

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

SIZE APPEAL OF:

McLendon Acres, Inc.

Appellant

Size Determination No. 3-2011-07

SBA No. SIZ-5222

Decided: March 25, 2011

APPEARANCE

Martin L. McLendon, President, McLendon Acres, 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 made clear error in designating the Appellant's primary industry and determining its affiliates.

III. Background

A. The Request for a Size Determination

On October 21, 2010, the Deputy Director of the Small Business Administration (SBA) Historically Underutilized Business Zone (HUBZone) program requested the SBA's Office of Government Contracting – Area III in Atlanta, Georgia (Area Office) perform a size determination on McLendon Acres, Inc. (Appellant). Appellant's HUBZone application had listed its primary North American Industry Classification System (NAICS) code as 236220, Commercial and Institutional Building Construction, with a corresponding \$33.5 million annual receipts size standard. The Deputy Director stated that Appellant's primary NAICS code should be in Sector 11 – Agriculture, Forestry, Fishing, and Hunting, with a corresponding \$750,000 annual receipts size standard.

On October 28, 2010, the Area Office informed Appellant of the request for a size determination and directed Appellant to submit a response, and an SBA Form 355, together with certain other information. On November 9, 2010, Appellant responded to the Area Office.

B. The Size Determination

On December 10, 2010, the Area Office issued Size Determination No. 3-2011-07 (Size Determination) concluding Appellant was other than small. The Area Office found that Martin McLendon is Appellant's President and sole shareholder. Mr. McLendon's wife, Tracie McLendon, is Appellant's Secretary/Treasurer. There are no other directors. Appellant provides agriculture support services and farm crops. The Area Office determined Appellant's size using both the size standard for Subsector 111, Crop Production, of \$750,000 in annual receipts, and Subsector 115, Support Activities for Agriculture and Forestry, of \$7 million in annual receipts.

The Area Office found that Mr. McLendon has a 50% ownership interest in 1-800 RR Emergency, LLC (RR Emergency). Fred Dennin, who is unrelated to Mr. McLendon, owns the other 50%. RR Emergency is a call center started in 2009, but had no financial activity in 2009. The Area Office found RR Emergency affiliated with Appellant because of Mr. McLendon's power to control the firm.

Ms. McLendon is sole owner of Bullneck Barn, LLC (Bullneck Barn). The Area Office found Bullneck Barn affiliated with Appellant under the identity of interest rule.

Appellant owns 49% of Bullneck Contracting, LLC (Bullneck Contracting or BC). Steven Belk, unrelated to Mr. McLendon, owns 51%. Bullneck Contracting is located at the same address as Appellant (the McLendon home address), and has a similar name to Bullneck Barn. Appellant's initial capital contribution was \$2,365, Mr. Belk's, \$100. Bullneck Contracting's Operating Agreement vests overall management in its members in proportion to their initial capital contributions. BC Operating Agreement, § 3.1(a). The Operating Agreement requires the unanimous consent of the members to certain major decisions: sale of all or substantially all of the concern's assets; mortgage or encumbrance of all or substantially of the concern's assets; any matter which could result in a change in the amount or character of the concern's contribution to capital; a change in the character of the business of the concern; borrowing money; commission of any act which would make it impossible for Bullneck Contracting to carry on its ordinary business; or contravene the Operating Agreement. BC Operating Agreement, § 3.2(a). The Area Office found Appellant affiliated with Bullneck Contracting because of the disparity in capital contributions, the similar name to Bullneck Barn, the requirements for unanimous consent for major decisions, and the concern being located at the same address as Appellant.

Concordia Allied Producers, LLC (Concordia Allied) is 40% owned by Appellant, 10% owned by Ms. McLendon, and 50% owned by Ronald Coley, who is unrelated to the McLendons. The Area Office found Concordia Allied affiliated with Appellant, based on identity of interest and common ownership.

Mr. McLendon is Chairman and 22.53% owner of Concordia, LLC (Concordia). Ms. McLendon has a 3.37% interest in Concordia. None of the remaining 40 members has a share as large as 9%, and many own less than 1%. The Area Office found Concordia affiliated with Appellant.

My Downtown Bistro, LLC (Downtown) is 51% owned by Appellant and 49% owned by Matthew Beard. Appellant has stated this restaurant is out of business, but its most recent tax return is not identified as final. The Area Office found Appellant affiliated with Downtown.

Mr. McLendon is President and 50% owner of MAI Auto Sales, Inc., dba Yourway Auto Sales (MAI). Tony Leahy owns 35% and Dwight Kulbe owns 15% of MAI. The Area Office found Appellant affiliated with MAI.

The Area Office determined Appellant's size as of the date of its HUBZone application, and the date of its certification. 13 C.F.R. §§ 126.203(a); 121.404(b). Appellant submitted its application on June 14, 2010. The Area Office chose October 27, 2010, the date of its receipt of the size determination request, as the date of certification.¹ The Area Office thus used Appellant's three most recent completed fiscal years, 2007, 2008, and 2009 to determine its size. After reviewing the annual receipts of Appellant and its affiliates, the Area Office determined Appellant was other than small under both the \$750,000 and \$7 million size standards.

D. The Appeal

On December 10, 2010, Appellant received the Size Determination. On January 7, 2011, Appellant filed the instant appeal.

Appellant asserts that 58% of its receipts are generated through Support Activities for Agriculture (NAICS Subsector 115). Appellant asserts it is not a producer of agricultural commodities, and submits a letter from its accountant and spreadsheets to support that assertion. Appellant also asserts that it derives 35% of its receipts from warehousing and storage, under NAICS code 493190 (Other Warehousing and Storage); 5% from construction (NAICS code 236220, Commercial and Institutional Building Construction), and 2% from trucking (NAICS code 484110, General Freight Trucking, Local). Appellant does not explicitly ask to be classified under a different NAICS code and size standard than those designated by the Area Office.

Appellant argues that it does not control those concerns (RR Emergency, Concordia Allied, MAI) in which Appellant or the McLendons have only a 50% interest, because a 50% interest is not a majority. Appellant further argues that Mr. McLendon has only a minority interest in Concordia, and thus does not control it. Appellant further asserts it is not affiliated with Bullneck Barn, because Mr. McLendon has no interest in or control over it.

¹ The Area Office erred in selecting the date of its receipt of the request for the size determination as the date of certification. *See Size Appeal of Innovative Construction & Management Services, LLC*, SBA No. SIZ-5202, at 7-8 (2011). Here, however, this is harmless error, as it does not alter the three fiscal years used to determine Appellant's size.

Appellant further asserts that Downtown is no longer open. Appellant appears to argue that Downtown should be treated as a former affiliate, and not included in determining Appellant's size.

Appellant asserts that while Mr. McLendon made the bulk of the initial investment in Bullneck Contracting, Mr. Belk brings extensive knowledge that cannot be quantified by cash value. Appellant appears to argue that Mr. Belk should be considered to control Bullneck Contracting.

Appellant argues that all of the concerns the Area Office found it affiliated with should be treated as independent entities, and determined whether they are small or not based upon the NAICS code for the primary industry of each individual concern. Appellant asserts it is not affiliated with any of its alleged affiliates. Appellant asserts it is a small business under NAICS code 11511 [sic] Support Activities for Agriculture.

Appellant submits a December 17, 2010, letter from its accountant and spreadsheets.

IV. Discussion

A. Threshold Issues

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 Area Office's size determination only if the Administrative 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).

A review of the December 17, 2010, letter and spreadsheets submitted on appeal shows these are not new evidence but argument based on the existing record. Specifically, they are calculations of the percentages of Appellant's and its affiliates' receipts by NAICS code. As argument, they ADMITTED. *Size Appeal of Diverse Construction Group, LLC*, SBA No. SIZ-5112, at 5 (2010).

B. Merits of the Appeal

1. Appellant's Primary Industry

An applicant for SBA's HUBZone program must meet the size standard for its primary industry classification. 13 C.F.R. § 126.203(a). SBA determines a firm's primary industry by considering the distribution of receipts, employees, and the costs of doing business among the

different industries in which business operations occurred during the most recent fiscal year. 13 C.F.R. § 121.107. SBA may also consider other factors. *Id.* Among those factors are the industries identified on official filings made by the firm, and its initial designation in its application to SBA, which carries more weight than a later claim. *Size Appeal of Summit Technologies & Solutions, Inc.*, SBA No. SIZ-5132, at 6 (2010).

Here, there appears to be some confusion over the appropriate NAICS code for Appellant's primary industry. Appellant initially filed its HUBZone application under NAICS code 236220. On its Form 355, it used NAICS code 493190, Other Warehousing and Storage, but does not maintain that position on appeal. Appellant now argues that its size standard should be that of support activities for crop production, although there is no specific NAICS code 115110 so designated. The NAICS codes under Subsector 115 run from 115111, Cotton Ginning, to 115310, Support Activities for Forestry, all with corresponding \$7 million annual receipts size standards. Appellant also argues that its alleged affiliates should be judged to be small or not depending upon the NAICS code for the primary industry of each individual affiliate.

The Area Office conducted the size determination using two size standards, and for each size standard chose only the Subsector codes, 111, Crop Production, and 115, Support Activities for Agriculture and Forestry. This was error on the part of the Area Office. While the higher-level descriptions in the NAICS system, for the two-digit sector, the three-digit subsector, and the four-digit industry group designations, are helpful in understanding the meaning of a particular NAICS industry, ultimately there must be a single six-digit NAICS code which is the challenged concern's primary industry designation. *Size Appeal of Heather Farms Nursery, Inc.*, SBA No. SIZ-4931, at 9 (2008).

Only one NAICS code and one size standard represents a firm's primary industry. *Size Appeal of E & J Realty Company, Inc.*, SBA No. SIZ-4331, at 4 (1998). When a firm is in more than one business, the applicable primary industry generally is the one accounting for "the largest distinct and indivisible component of . . . revenues." *Size Appeal of Richard E. Muck*, SBA No. SIZ-2522, at 4 (1986). When, however, SBA makes a primary industry determination of a concern and its affiliates, the Agency must aggregate all the business activities of all the affiliated firms and look at the group of affiliates as a whole. *Size Appeal of Compton Irrigation, Inc.*, SBA No. SIZ-2408, at 6 (1986). "With respect to firms that are affiliated, the term 'primary industry' means the work that accounts for the greatest percentage of the aggregated receipts of those affiliates." *Size Appeal of Sargent Pipe Company, Inc.*, SBA No. SIZ-2691, at 3 (1987).

Size Appeal of Group O, Inc., SBA No. SIZ-4441, at 5 (2001) (internal footnote omitted).

The Area Office erred in conducting the Size Determination using two size standards and two NAICS subsector codes. When performing a size determination not related to a procurement that requires a designation of the challenged concern's primary industry, an area office must make that designation by considering the work that accounts for the greatest percentage of the receipts for the challenged concern and all its affiliates, then designate one six-digit NAICS code and corresponding size standard as the concern's primary industry. The Area

Office failed to do this here, and that was clear error. This error requires that I remand this case for a new determination, which designates the appropriate NAICS code for the primary industry of Appellant and all its affiliates.

2. Appellant's Affiliates

Appellant also disputes the Area Office's findings of affiliation.

SBA's size regulations provide that concerns are affiliates when one controls or has the power to control the other or a third party controls or has the power to control both. 13 C.F.R. § 121.103(a)(1). Concerns can be affiliated through common ownership, common management, or both. 13 C.F.R. § 121.103(a)(2). Affiliation may arise among two or more persons with an identity of interest, such as family members, who may be treated as one party with their interests aggregated. 13 C.F.R. § 121.103(f).

Appellant argues that its interests and those of Mr. McLendon must be considered separate from those of Ms. McLendon, but this position is without merit.

This Office's long-standing precedent is that 13 C.F.R. § 121.103(f) creates "a rebuttable presumption that family members have identical interests and must be treated as one person, unless the family members are estranged or not involved with each other's business transactions." *Size Appeal of Jenn-Kans, Inc.*, SBA No. SIZ-5114, at 7 (2010). The presumption arises not from active involvement in each other's business affairs, but from the family relationship itself. *Id.* A challenged concern may rebut the presumption of affiliation based upon family relationship if it is able to demonstrate a clear line of fracture among the family members. *Id.* There must be no business relationship or involvement between the family members for a protested concern to prove clear fracture. *Size Appeal of Speegle Construction, Inc.*, SBA No. SIZ-5147, at 8 (2010); *Size Appeal of Osirus, Inc.*, SBA No. SIZ-4546, at 5 (2003).

Size Appeal of Allied Safety and Environmental Distributing, Inc., SBA No. SIZ-5209, at 4 (2011).

Here, while Ms. McLendon has no direct ownership interest in Appellant, she serves as its Secretary/Treasurer and owns shares of both Concordia and Concordia Allied with Mr. McLendon. Mr. and Ms. McLendon clearly engage in business together and there is no clear fracture between their business interests. Accordingly, the Area Office correctly treated the McLendons as one party with their interests aggregated.

Appellant also argues that 50% ownership is not sufficient for a finding of control. Again, this position is meritless. SBA's size regulations provide that a person or entity who owns or controls 50% or more of a concern's voting stock controls that concern. 13 C.F.R. § 121.103(c)(1). The regulation thus treats an ownership interest of 50% as a controlling interest, contrary to Appellant's argument.

It is therefore clear that, treating Mr. and Ms. McLendon as one party with the interests aggregated, they own the controlling interest in Appellant, RR Emergency, Bullneck Barn, Concordia Allied, Downtown and MAI, and that all these concerns are thus affiliated with Appellant through common ownership. Information in the record identifying Mr. McLendon as President of Concordia Allied and MAI also affiliates Appellant with them through common management. 13 C.F.R. § 121.103(e).

The size regulations further provide that a person or entity who owns or controls a block of stock which is large compared to other outstanding blocks of stock, controls or has the power to control the concern. 13 C.F.R. § 121.103(c)(1). Under this single largest minority shareholder rule, the McLendons' aggregated 25.9% interest in Concordia, when none of the other 40 members has a share as large as 9%, establishes the McLendons' control over Concordia. *Size Appeal of SIGA Technologies, Inc.*, SBA No. SIZ-5201, at 12-13 (2011). Concordia and Appellant are thus affiliated through common ownership. Mr. McLendon's position as Chairman also establishes affiliation between Concordia and Appellant through common management. 13 C.F.R. § 121.103(e).

While Appellant does not have a majority share in Bullneck Contracting, the Area Office properly notes that the BC Operating Agreement vests management of the company in the members not in proportion to the size of their membership interests, but in proportion to their initial capital contributions. BC Operating Agreement, § 3.1(a). Appellant's contribution is more than twenty three times as large as Mr. Belk's. Accordingly, the Area Office properly found that under the Operating Agreement, Appellant has the power to control Bullneck Contracting. The Area Office also found negative control in Appellant's ability as a minority shareholder to block certain actions. BC Operating Agreement, § 3.2(a). However, most of these, except for the borrowing of money, come under the category of limitations on actions for the protection of investors, and thus are not indicia of affiliation. *Size Appeal of EA Engineering, Science, and Technology, Inc.*, SBA No. SIZ-4973, at 9-10 (2008). Further, the fact that Bullneck Contracting has a similar name to Bullneck Barn also is no indicia of affiliation, as many firms may have similar names. Nevertheless, the provisions of the BC Operating Agreement clearly give Appellant management control over Bullneck Contracting. Further, Appellant does not really dispute this in its appeal, merely referring to Mr. Belk's intangible contributions, when the Operating Agreement vests control based on initial capital contributions. Appellant has the power to control, and is thus affiliated with, Bullneck Contracting.

Appellant argues that Downtown is out of business, and that it should therefore not be counted in determining Appellant's size. A concern's former affiliates are excluded from the size determination if the affiliation ceased before the date for determining size. 13 C.F.R. § 121.104(d)(4). However, SBA has insisted on some formal documentation of a concern's dissolution before excluded it as a former affiliate. *Size Appeal of Hallmark-Phoenix 8, LLC*, SBA No. SIZ-5046, at 4 (2009). It was therefore not clear error for the Area Office to include this concern in the calculation of Appellant's receipts, absent firmer documentation of its dissolution.

I therefore conclude that the Area Office properly found Appellant affiliated with RR Emergency, Bullneck Barn, Bullneck Contracting, Concordia Allied, Concordia, Downtown, and

MAI. I also find no error in the Area Office's calculation of Appellant's annual receipts. However, the Area Office failed to properly designate Appellant's primary industry. The primary industry must be designated by considering the work that accounts for the greatest percentage of the receipts for the challenged concern and all its affiliates, then designate one six-digit NAICS code and corresponding size standard as the concern's primary industry. The Area Office failed to do this here, and that was clear error. As noted above, this requires that I remand this case for a new size determination, which designates the appropriate NAICS code for the primary industry of Appellant and all its affiliates. Once that has been done, Appellant's annual receipts must be compared to that standard to determine whether Appellant is small.

III. Conclusion

For the foregoing reasons, I AFFIRM the Size Determination in part, as to the findings of affiliation, and REVERSE in part, as to the failure to properly designate Appellant's primary industry. I REMAND this case to the Area Office for a new size determination, consistent with this decision.

CHRISTOPHER HOLLEMAN
Administrative Judge