

**United States Small Business Administration
Office of Hearings and Appeals**

SIZE APPEAL OF:

Pugh Enterprises, LLC

Appellant

SBA No. SIZ-5194

Decided: February 9, 2011

APPEARANCES

John D. Pugh and Jack Y. Pugh, Jr., Owners, for Appellant

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, 123, and 134.

II. Issue

Whether there was clear error of fact or law in the Disaster Office's determination of Appellant's size status. See 13 C.F.R. § 134.314.

III. Background

A. The Loan Application and Informal Size Determination

On July 14, 2010, Pugh Enterprises, LLC dba South Bay Ace Hardware & Lumber (Appellant) applied to the Small Business Administration's (SBA) Office of Disaster Assistance, Processing and Disbursement Center in Fort Worth, Texas (Disaster Office), for an Economic Injury Disaster Loan (EIDL). Appellant sought the loan in connection with Disaster Declaration FL-00056. This disaster declaration, for the Deepwater BP Oil Spill, was authorized on May 13, 2010, and the Commencement Date of the disaster was April 20, 2010. Appellant's business is located in Santa Rosa and Bay Counties, Florida, counties covered by the Disaster Declaration; however, neither county is located in a Labor Surplus Area.

On Appellant's SBA Form 5, "Disaster Business Loan Application," Appellant identified its "Type of Business" as "Building Supply." On its 2007, 2008, and 2009 Federal income tax returns, Appellant had identified its "Principal product or service" and "Business code number" as "Hardware and lumber" and "444130" respectively. The Disaster Office classified Appellant under North American Industry Classification System (NAICS) code 444130, Hardware Stores.

NAICS code 444130 has an annual receipts size standard of \$7 million.

On July 26, 2010, the Disaster Office issued its informal decision declining Appellant's EIDL application because Appellant is not a small business under NAICS code 444130.

B. The Reconsideration and Formal Size Determination

On July 27, 2010, Appellant requested reconsideration of the Disaster Office's informal decision. Appellant asserted it had been using an incorrect NAICS code and that its correct NAICS code is 452990, All Other General Merchandise Stores. On April 20, 2010, NAICS code 452990 had a small business size standard of \$11 million.

Appellant submitted its completed SBA Form 355, "Information for Small Business Size Determination," and its amended 2009 Federal income tax return, in which it had revised its "Principal product or service" and "Business code number" to state "General merchandise" and "452900" respectively. In its cover letter, Appellant noted that its accountant had used NAICS code 444130 on the tax returns since 2000, but that since then Appellant added many "general merchandise" items such as feed and seed for farm animals, hunting supplies, automotive supplies, swimming pool supplies, farm equipment (fencing, gates, etc), household goods, lawn and garden supplies, outdoor furniture, trailers, golf carts, natural gas, beach supplies, marine supplies, sand, asphalt, pilings, etc. Thus, the correct NAICS code is 452990. Appellant claimed its gross sales were below the \$11 million size standard for NAICS code 452990.

At the Disaster Office's request, Appellant submitted the estimated percentage break-out of its 2009 sales by category. The top three categories were: Lumber 22%, Panel products 18%, and Hardware 15%. The next three categories were Paint 9%, Marine supplies 7%, and Doors 6%. Smaller categories included Molding, Fencing, Steel, Plumbing, Electrical, Home and garden, and Sporting goods. Appellant also stated that its distribution of sales varies by season, that it is 85% contractor/builder based, and that its staff is trained on the products sold.

The Disaster Office file includes a July 19, 2010, Dun & Bradstreet (D&B) Report on Appellant. The D&B Report shows Appellant's lines of business as NAICS codes 444110, Home Centers, and 444130, Hardware Stores. The Disaster Office file also contains Federal income tax returns for Appellant's three affiliates. Appellant's fiscal year ends on December 31st. The Disaster Office also considered other evidence, including the content of Appellant's website.

On September 29, 2010, the Disaster Office issued its formal size determination (Size Determination), again concluding that Appellant is not a small business. In discussing primary industry, the Disaster Office first took note of Appellant's three affiliates, but concluded Appellant itself is the most significant source of income, and thus the primary activity of the affiliated group is the same as that of Appellant. The Disaster Office then discussed Appellant's submissions, its 2009 sales break-out, and its arguments in favor of NAICS code 452990.

Looking first at NAICS subsectors 452 (General Merchandise Stores) and 444 (Building Material and Garden Equipment and Supplies Dealers), the Disaster Office determined Appellant's primary industry is in subsector 444 rather than in 452. Therefore, Appellant's

NAICS code could not be 452990. Within subsector 444, however, the Disaster Office noted that two NAICS codes “match up well” with Appellant's primary activity; these were NAICS code 444110, Home Centers, and 444130, Hardware Stores. Both of these NAICS codes had the same \$7 million annual receipts size standard, so the Disaster Office used NAICS code 444130 for analysis, since Appellant had originally classified itself as Hardware Stores. In calculating Appellant's and its affiliates' three-year average annual receipts, the Disaster Office determined Appellant exceeded the applicable \$7 million size standard and thus was other than small and ineligible for the EIDL.

Appellant filed the instant appeal on November 8, 2010.

C. The Appeal

Appellant renews its argument, made to the Disaster Office on reconsideration, that its correct NAICS code is 452990, All Other General Merchandise Stores. Appellant also asserts that the “non policed” choice of NAICS code made on one's income tax return should not be the determining factor on whether a clearly-needed disaster loan should be granted or denied.

IV. Discussion

A. Timeliness and Standard of Review

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

Appellant has the burden of proving, by a preponderance of the evidence, all elements of its appeal. Specifically, Appellant must prove the Size Determination is based on a clear error of fact or law. 13 C.F.R. § 134.314; *Size Appeal of Procedyne Corp.*, SBA No. SIZ-4354, at 4-5 (1999). OHA will disturb the Size Determination only if the Judge, after reviewing the record and pleadings, has a definite and firm conviction the Area Office erred in making its key findings of fact or law. *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 11 (2006).

B. The Merits of the Appeal

The SBA's regulations for disaster loans (other than physical disaster loans) require that an applicant business concern¹ must not exceed the size standard designated for the industry in which the applicant is primarily engaged; and² combined with its affiliates must not exceed the size standard designated for either the primary industry of the applicant alone or the primary industry of the applicant and its affiliates, whichever is higher. 13 C.F.R. § 121.301(a). The size

¹ Executive Office of the President, Office of Management and Budget, North American Industry Classification System-United States (2007). The NAICS Manual is also available on the Internet at www.census.gov/naics/2007/index.html.

² On November 5, 2010, new size standards went into effect for some industries. These include NAICS code 444110, Home Centers, whose size standard was changed to \$35.5 million. 75 Fed. Reg. 61597, 61603 (Oct. 6, 2010) (to be codified at 13 C.F.R. § 121.201).

standards are set forth in § 121.201. *Id.* As is clear from the regulation, the “primary industry” determines the size standard against which the applicant business concern is measured.

The Disaster Office determined the primary industry of Appellant and its affiliate group is the same as that for Appellant itself, because Appellant itself has the vast majority of receipts. I agree with that conclusion.

1. Appellant's Primary Industry

Appellant argues the Disaster Office did not properly determine the industry in which the Appellant is primarily engaged. I must reject this argument. The size regulations provide:

In determining the primary industry in which a concern ... is engaged, SBA considers the distribution of receipts, employees and costs of doing business among the different industries in which business operations occurred for the most recently completed fiscal year. SBA may also consider other factors, such as the distribution of patents, contract awards, and assets.

13 C.F.R. § 121.107. The date as of which size status is determined is the date the disaster commenced, here April 20, 2010. *See* 13 C.F.R. § 121.302(c). As of April 20, 2010, Appellant's most recently completed fiscal year is 2009. Thus, the Disaster Office correctly focused on Appellant's 2009 receipts. Appellant provided break-outs of its receipts by category.

NAICS is a hierarchical classification system, and the higher-level descriptions include the three-digit subsector. NAICS Manual¹, at 17-19. In determining a firm's primary industry, SBA has used material from the higher-level descriptions to understand a particular NAICS industry. *See* Size Appeal of Heather Farms Nursery, Inc., SBA No. SIZ-4931 (2008) Here, the Disaster Office looked at NAICS subsectors 444 and 452 to help it understand the NAICS codes at issue. The Disaster Office was not incorrect in doing so, and its effort also focuses attention on other possible NAICS codes within subsector 444 under which Appellant might qualify.

Subsector 444, Building Material and Garden Equipment and Supplies Dealers, includes industries that retail new building material and garden equipment and supplies from fixed point-of-sale locations. Establishments in this subsector have display equipment designed to handle lumber and related products and garden equipment and supplies that may be kept either indoors or outdoors under covered areas. The staff is usually knowledgeable in the use of the specific products being retailed in the construction, repair, and maintenance of the home and associated grounds.

NAICS Manual, at 567-68.

As the Disaster Office correctly noted, Appellant's two leading sales categories (Lumber 22% and Panel products 18%) place Appellant squarely within this NAICS subsector. Also, several of Appellant's smaller sales categories, its trained sales staff, and the fact its sales are 85% contractor/builder based further support this conclusion.

Within NAICS subsector 444, the Disaster Area Office noted that, in addition to NAICS code 444130, Hardware Stores, NAICS code 444110, Home Centers, “appears to be a potentially appropriate classification.” However, as of April 20, 2010, the date as of which size is to be determined, both these NAICS codes (and, in fact, all subsector 444 NAICS codes) had the same \$7 million size standard. Thus, the Disaster Office chose to use NAICS code 444130, Hardware Stores, for analysis. This choice is consistent with SBA practice of giving more weight to a concern's initial characterization of its business as opposed to a later claim. See Heather Farms.

Accordingly, I conclude that the Disaster Office properly classified Appellant's primary industry as NAICS code 444130, Hardware Stores.

2. The Size Standard and Calculation of Receipts

The Disaster Office correctly determined the annual receipts size standard for NAICS code 444130 on April 20, 2010, was \$7 million. See 13 C.F.R. § 121.201.2 The Disaster Office then calculated Appellant's and its affiliates' combined annual receipts (based on their Federal income tax returns) for their three most recently completed fiscal years (2007, 2008, and 2009) and then divided the combined totals by three. See 13 C.F.R. § 121.104(c)(1). Finally, the Disaster Office determined that Appellant's average annual receipts exceeded the \$7 million size standard for NAICS code 444130.

The Disaster Office then correctly determined that Appellant, by itself or combined with its affiliates, exceeded the applicable \$7 million size standard. Therefore, Appellant is ineligible for an Economic Injury Disaster Loan. I note also that, even if Appellant had prevailed in its contention that its primary industry was NAICS code 452990, All Other General Merchandise Stores, Appellant, by itself, also exceeded that NAICS code's \$11 million size standard.

Accordingly, Appellant has failed to prove the Disaster Office's Size Determination was based on clear error of fact or law.

V. Conclusion

For the above reasons, I DENY the instant appeal and AFFIRM the Disaster Office's Size Determination.

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

CHRISTOPHER HOLLEMAN
Administrative Judge