which the Area Office relied, contracts from the alleged affiliate accounted for over 80% of the challenged firm's receipts. In that case OHA held that affiliation under the rule arises where one firm is dependent upon another for contracts and business to such an extent that its economic viability would be in jeopardy without such contracts or business. *Pointe Precision*, at 8-9. Here, however, Appellant is reliant upon Northland for only 9.5% of its receipts. Further, Appellant has only subcontracted less than half the work on two of its prime contracts to Northland. Although it is possible that a firm that consistently subcontracts most of the work on its prime contracts to another firm may be found affiliated with the second firm under the contractual relationships regulation, Appellant has not done so here.

The Area Office erred in finding Appellant dependent on Northland for 99% of its contract receipts. The Area Office reached this calculation by finding Appellant dependent upon Northland for entire contracts when Appellant was the awardee for the prime contract, and had subcontracted only a portion to Northland. This was error because Appellant cannot be dependent upon Northland for a contract awarded directly to Appellant by the Government, even if Northland has received a subcontract for a portion of the work on that contract. Further, it was error to find Appellant dependent upon Northland for contracts where Northland's only connection was as recipient of a subcontract awarded by Appellant, when the portion of the work subcontracted was not so great as to suggest dependency by Appellant.

Appellant is dependent on Northland for only 9.5% of its receipts on two subcontracts, and has granted subcontracts for 48.1% and 37.4% on two of its three other prime contracts. This is simply not a great enough dependency to support a finding of identity of interest based upon contractual relations.

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Accordingly, the Area Office erred in finding affiliation between the two firms based upon an identity of interest. Further, the Area Office erred in requiring Appellant to demonstrate a clear fracture between itself and Northland. The requirement that a firm demonstrate a clear fracture between itself and another firm only arises when the firm must rebut an identity of interest finding already made. *Size Appeal of Blue Cord Constr., Inc.*, SBA No. SIZ-5077 (2009). Because identity of interest was not established to begin with, there was no need for Appellant to demonstrate a clear fracture between itself and Northland.

The Area Office also found Appellant and Northland affiliated under the totality of the circumstances. SBA may find firms affiliated under the totality of the circumstances even where no one factor is sufficient to constitute affiliation. 13 C.F.R. § 121.103(a)(5). SBA may find the firms affiliated under this rule where the interactions between the businesses are so suggestive of reliance as to render the firms affiliates. *Size Appeal of Lance Bailey & Assocs., Inc.*, SBA No. SIZ-4817, at 14 (2006). Although the evidence in the record may not establish affiliation under one of the specific factors enumerated in the regulation, a review of all the factors may lead to a conclusion one business has the power to control the other and, thus, both are affiliated. *Id.*

Here, the ties between Appellant and Northland are these:

1. Seven Northland employees together own 49% of Appellant. These individuals have no ownership interest in Northland, and are not key employees of Northland.

2. Appellant is managed by its 51% owner, Mr. Grimes, who has sole and exclusive right to manage the firm's business, and has no prior connection with Northland.

3. Appellant has received two subcontracts from Northland, which constitute approximately 9.5% of Appellant's receipts to date.

4. Appellant has granted two subcontracts to Northland on contracts where it is the prime contractor. The amounts paid to Northland under these subcontracts represent 48.1% and 37.4% of the value of these contracts.

5. Appellant and Northland have no common ownership, management, facilities, equipment, or employees. Northland has provided Appellant with no financial assistance, indemnification or bonding, and the two firms have never entered into a Joint Venture or Teaming Agreement.

I conclude upon reviewing these ties, or rather, the absence of ties between the firms, that there is simply not enough here to give either Appellant or Northland control or power to control the other. Mr. Grimes has firm control of Appellant's management, Appellant's subcontracts from Northland amount to a relatively small part of its receipts, and its granting of two subcontracts to Northland, a large firm, does not create any dependency by one firm upon the other, especially when there is no showing that Northland is acting as an ostensible subcontractor

for these contracts. I therefore conclude that the Area Office clearly erred when it found Appellant and Northland affiliated under the totality of the circumstances.

Appellant has thus met its burden of establishing that the Area Office erred in finding Appellant affiliated with Northland under both the identity of interest and the totality of the circumstances rules. I therefore grant the instant appeal and reverse the Area Office's size determination.

V. Conclusion

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

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

CHRISTOPHER HOLLEMAN
Administrative Judge