United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Wear Mark, Inc. d/b/a All Seasons Apparel, Appellant, RE: A2Z Promo Zone Appealed From Size Determination Nos. 5-2012-061, -062	SBA No. SIZ-5397 Decided: September 12, 2012

APPEARANCES

Ruth E. Ganister, Esq., Rosenthal and Ganister LLC, West Chester, Pennsylvania, for Appellant

James DelSordo, Esq., Argus Legal, LLC, Manassas, Virginia, for A2Z Promo Group

DECISION

I. Introduction and Jurisdiction

On July 16, 2012, the SBA Office of Government Contracting, Area V (Area Office) issued Size Determination Nos. 5-2012-061 and -062, finding that A2Z Promo [Zone] (A2Z) is a small business under the size standard associated with Solicitation No. VA798S-12-R-0001.

Wear Mark, Inc. (Appellant) maintains that the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse, and determine that Appellant is a small business. For the reasons discussed *infra*, the appeal is denied and the size determination is affirmed.

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 the size determination was issued April 20, 2012, but not received by Appellant until April 24, 2012. 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 Protests

On February 17, 2011, the U.S. Department of Veteran Affairs, Strategic Acquisition Center issued Solicitation No. VA798S-12-R-0001 (RFP) for the purchase of interment flags. The Contracting Officer (CO) set aside the procurement exclusively for Service-Disabled Veteran-Owned Small Businesses (SDVOSB) and assigned North American Industry Classification System (NAICS) code 314999, All Other Miscellaneous Textile Product Mills, with a corresponding size standard of 500 employees. A2Z submitted its initial offer on March 2, 2012, the date proposals were due.

On April 12, 2012, the CO notified unsuccessful offerors that A2Z was the apparent awardee. VE Source and Appellant protested the award, alleging among other things that A2Z does not qualify as a nonmanufacturer. On May 15, 2012, the Area Office issued Size Determination Nos. 05-2012-043 and -045, finding that A2Z did not meet the "ownership or possession" requirement of the nonmanufacturer rule, 13 C.F.R. § 121.406(b)(iii), and therefore was not a small business for the instant procurement. A2Z appealed the size determination to OHA on June 1, 2012. On June 13, 2012, SBA moved to remand the proceedings to the Area Office to permit the Area Office to render a new size determination in accordance with 13 C.F.R. § 121.406. On June 20, 2012, OHA vacated Size Determination Nos. 05-2012-043 and -045, and granted SBA's Motion to Remand. *Size Appeal of A2Z Promo Zone*, SBA No. SIZ-5365 (2012).

B. The Instant Size Determination

On July 16, 2012, the Area Office issued Size Determination Nos. 5-2012-061 and -062, finding that A2Z did in fact satisfy the "ownership or possession" requirement of the nonmanufacturer rule, and therefore was a small business for the instant procurement.[1] In reaching this determination, the Area Office noted A2Z would place an order with Allied Materials & Equipment Company (Allied) for the flags, and Allied's carriers would transport the flags to Allied's loading dock in Kansas City. Allied represented its "performance obligation extends up to, and including, packaging of completed end items for delivery. At that point A2Z is obligated to arrange for product pick up at [Allied's] loading dock, at which point title and risk of loss passes to A2Z." Size Determination Nos. 5-2012-061 and -062 at 6. A2Z stated this process is current industry standard. The Area Office reviewed Allied's IRS Form 941 and SBA Form 355 and concluded that Allied was a small business.

C. Appeal

On August 3, 2012, Appellant filed its appeal of Size Determination Nos. 5-2012-061 and

[1] The Area Office also determined (1) no evidence suggested A2Z was affiliated with A2Z Supply Corp, and (2) Allied Materials & Equipment Company was not A2Z's ostensible subcontractor, because the procurement was for supplies.

-062 with OHA. Appellant maintains that the size determination is clearly erroneous and should be reversed.

Appellant argues the Area Office erred in determining A2Z qualified as a small business under the nonmanufacturer rule. According to Appellant, A2Z does not take free and clear ownership of the flags, as they are encumbered by a carrier lien. As a result, the common carrier may refuse to deliver the flags or sell them to satisfy a debt resulting from A2Z's failure to pay. See Uniform Bills of Lading Act, 49 U.S.C. §§ 80101 *et. seq.*, and 13707(a).

Appellant argues further that A2Z does not take ownership with its own personnel, equipment, and facilities, as the regulation requires. A2Z does not own or lease the trucks used to transport the flags, but will hire a carrier service.

Appellant argues Allied approached A2Z and other prospective SDVOSB offerors with its package of teaming agreement, subcontract agreement, and contract proceeds assignment. According to Appellant, Allied prepared the offer and designated the common carriers. In addition to making the flags, Allied would extend any credit necessary to make them and perform all manufacturing, inspection, quality control, packing, labeling, and preparation for shipping. Appellant also asserts that A2Z's choice of counsel indicates affiliation with Allied.

Appellant goes on to argue that A2Z does not normally sell interment flags, as 13 C.F.R. § 121.406(b)(1)(ii) requires.

D. Response

On August 21, 2012, A2Z filed its response to the appeal. A2Z maintains OHA should uphold Size Determination Nos. 5-2012-061 and -062 because the size determinations are not based upon a clear error of law or fact.

A2Z contends the Area Office correctly interpreted the nonmanufacturing rule's requirement that the nonmanufacturer "[t]ake[] ownership or possession of the item(s) with its personnel, equipment, or facilities in a manner consistent with industry practice." 13 C.F.R. § 121.406(b)(iii). The Area Office's interpretation that a manufacturer who does not take possession of the goods need only take "ownership of the goods consistent with industry practice," is based on a plain reading of the rule and is consistent with SBA's intent. In promulgating this final rule:

> SBA first notes that the proposed rule did not require a small business nonmanufacturer to take possession of the supply items in every case. It required that the nonmanufacturer take ownership *or* possession. If the nonmanufacturer arranged for transportation of the supply items (*e.g.*, it uses trucks it owns or leases to transport the items to the final destination), then it need not take ownership of the supply items. *If it does not arrange for the transportation, then it must at least take ownership of the supply items. SBA recognizes the validity of small business dealers and does not seek to harm legitimate small business dealers*. SBA continues to believe, however, that the ownership or possession

> requirement provides a necessary safeguard to abuse. A multimillion dollar supply contract in which a large business manufacturer provides the supply items directly to the Government procuring agency and the small business nonmanufacturer provides nothing more than its status as a small business does not foster small business development.

76 Fed. Reg. 8222, 8226 (Feb. 2011) (emphasis added). In A2Z's view, Appellant's interpretation that nonmanufacturers must "take ownership with equipment, personnel, or facilities" inhibits small business retailers from competing for prime contracts and therefore contravenes SBA's intent.

A2Z further argues this regulatory history demonstrates that SBA intended ""ownership" and "possession" to be two distinct concepts. Their placement in the regulation provides two independent means of satisfying § 121.406(b)(iii). A2Z argues that Appellant's interpretation vitiates the plain meaning of § 121.406(b)(iii), because the regulation is disjunctive. In A2Z's view, when SBA provided that a nonmanufacturer could satisfy § 121.406(b)(iii) by taking possession, SBA intended for the nonmanufacturer to take actual possession, and not constructive possession. Because the regulation is disjunctive, a small business concern need not take both ownership and actual possession of the supply items to meet the requirements of the nonmanufacturer rule. If the concern takes ownership of the supply items, that is sufficient to meet the requirements of the regulation.

A2Z argues the interpretation offered by Appellant is inconsistent with rules of property and commercial law. Property law only requires the exchange of consideration and the passage of title and risk of loss to establish ownership. Physical activity involving personnel or equipment is not necessary. Moreover, the Uniform Commercial Code (UCC) does not require a new owner to possess the goods in question for title to pass. UCC § 2-401 ("title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.").

A2Z then castigates Appellant's assertion that "A2Z will do nothing affirmatively toward the supply and delivery of the items to be produced." In A2Z's view, this argument rests on facts that are irrelevant to the enumerated requirements of the nonmanufacturer rule.

A2Z contends it offers much more to the procurement than its small business status. A2Z argues it excels at marketing, selling, and interfacing with customers, skills that a manufacturer may lack. A2Z goes on to argue it has ample experience as a government supplier, and it operates in NAICS codes 423840, Industrial Supplies Merchant Wholesalers, and 314999, Miscellaneous Textile Product Mills.

Contrary to Appellant's assertion, A2Z argues that ownership encumbered by a carrier lien still satisfies § 121.406(b)(iii). Carrier liens arise as a matter of law. UCC § 3-307. Under this lien, the carrier-lienor may not sell the encumbered property, unless the seller (lienee) refuses to pay the carrier for transportation costs and the carrier satisfies certain notice requirements. *See* UCC § 3-307; 49 U.S.C. § 80109 et seq. Should SBA interpret the nonmanufacturer rule so as to exclude titles encumbered by carrier liens, SBA would essentially

prohibit nonmanufacturers from using common carriers. As a result, nonmanufacturers would have to take possession of the goods being sold. In A2Z's view, such a result is contrary to the plain meaning of § 121.406(b)(1)(iii), which allows nonmanufacturers to take either ownership or possession. This result would also increase costs to dealers, foreclosing some from contracting with the Government.

A2Z argues it has proven sufficiently that title will transfer from Allied to A2Z at the loading docks. Allied and A2Z both submitted sworn statements representing as much. In addition, argues A2Z, if the Veterans Administration (VA) rejects a delivery, A2Z will be responsible for curing the defect. A2Z contends Appellant insists unreasonably that A2Z and Allied enter into a subcontracting agreement before award. Customarily, subcontracting agreements are not executed until after the contract has been awarded, so as to economize on proposal costs.

A2Z then argues its method for taking ownership is consistent with industry practice, but acknowledges Appellant made no argument to the contrary. Federal courts have recognized title shifting by drop shipments as part of the normal course of dealer sales. *See In re Valley Media, Inc.*, 226 F. App'x 120, 121 (3d Cir. 2007); *United States v. Dentsply Int'l, Inc.*, Nos. Civ. A. 99-005-SLR, 99-255-SLR, 99-854-SLR, 2001 WL 624807 at *11 (D. Del. Mar. 30, 2001). In addition, the U.S. Department of Defense relies on prime vendor contracts in which the prime vendor drop ships supplies to Government customers. *See e.g.* http://www.troopsupport.dla.mil/CE/mro/description.asp (last visited August 23, 2012).

As for its financing arrangements, A2Z contends Appellant makes these arguments for the first time on appeal. Response at 17 (citing Appeal at 8). Because the Area Office did not address this issue, OHA should disregard this argument. *See Size Appeal of Fort Carson Support Servs.*, SBA No. SIZ-4740 (2005).

E. Agency Response

On August 22, 2012, SBA timely intervened,[2] and filed its response to the appeal petition. SBA maintains OHA should deny the appeal because the Area Office correctly interpreted the nonmanufacturer rule.

SBA addresses Appellant's contention that OHA should disallow from bidding a concern that is "essentially only lending its name to enable a non-SDVOSB manufacturer" because allowing that firm to compete "thwarts the very purpose of the SDVOSB set aside program." SBA argues that OHA lacks jurisdiction to change VA set-aside procedures.

The Veterans Administration Acquisition Regulation (VAAR) procedures permit a recipient of an SDVOSB award to supply the product of any small business, so long as the product is made in the United States. VAAR 819.7003(d). SBA regulations permit the awardee of a SDVOSB set-aside to provide the product of a non-veteran-owned small business, but still

[2] "SBA may intervene as of right at any time in any case until 15 days after the close of record, or the issuance of a decision, whichever comes first." 13 C.F.R. § 134.210(a).

qualify as a nonmanufacturer. 13 C.F.R. § 125.15(c). Thus, the VA adopted the same procedure that SBA uses for the government-wide SDVOSB set-aside program. SBA concedes that the policy Appellant advocates would benefit service-disabled veterans economically, but argues the importance of comity overshadows that benefit.

SBA points out OHA has decided not to intrude on the VA's eligibility and status appeals processes. *See Matter of Airborne Constr. Servs.*, SBA No. VET-203 (2010); *Matter of United Med. Design Builders, LLC*, SBA No. VET-197 (2010). In this case, OHA should decide not to intrude on the VA's authority to set its own program requirements.

SBA explains it amended the nonmanufacturer rule in February 2011 to require a nonmanufacturer to take "ownership or possession" of the goods in question. *See* 13 C.F.R. § 121.406(b) (2010); 76 Fed. Reg. 8222 (Feb. 2011). From the initial promulgation of the nonmanufacturer rule in 1958 until the amendment in 2011, a small business nonmanufacturer could qualify for a small business set-aside never having touched or owned the item being procured. Small business nonmanufacturers therefore have a long history of drop shipping. SBA adds that the Small Business Act does not prohibit drop shipping, and OHA has permitted it. *Size Appeal of R.H. Whalen Co.*, SBA No. SIZ-2404 (1986); *Size Appeal of Controlled Sys.*, SBA No. SIZ-5039 (2009); *Size Appeal of Chartech, Inc.*, SBA No. SIZ-5219 (2011).

SBA then explains SBA did not intend for the recent revision to the nonmanufacturer rule to prohibit drop shipping by nonmanufacturers, only that nonmanufacturers would be required to handle items "in a manner consistent with industry practice," whether that be through ownership or control. 13 C.F.R. § 121.406(b)(1)(iii). SBA did not express intent to prohibit drop shipping. Indeed, it made plain that it "recognizes the validity of small business dealers." 76 Fed. Reg. 8222, 8226 (Feb. 2011). The SBA Administrator executed a statement that the rule "did not require a small business nonmanufacturer to take possession of the supply items in every case." *Id.*

According to SBA, Appellant's arguments reflect a misconstruction of SBA's intent. Specifically, Appellant argues that the rule now requires a nonmanufacturer to "take ownership of the items with its own personnel, equipment or facilities," and a drop shipping nonmanufacturer using a common carrier does not have "'ownership' of the goods as required by the terms of the regulations." Agency Response at 8 (citing Appeal at 3). SBA argues it did not intend this interpretation.

SBA asserts it amended the nonmanufacturer rule to address situations where small business participation is minimal because of a waiver of the nonmanufacturer rule. SBA then changed the rule to require set-aside awardees to perform like other nonmanufacturers would under industry practice.

Finally, SBA argues adopting Appellant's interpretation would impact over one million small business retailers and wholesalers while affording them no notice or opportunity to comment on the proposed restriction. Burdening small businesses with new regulations, without adequate justification, violates the policies and orders of the current administration.

Memorandum for the Heads of Executive Departments and Agencies on Regulatory Flexibility, Small Business and Job Creation, 76 Fed. Reg. 3827 (Jan. 18, 2011).[3]

III. Discussion

A. Standard of Review

Appellant has the burden of proving, by a preponderance of the evidence, all elements of the 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 an 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

When a manufacturing or supply contract is set aside for small businesses, an offeror must either be the manufacturer or producer of the end item, or must fall within certain "non-manufacturer" exceptions. 13 C.F.R. § 121.406. According to the regulation, 13 C.F.R. § 121.406 applies to procurements that have been assigned a manufacturing or supply NAICS code. 13 C.F.R. § 121.406(b)(3). In this case, the CO plainly designated a manufacturing NAICS code (314999, All Other Miscellaneous Textile Product Mills) for the instant procurement. Therefore, 13 C.F.R. § 121.406 applies.

It is undisputed that A2Z is not the manufacturer; Allied is. Therefore, A2Z must fall within "non-manufacturer" exceptions. The nonmanufacturer rule provides:

> (1) A firm may qualify as a small business concern for a requirement to provide manufactured products or other supply items as a nonmanufacturer if it:
> (i) Does not exceed 500 employees;
> (ii) Is primarily engaged in the retail or wholesale trade and normally sells the type of item being supplied;
> (iii) Takes ownership or possession of the item(s) with its personnel, equipment or facilities in a manner consistent with industry practice; and
> (iv) Will supply the end item of a small business manufacturer, processor or producer made in the United States, or obtains a waiver of such requirement pursuant to paragraph (b)(5) of this section.

13 C.F.R. § 121.406(b).

Appellant argues A2Z does not satisfy the ownership prong of 13 C.F.R. § 121.406(b)(1)(iii) because the flags are encumbered with a common carrier lien. However, the

[3] On September 4, 2012, Appellant filed a Motion for Leave to Reply, together with the reply. Because this Motion was filed nearly two weeks after the close of record, I will not consider it.

regulation only requires ownership, not unencumbered ownership. The fact that a lien may arise against the items sold to the Government does not mean that they are not owned by the seller. To hold otherwise would call into question the ownership of any item shipped by common carrier, and this cannot have been the intent of the regulation. In addition, carrier liens arise as a matter of law. UCC § 3-307. Only if the seller refuses to pay the carrier for transportation costs and the carrier satisfies certain notice requirements, may the carrier sell off the goods to satisfy the debt. *See* UCC § 3-307; 49 U.S.C. § 80109 *et seq.* The law requires the carrier to notify the seller because the seller's property is at risk. Therefore, I reject Appellant's argument and conclude a nonmanufacturer may satisfy § 121.406(b)(1)(iii) despite encumbrances on the goods in question.

The interpretation that § 121.406(b)(1)(iii) requires a nonmanufacturer to take ownership of the items with its personnel, equipment, or facilities contravenes SBA's intent in amending the regulation. The regulatory history states:

> If the nonmanufacturer arranged for transportation of the supply items (e.g., it uses trucks it owns or leases to transport the items to the final destination), then it need not take ownership of the supply items. If it does not arrange for the transportation, then it must at least take ownership of the supply items.

76 Fed. Reg. 8222, 8226 (Feb. 2011). This language demonstrates SBA contemplated a nonmanufacturer would take possession and use its facilities and equipment to do so. Alternatively, the nonmanufacturer could take ownership of the items. There is no requirement that the nonmanufacturer take ownership with its personnel, facilities, and equipment. Those requirements modify only the possession prong of the regulation. This interpretation is consistent with common sense and experience. It is difficult to imagine an instance in which a nonmanufacturer would take ownership using its personnel, facilities, and equipment without taking possession.

I agree that regulation is disjunctive, and requires the nonmanufacturer to either take ownership of the items, or take possession of them with its own personnel, equipment or facilities. Possession is a physical act, and thus requires the use of personnel, equipment or facilities. It is therefore appropriate that the regulation should enumerate these methods of taking possession. Ownership is a question of law, and one need not take physical possession to take ownership of an item, if title to the item has passed under a contract. Here, A2Z has satisfied § 121.406(b)(1)(iii) because A2Z will take ownership of the flags. The evidence shows the risk of loss shifts to A2Z at the loading docks, and Appellant has submitted no evidence to the contrary.

As SBA argues, a policy that required nonmanufacturers to take ownership using its personnel, equipment, and facilities would prohibit drop shipping. As A2Z points out, there is ample precedent that title shifts by drop shipments as part of the normal course of business. *See Valley Media, Inc.*, 226 F. App'x 120, 121; *Dentsply*, 2001 WL 624807 at *11. The preamble to the published regulations makes clear SBA never intended to prohibit drop shipping.

I therefore find that SBA made no error in concluding that A2Z had taken ownership of the flags through its contract with Allied. Accordingly, I conclude a nonmanufacturer may take

ownership of supplies if title to the supplies passes to the nonmanufacturer under a contract, even if they do not physically take possession of the supplies.

A2Z correctly notes that Appellant raised the issue of its financing for the first time on appeal, and so it cannot be considered here. *Size Appeal of Fort Carson Support Servs.*, SBA No. SIZ-4740 (2005). This is also true of Appellant's allegations concerning A2Z's counsel.

Finally, A2Z also meets the requirement that it normally sells the type of item being supplied as required by13 C.F.R. § 121.406(b)(1)(ii). A2Z's submission to the Area Office establishes that it sells flags, pennants, banners, and other such items. While they do not specify that they have sold internment flags, "the language in 13 C.F.R. § 121.406(b)(1)(ii)requiring a contractor to normally sell the type of item being supplied requires area offices to apply a rule of reason." *Size Appeal of Precision Standard*, SBA No. SIZ-4858, at 8 (2007). Here, I apply this rule of reason and conclude that because A2Z has sold flags it meets the requirement of the regulation that it normally sells the type of item being supplied in this procurement. I therefore conclude Appellant has failed to establish the Size Determination Nos. 5-2012-061 and - 062 are based upon clear error.

V. 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).

CHRISTOPHER HOLLEMAN
Administrative Judge