United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: The Associated Construction Co., Appellant, Appealed From Size Determination No. 1-2-11-63	SBA NO. SIZ-5314 Decided: December 28, 2011

APPEARANCES

J. Randolph MacPherson, Esq., and Rebecca Bailey Jacobsen, Esq., Halloran & Sage LLP, Washington, D.C., for Appellant

Amanda L. Sisley, Esq., and Mark E. Block, Esq., Block, Janney & Pascal LLC, Norwich, Connecticut, for The Nutmeg Companies, Inc.

DECISION

I. Introduction & Jurisdiction

On October 18, 2011, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area I (Area Office) issued Size Determination No. 1-2011-63 finding The Associated Construction Company (Appellant) other than small. On November 4, 2011, Appellant appealed the size determination, claiming it contains clear errors. For the reasons discussed below, the appeal is denied, and the size determination is affirmed.

SBA's 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. The record reflects that Appellant received the size determination on October 21, 2011. Appellant filed the instant appeal within fifteen days of receiving the size determination, so the appeal is timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Solicitation and Protest

On July 15, 2011, the U.S. Department of the Army, National Guard Bureau issued Solicitation No. W912LD-11-R-0002 (RFP) for construction of an office/warehouse facility at Camp Fogarty in East Greenwich, Rhode Island. The

Contracting Officer (CO) set aside the procurement entirely for small businesses and designated North American Industry Classification System (NAICS) code 236220, Commercial and Institutional Building Construction, with a corresponding size standard of $33.5 million in average annual receipts. Appellant self-certified as a small business on August 25, 2011, when the firm submitted its offer.

On September 26, 2011, offerors were notified that Appellant was the apparent successful offeror. On September 29, 2011, The Nutmeg Companies, Inc. (Nutmeg), a disappointed offeror, filed a protest challenging Appellant's size based on Appellant's alleged affiliation with other entities.

B. Size Determination

On October 18, 2011, the Area Office issued its size determination. Appellant acknowledged that it is affiliated with Ten-Ten Holding Corporation, The Marshall Realty Corporation, and Deep River Realty Corporation based upon common ownership. Appellant informed the Area Office that, according to Appellant's calculations, the average annual receipts of Appellant and its affiliates were below the applicable size standard. However, the Area Office noted that, in reaching this conclusion, Appellant excluded various transactions, including rent paid to affiliates, intercompany commissions, and "interdivision labor charges."

The Area Office determined that interdivision labor charges should not be excluded from Appellant's receipts. Specifically, the Area Office explained that those charges did not meet the exclusion requirements set forth in 13 C.F.R. § 121.104 because they "are not between affiliates which are separate or distinct legal entities, but are debit and credit account items within [Appellant] itself." (Size Determination 2.) The Area Office rejected Appellant's argument that these amounts should be excluded because they were erroneously reported as revenue on Appellant's 2008 and 2009 tax returns. Instead, the Area Office emphasized that it must rely on Appellant's tax returns in calculating the firm's receipts. 13 C.F.R. § 121.104(a)(1). The Area Office concluded that once the interdivision labor charges are included in Appellant's average annual receipts, Appellant exceeds the size standard.

The Area Office also considered that Appellant's other proposed exclusions — the rent paid to affiliates and intercompany commissions — were likely not excludable because Appellant and its affiliates could not file a consolidated tax return and, therefore, there was no potential for double-counting those receipts. *See* 69 Fed. Reg. 29,192, 29,197 (May 21, 2004); *Size Appeal of Columbus Techs. and Servs., Inc.*, SBA No. SIZ-4831 (2007). However, because the interdivision labor charges definitely were not excludable, the Area Office determined that Appellant is other than small under the $33.5 million size standard.

C. Appeal Petition

On November 4, 2011, Appellant filed the instant appeal claiming that the size

determination is procedurally defective, and that the Area Office incorrectly calculated Appellant's annual receipts.

Appellant first argues that the size determination is inadequate because it does not include the Area Office's specific calculation of Appellant's receipts. Nor does it contain an explanation of precisely what amounts were included and excluded. Appellant thus contends that, at a minimum, the size determination should be remanded so the Area Office can properly and thoroughly explain its calculation of Appellant's receipts.

Appellant next asserts that the Area Office improperly failed to exclude the interdivision labor charges, which are transactions between itself and its field labor division. Appellant argue the field labor division is Appellant's affiliate, and the amounts must be excluded to avoid double-counting. Appellant explains that, pursuant to 13 C.F.R. § 121.103, Appellant is affiliated with its field labor division because they have common management and an identity of interest. Appellant argues the regulation does not require that affiliates be separate legal entities. Appellant emphasizes that SBA's purpose in allowing the exclusion of inter-affiliate transaction is to prevent receipts from being double-counted, and Appellant maintains that this rationale applies equally to Appellant's transactions with its field labor division. *See Size Appeal of Crown Moving and Storage Co. d/b/a Crown Worldwide Moving and Storage*, SBA No. SIZ-4872 (2007).

Appellant explains that when it performs a job for a customer, payments are reported in two accounts: “contract revenues” and “revenue accrued,” which are both reported as gross receipts or sales (Line 1) on Appellant's tax returns. Appellant further explains that because it performs many cost-plus contracts, the field labor division was established, and the labor charges incurred are debited from the “labor” account and credited to the “field labor billed to cost of goods sold” account. It is these transactions that Appellant proposed to exclude as interdivision labor charges. Appellant submits that these amounts are duplicative of charges already include in the “contract revenues” and “revenue accrued” accounts and should be excluded from Appellant's receipts. Appellant acknowledges that the interdivision labor charges it seeks to exclude were included in Appellant's 2008 and 2009 tax returns in “cost of goods sold” (Line 2 Appellant contends, however, that the 2008 and 2009 tax returns were in error, and that Appellant corrected the mistake in its 2010 return. Appellant also argues the inclusion of these amounts would improperly treat as “receipts” revenues that were never received from any customer.

Appellant also asserts that the Area Office erred in not excluding intercompany commissions and intercompany rents from Appellant's receipts. Appellant contends that SBA deleted from 13 C.F.R. § 121.104(a)(1) the requirement that affiliates must file consolidated tax returns to be eligible to exclude proceeds from inter-affiliate transactions. Appellant also challenges the Area Office's reliance on *Columbus Techs.*, SIZ-4831, because, according to Appellant, the case does not support the proposition that a consolidated tax return is necessary to apply the inter-affiliate transaction exclusion. Instead, Appellant claims the intercompany commissions and intercompany rents must be

excluded to avoid double-counting.

Finally, Appellant provides its own calculation of its average annual receipts. Excluding amounts for interdivision labor charges, intercompany commissions, and intercompany rents, Appellant claims its receipts fall within the applicable $33.5 million size standard. On these grounds, Appellant requests that OHA reverse the size determination.

D. Nutmeg Response

On November 22, 2011, Nutmeg filed its response to the appeal petition. Nutmeg disputes Appellant's claim that the size determination is procedurally defective. Nutmeg asserts that the size determination contains sufficient detail for OHA to perform an evaluation because it clearly articulates the basis for the Area Office's calculations: Appellant's tax returns without the requested exclusions. Nutmeg contends that the Area Office amply explained its rationale for rejecting the exclusions, and that the size determination is reviewable.

Nutmeg also argues the Area Office made no error in refusing to exclude the interdivision labor charges. Nutmeg relies on *Size Appeal of Blaine Larsen Farms, Inc.*, SBA No. SIZ-4742 (2005), where OHA stated that "a division or line of business within a protested concern is not an affiliate under 13 C.F.R. §§ 121.101 through 121.108." *Blaine Larsen*, SIZ-4742, at 9; *see also Size Appeal of United Coupon Clearing House*, SBA No. SIZ-3359 (1990); *Size Appeal of Microtech Indus., Inc.*, SBA No. SIZ-1866 (1984). Nutmeg contends that *Blaine Larsen* and similar cases support the Area Office's determination that the field labor division is not Appellant's affiliate. Moreover, claims Nutmeg, the Area Office properly relied upon Appellant's tax returns, notwithstanding Appellant's argument that the returns themselves contain incorrect information. *Size Appeal of Hal Hays Constr., Inc.*, SBA No. SIZ-5234 (2011).

Nutmeg further asserts that the Area Office properly rejected Appellant's claimed intercompany rent exclusions. Nutmeg asserts that the Area Office did not indicate that Appellant was required to file a consolidated tax return to claim such exclusions, only that Appellant and its affiliates must have been permitted to file a consolidated tax return. Furthermore, the Area Office found no evidence that the intercompany rents would result in double-counting, so Nutmeg submits that the Area Office properly concluded that the amounts are not excludable. In addition, Nutmeg argues the Area Office's refusal to exclude these amounts can be no more than harmless error because inclusion of the interdivision labor charges alone brings Appellant's receipts above the size standard. Nutmeg urges OHA to affirm the size determination.

E. Appellant's Reply

On December 2, 2011, Appellant filed a Motion to Permit Supplemental Pleading,

along with its reply to Nutmeg's response.[1] Appellant claims that the instant case is factually dissimilar to *Blaine Larsen*. In *Blaine Larsen*, the challenged firm, a farm, operated a hay terminal, which became a separate stand-alone business before the date to determine size. The farm did not count the individuals employed at the hay terminal before the separation as its own employees because it considered them to be employees of a former affiliate pursuant to 13 C.F.R. § 121.106(b)(4)(ii). Thus, *Blaine Larsen* did not deal with the calculation of receipts, and there was no consideration of 13 C.F.R. § 121.104(a). Appellant also distinguishes the facts of this case from United Coupon and *Microtech* on similar grounds. Appellant reiterates its position that interdivision labor charges, intercompany commissions, and intercompany rents should be excluded because inclusion would result in double-counting.

III. Discussion

A. Standard of Review

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 upon a clear error of fact or law. 13 C.F.R. § 134.314. OHA will disturb the Area Office's size determination only if, after reviewing the record, the administrative judge has a definite and firm conviction that 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. Analysis

Appellant first complains that the Area Office failed to document its specific calculations in the size determination. It is, however, routine practice for a size determination to omit such information. "The reason for this is that the size determination is provided to the protestors, and to include the figures from a challenged firm's tax return would disclose confidential financial information to competitors." *Size Appeals of SETA Support Servs. Alliance, LLC, et al.*, SBA No. SIZ-5101, at 6 (2009), *recons. dismissed*, SBA No. SIZ-5111 (2010) (PFR). As Appellant points out, the complete record must contain sufficient detail so that OHA may ascertain whether there is any material error of fact or law. *Size Appeal of Innovative Resources*, SBA No. SIZ-5231, at 2 (2011); *Size Appeal of PMTech, Inc.*, SBA No. SIZ-5142, at 5-6 (2010). Here, the size determination explains that the Area Office based its calculation upon Appellant's tax returns, and sets forth the Area Office's rationale for refusing to exclude the interdivision labor charges from Appellant's receipts. Additionally, documents elsewhere in the record reflect the Area Office's calculations. I therefore find that the size determination is not procedurally defective.

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[1] Because the reply does not enlarge the issues, but seeks only to respond briefly to Nutmeg's legal arguments, I GRANT Appellant's motion and ADMIT the reply into the record. *See, e.g., Size Appeal of Spiral Solutions and Techs., Inc.*, SBA No. SIZ-5279, at 15 (2011).

I turn next to the issue of whether the Area Office erred in determining that the interdivision labor charges are not excludable. SBA regulation pertinently provides that:

> Receipts do not include ... proceeds from transactions between a concern and its domestic or foreign affiliates .... For size determination purposes, the only exclusions from receipts are those specifically provided for in this paragraph. All other items ... may not be excluded from receipts.

13 C.F.R. § 121.104(a). Appellant contends that its field labor division is an affiliate within the meaning of this regulation, and that transactions between Appellant and the field labor division should be excluded from Appellant's receipts. The Area Office determined that Appellant and its field labor division are not affiliates because they are not separate legal entities. Accordingly, the Area Office concluded that these amounts are not excludable as inter-affiliate transactions. Nutmeg supports the Area Office's conclusion, citing *Size Appeal of Blaine Larsen Farms, Inc.*, SBA No. SIZ-4742 (2005).

I agree with the Area Office and Nutmeg that Appellant and its field labor division are not affiliates. Under 13 C.F.R. § 121.103(a)(1), "[c]oncerns or entities are affiliates of each other when one controls or has the power to control the other." Here, it is undisputed that Appellant controls its field labor division. Nevertheless, the field labor division alone cannot be characterized as a "concern" or an "entity." 13 C.F.R. § 121.105, which defines "concern," provides that "[a] business concern may be in the legal form of an individual proprietorship, partnership, limited liability company, corporation, joint venture, association, trust or cooperative." 13 C.F.R. § 121.105(b). Appellant's field labor division is none of these things. Nor can the field labor division be considered an "entity" separate from Appellant. Legally, the field labor division is simply part of Appellant itself.

OHA case precedent further supports the conclusion that a company cannot be affiliated with a division of itself. Appellant contends that *Blaine Larsen* does not apply here because the facts of that case are too dissimilar to the facts of this case. However, OHA has held in multiple contexts that a division of a company cannot be considered that company's affiliate. In *Blaine Larsen* (and *United Coupon* and *Microtech*), OHA considered the issue in the context of the former affiliate rule and determined that a division cannot be a former affiliate. In *Size Appeal of Fiore Industries*, SBA No. SIZ-3401 (1991), OHA cited *United Coupon* and *Microtech* in determining that a division cannot be an affiliate for purposes of the newly-organized concern rule. In *Size Appeal of Elk Rapids Packing Co.*, SBA No. SIZ-2037 (1984), the challenged firm acknowledged that it was a division of another concern, and OHA opined that "[the challenged firm] is a wholly owned subsidiary of [the parent company] and is considered a part of [the parent company], not its affiliate." *Elk Rapids*, SIZ-2037, at 9. Accordingly, I find that the Area Office made no error in determining that Appellant's field labor

division is not affiliated with Appellant.[2]

Because 13 C.F.R. § 121.104(a) expressly provides that "the only exclusions from receipts are those specifically provided for in this paragraph," and Appellant makes no argument that any exclusion other than the inter-affiliate exclusion applies to its interdivision labor receipts, I also conclude the Area Office made no error in refusing to exclude those receipts. Appellant maintains that those receipts were double-counted, which is the rationale underlying the exclusions contained in 13 C.F.R. § 121.104(a), so they must be excluded. Unfortunately for Appellant, there is no general "catch-all" exclusion for double-counting in the regulation, and Appellant's interdivision labor receipts do not fall within any of the articulated exclusions. Accordingly, by the terms of the regulation itself, Appellant's interdivision labor receipts are not excludable.

Furthermore, the Area Office properly complied with the applicable regulation, which requires the Area Office to calculate a firm's receipts based upon the information in the firm's tax returns. 13 C.F.R. § 121.104(a)(1) ("The Federal income tax return and any amendments filed with the IRS on or before the date of self-certification must be used to determine the size status of a concern."). Appellant contends that its 2008 and 2009 tax returns are incorrect because they too erroneously double-count the interdivision labor receipts. OHA has explained, however, that:

> [T]he only exception for not basing a determination of annual receipts upon tax returns is when a concern has not filed a federal income tax return with the IRS for the fiscal year which must be included in the period of measurement .... Beyond the lack of authority to consider evidence contradicting tax returns and the mandate of 13 C.F.R. § 121.104(a)(1) that they must be used, it would also be problematic (even chaotic) for SBA to permit protested concerns to impeach their own tax

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[2] In a footnote, Appellant asserts that:

> [T]here are numerous forms of business relationships which do not involve 'separate and distinct legal entities' and ... it is inconsistent for the SBA to apply the concept of affiliation to cover 'all possible business relationships' for purposes of determining affiliation but then seek to constrain affiliation to 'separate and distinct legal entities' for purposes of the exclusion of proceeds from transactions with affiliates per [13 C.F.R.] § 121.104(a), particularly when there is no reference in the regulations to such a limitation.

(Reply 6 n.2.) Appellant's argument is specious. The field labor division is not Appellant's affiliate; it is part of Appellant itself. There can be no "business relationship" between an entity and itself. Similarly, the field labor division's receipts are Appellant's own receipts. There could be no finding of affiliation between Appellant and its own field labor division for purposes of either 13 C.F.R. § 121.103 or § 121.104(a).

> returns. I also note that if [the challenged firm] were to prevail on its argument that information outside of tax returns should be considered by area offices, this would defeat the entire purpose of requiring decisions to be based upon tax returns, which is to ensure standardization and uniformity in the size evaluation process by relying on tax returns submitted to the IRS under well-understood rules and the penalty of perjury.

Size Appeal of Thomas Computer Solutions, LLC, SBA No. SIZ-4841, at 8 (2007); *see also Size Appeal of Hal Hays Constr., Inc.*, SBA No. SIZ-5234, at 8, 11 (2011) (finding that an area office must calculate a firm's size based upon the firm's tax returns filed before self-certification, pursuant to 13 C.F.R. § 121.104(a)(1)); *Size Appeal of Judson Builders, Inc.*, SBA No. SIZ-5144, at 3 (2010) (affirming an area office's decision to calculate a firm's size based upon the firm's original tax returns where the firm had filed amended returns after initiation of the size determination); *Size Appeal of J. M. Waller Assocs., Inc.*, SBA No. SIZ-5108, at 4 (2010) (rejecting the challenged firm's argument that SBA must consider extrinsic evidence beyond the tax returns when calculating a firm's receipts). Thus, the Area Office did not err in basing its calculations on the amounts reported on Appellant's tax returns, notwithstanding Appellant's contention that the tax returns are incorrect.[3]

Because the inclusion of Appellant's interdivision labor receipts renders Appellant's average annual receipts above the applicable size standard, I need not consider whether Appellant's other alleged exclusions—the inter-affiliate rents and inter-affiliate commissions—were proper. Instead, I conclude that the Area Office properly found that Appellant is other than a small firm for this procurement and any procurement employing a size standard of $33.5 million or smaller.

IV. Conclusion

Appellant has not demonstrated that the size determination is clearly erroneous. I therefore DENY this appeal and AFFIRM the Area Office's size determination. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(d).

KENNETH M. HYDE
Administrative Judge

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[3] In years past, SBA regulation provided that "[w]here other information gives SBA reason to regard Federal Income Tax returns as false, SBA may base its size determination on such other information." 13 C.F.R. § 121.104(c) (2004). That regulation, however, has since been rescinded and is not at issue here. *Thomas Computer Solutions*, SIZ-4841, at 6-7.