

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

SIZE APPEAL OF:

Stronghold Engineering, Inc.,

Appellant,

Appealed From  
Size Determination No. 6-2013-127

SBA No. SIZ-5543

Decided: March 27, 2014

APPEARANCES

Steven J. Koprince, Esq., Petefish, Immel, Heeb & Hird LLP. Lawrence, Kansas  
for Appellant

Alison M. Mueller, Esq., Agency Representative, for the U.S. Small Business  
Administration

DECISION<sup>1</sup>

I. Introduction and Jurisdiction

On October 30, 2013, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area VI (Area Office) issued Size Determination No. 6-2013-127, concluding that Stronghold Engineering, Inc. (Appellant), is not a small business.

Appellant contends the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse the size determination and find 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. 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.

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<sup>1</sup> This Decision was originally issued under the confidential treatment provision of 13 C.F.R. § 134.205. After reviewing the Decision, Appellant informed OHA it had no requested redactions. Therefore, I now issue the entire Decision for public release.

## II. Background

### A. The Protests

On September 12, 2013, Pacific Power, LLC (PPL), filed a size protest against Appellant regarding its offer on Solicitation No. W912DY-11-R-0036. The SBA Office of Government Contracting, Area VI (Area Office) issued Size Determination No. 6-2013-126, dismissing PPL's protest after determining that PPL was not an interested party and, therefore, lacked standing to protest.

On September 27, 2013, the Area Director, on reviewing Appellant's System for Award Management (SAM) listing, instituted his own size protest of Appellant's size status, under authority of 13 C.F.R. § 121.1001(b)(9). The Area Office notified Appellant that SBA questions whether Appellant, given the wide range of products and services it offered, was primarily engaged in "the generation, transmission and distribution of electric energy for sale" as required under North American Industry Classification System (NAICS) code 221118, Other Electric Power Generation, Appellant's listed NAICS code. The size standard for this NAICS code provides that a concern is small if it is primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and its total electric output for the preceding fiscal year did not exceed 4 million megawatt hours. 13 C.F.R. § 121.201, fn. 1.

In response to the notification, Appellant submitted to the Area Office its completed SBA Form 355, Federal income tax returns, its response to the protest, and other materials. Among the information in the Area Office file are the following facts:

Appellant is 51% owned by Beverly A. Bailey, and 49% owned by Scott A. Bailey (the Baileys) who are a married couple. Beverly is the sole owner of Lamb Energy, Inc. (LE). Appellant reported generating neither revenues nor megawatt hours under NAICS code 221118. Most of Appellant's revenues came from NAICS code 236210, Industrial Building Construction. Appellant stated to the Area Office that it had no revenues in its primary NAICS code, 221118. LE is a provider of renewable energy products, with a primary NAICS code of 221114, Solar Electric Power Generation, with the same size standard as 221118.

### B. The Size Determination

On October 30, 2013, the Area Office issued Size Determination No. 6-2013-127 (the size determination). The size determination determined Appellant's size as of September 27, 2013, the day the Area Director requested the size determination, pursuant to 13 C.F.R. § 121.1001(b)(9). The Area Office found that most of Appellant's revenues came from the construction of industrial buildings and facilities, and should be categorized under NAICS code 236210, Industrial Building Construction, with a corresponding \$33.5 million annual receipts size standard. The Area Office found Appellant had over \$91 million in annual receipts. Appellant had no revenues in NAICS code 221118, and so the Area Office found Appellant is not primarily engaged in the business of the generation, transmission and distribution of electric energy for sale. The Area Office thus concluded that Appellant is not a small business under NAICS code 221118.

### C. The Appeal

On November 14, 2013, Appellant filed the instant appeal. Appellant argues that energy has always been an important part of its business. The company was founded in 1991 as an electrical contractor. Its work has included rebuilding lighting systems, replacing emergency generators, upgrading city power grids, designing and building photovoltaic systems, constructing a solar power generator system, and other similar work.

Appellant recently decided to begin producing energy for sale. This is a time-consuming and costly transition. Appellant must invest an enormous amount of time and resources before any revenue can be generated. The Appeal Petition discusses in detail the lengthy and arduous process required to establish a renewable energy project, including site selection, site planning, interconnection studies land surveys, environmental studies, and a proposal to a utility.

Appellant has begun ramping up its energy business. In 2011, only a small fraction of its costs were dedicated to energy. In 2012, 42.62% of Appellant's labor costs were dedicated to energy, with a similar percentage in 2013. Appellant also devoted an increasing portion of its non-labor costs to energy, 11% in 2011, and 25% in 2012.

Appellant argues that the term “primarily engaged” should be read as synonymous with “primary industry” under 13 C.F.R. § 121.107. Thus, factors other than industry receipts should also be considered. Appellant argues that, in *Size Appeal of Doyon Properties, Inc.*, SBA No. SIZ-4838 (2007) and *Size Appeal of Tikigaq Engineering Services, LLC*, SBA No. SIZ-4842 (2007), OHA took the position that the Area Office is to consider a concern's “main purpose as a business entity” or “first occupation” in determining whether the concern was primarily engaged in the generation, transmission or distribution of electric power, and also to consider 13 C.F.R. § 121.107. Appellant, however, noted that in *Size Appeal of Hui O Aina, LLC*, SBA No. SIZ-5262 (2011), OHA concluded that a concern's receipts are determinative of whether a concern is primarily engaged in an industry.

Appellant asserts that SBA has issued regulatory guidance on the matter in the form of a preamble to a proposed regulation which would eliminate the MWh size standard. 77 Fed. Reg. 42441, 42447 (July 19, 2012). Appellant asserts the preamble to the proposed regulation would replace the term “primarily engaged” with “primary industry.” Appellant argues that SBA has clarified its interpretation of the term in a formal rulemaking, and that this interpretation should be accorded due deference, and that, therefore, OHA must consider the factors under 13 C.F.R. § 121.107 in determining whether a form is primarily engaged in the energy industry. In effect, Appellant argues that the proposed regulation mandates the overruling of *Hui O Aina*.

Appellant further asserts OHA case law interpreting the term “primarily engaged” in the context of SBA's Disaster Loan Program has treated the term as interchangeable with primary industry. *See, e.g., Size Appeal of Pugh Enterprises, LLC*, SBA No. SIZ-5194 (2011) and *Size Appeal of Frost & Sullivan*, SBA No. SIZ-4608 (2004). Appellant argues *Hui O Aina* creates an unnecessary inconsistency between energy cases and Disaster Loan cases.

Appellant further maintains that public policy supports the argument that “primarily engaged” should not be based on receipts alone, but on the broader criteria in 13 C.F.R. § 121.107. Appellant again points to the proposed rule as supporting its position that the requirement is unintentionally restrictive. A firm entering the field might expend a great deal of time, money, and effort before it generates any energy. Appellant asserts that the preamble to the proposed rule, which expressed SBA's concern that the current requirement may have adversely affected small businesses, supports its contention that the current interpretation of the regulation unfairly penalizes small business. Appellant argues the current rule creates an unwinnable “chicken and egg” situation, where a concern cannot generate revenues from Federal set-aside contracts until it is primarily engaged in the energy industry, but cannot be considered “primarily engaged” unless it is already generating the bulk of its receipts in energy. This no-win situation unfairly penalizes start-ups, contrary to the principles expressed in *Size Appeal of Argus & Black, Inc.*, SBA No. SIZ-5204 (2011).

Finally, Appellant argues the Area Office failed to consider Appellant's distribution of employees and costs as required by 13 C.F.R. § 121.107. This consideration would have demonstrated Appellant is dedicating a substantial portion of its resources to the developing its energy business.

#### D. Agency Response

The Agency filed comments on this matter, in response to my Order requesting them. SBA noted that it added Footnote 1 to the regulation in 2000. SBA asserted that it was establishing the rule because a business not primarily engaged in the generation, transmission and/or distribution of electric energy, but that could perform a contract for such utilities, was not a small business.

SBA notes that OHA held in *Size Appeal of Tikigaq Engineering Services, LLC*, SBA No. SIZ-4842 (2007) that “primarily engaged” means a concern's main purpose as a business entity must be to generate, transmit, and/or distribute electrical energy for sale. In *Hui O Aina* OHA held that “primarily engaged” means that the majority of the annual receipts of a concern and its affiliates, taken in the aggregate, are derived from the generation, transmission, and/or distribution of electric power.

SBA then discussed the proposed rule upon which Appellant relies. SBA stated it was considering three possible changes to the size standard (1) increasing the size standard and modifying Footnote 1; (2) adding an employee based size standard of 500 employees along with the 8 million MWh standard and eliminating Footnote 1; and (3) replacing the size standard with a 500 employee size standard and eliminating Footnote 1. SBA stated that if it were to adopt the first alternative SBA would consider revising Footnote 1 by substituting the term “primarily engaged” with “primary industry” and applying 13 C.F.R. § 121.107 when determining to concern's primary industry. SBA asserts the proposed rule demonstrates SBA's policy definition of primary industry may be used when determining whether a concern is primarily engaged in the energy industry. SBA is not strictly bound by the terms of § 121.107, and the standards there are not mandatory.

SBA argues that even if the Area Office had applied § 121.107 to Footnote 1, as Appellant suggests, Appellant would not have been eligible under it. Most of Appellant's receipts came from construction, whereas it had no receipts from energy. SBA argues that however Appellant's business is viewed, it cannot be said to be primarily engaged in the energy business.

Finally, SBA asserts that while its rules should not be interpreted in such a way as to penalize start-ups, Appellant cannot claim to be a start-up. Appellant was incorporated over 20 years ago and has receipts in excess of \$91 million, over 88% of which came from NAICS code 236210.

#### E. Appellant's Reply

Appellant argues that SBA's Response is in agreement with its contention that it would have been appropriate for the Area Office to evaluate whether it was primarily engaged in the energy business using § 121.107. Appellant further argues that SBA's position that the Area Office had discretion to apply or disregard these factors is contrary to its earlier position, and would create an environment of uncertainty and inconsistency.

Appellant argues that had the Area Office evaluated it using § 121.107, it might have found Appellant small. Appellant maintains this mandates a remand to the Area Office, because OHA can only speculate as to the result of such a review.

Appellant again argues that applying the “primary industry” definition in § 121.107 is mandatory, based upon the 2012 proposed rule. Appellant asserts SBA's position that the Area Offices have discretion to either apply § 121.107 or not is unworkable, and would create an unequal playing field.

Appellant also argues that it was not harmless error to fail to apply the primary industry test. Appellant maintains a primary industry need not account for the majority of a concern's receipts; it is sufficient if it is the largest single block, citing *Size Appeal of Group O, Inc.*, SBA No. SIZ-4441 (2001).

Appellant further states that while it is not a start-up, it is transitioning to a new industry, implying that it should be analyzed as similar to a start-up. Finally, Appellant notes that SBA has since issued a final rule for this NAICS code, and that Appellant would be small under this new size standard. 78 Fed. Reg. 77343 (December 23, 2013).

### 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 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. Analysis

The size standard for NAICS code 221118, Other Electric Power Generation, is set in the regulation at Footnote 1 to 13 C.F.R. § 121.201.<sup>2</sup> Footnote 1 provides:

A firm is small if, including its affiliates, it is primarily engaged in the generation, transmission, and/or distribution of electric energy for sale and its total electric output for the preceding fiscal year did not exceed 4 million megawatt hours.

In *Size Appeal of Tikigaq Engineering Services, LLC*, SBA No. SIZ-4842 (2007), OHA rejected the contention that an area office should look to the definition of “primary industry” in 13 C.F.R. § 121.107, and held that the plain meaning of “primarily engaged” in the context of Footnote 1, is that a concern’s “main purpose as a business entity, or first occupation, must be to generate, transmit, and/or distribute electrical energy for sale.” *Tiqigaq* at 11.

In *Size Appeal of Hui O Aina, LLC*, SBA No. SIZ-5262 (2012) (PFR), OHA noted that this definition requires that a firm may be small only if it is primarily engaged in the generation and sale of electricity; in other words, only if the firm is genuinely a utility company. OHA held that the term meant that a firm and its affiliates, taken in the aggregate, must have as their primary business the generation, transmission and/or distribution of electric power. *Hui O Aina* at 7. In measuring whether the concerns had electricity as their primary business, OHA again rejected the contention that the factors in 13 C.F.R. § 121.107, used to determine a concern’s primary industry, should be used in determining whether a concern is primarily engaged as a utility company. Rather, OHA held the standard to be used was whether majority of the annual receipts for the preceding fiscal year of a concern and its affiliates, taken in the aggregate, as measured by the receipts in items 2, 12, and 13d in a challenged concern’s SBA Form 355, are derived from the generation, transmission, and/or distribution of electric energy. *Hui O Aina* at 8.

Appellant argues that OHA should overturn *Hui O Aina*. Appellant asserts that SBA’s issuance of a proposed rule establishes that OHA has misread the regulation. 77 Fed. Reg. 42441 (July 19, 2012). However, this proposed rule is not a formal interpretive rule, which would be binding upon OHA. Further, while Appellant correctly noted that the preamble to the proposed rule states that it was erroneous to require that a concern and each of its affiliates be primarily engaged in the electrical energy industry, that is no longer relevant because OHA rejected that approach in *Hui O Aina*, above. *Id.*, at 42447. The preamble also states that Footnote 1 should be revised and that the revision should substitute the term “primary industry” for “primarily engaged”. *Id.*, at 42448. However, this is not a direction on how the current regulation should be read, but a recommendation for change in the regulation. As such, it does not undermine *Hui O Aina*. Rather, it accepts this interpretation as the current reading of the regulation, and makes

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<sup>2</sup> SBA eventually issued a final rule changing the size standard for NAICS code 221118. This rule became effective on January 22, 2014. 78 Fed. Reg. 77343 (Dec. 23, 2013).

some suggestion for change. I therefore reject Appellant's suggestion that the proposed rule mandates a reversal of *Hui O Aina*.

Further, OHA has held that an area office erred in relying on preamble comments to a proposed rule that had not been issued as final and had not become effective in time to apply to a challenged firm's size determination. *Size Appeal of VMD-MT Security LLC*, SBA No. SIZ-5380, at 8 (2012) (overturning the size determination). In another case where a proposed rule had not been issued as final and become effective, OHA rejected an argument, made on appeal, that was based on a preamble to that proposed rule. *Size Appeal of Tyler Construction Group, Inc.*, SBA No. SIZ-5323, at 3 (2012). Because a proposed rule that has not been issued as final and has not become effective as required by the Administrative Procedure Act, 5 U.S.C. § 553, does not state the law, I see no need to revisit these precedents.

Appellant's other arguments are meritless here, because they do not take account of the actual wording of the regulation. It is clear from the record that that over 88% Appellant's revenues are derived from the construction of industrial facilities, work performed under NAICS code 236210. Appellant's own statements are that it is in process of transitioning to becoming an energy company. Appellant discusses all of its preparatory work towards becoming a company which generates, transmits, and/or distributes electric energy. This work includes rebuilding lighting systems, replacing emergency generators, upgrading city power grids, designing and building photovoltaic systems, constructing a solar power generator system. However, this work is not generating, transmitting or distributing electrical energy.

It is thus critical to note that the regulation is phrased in the present tense. "A firm is small; if it *is* primarily engaged in the generation, transmission, and/or distribution of electric energy for sale." Footnote 1 (emphasis supplied). As noted in *Hui O Aina*, the regulation requires a concern must be primarily engaged as a utility company as of the date size is determined. Appellant is devoting a great deal of effort and preparation towards its goal of ultimately providing electrical energy, but is not yet producing megawatts. Rather, Appellant is generating revenue primarily from its construction of industrial facilities, and facilities which will be part of generating, transmitting or distributing electricity, but Appellant is not yet doing so. Appellant is preparing to become a utility company, but it is not yet there.

Appellant makes some cogent policy arguments in favor of its reading of the regulation, but they cannot support a challenge to the plain meaning of the regulation, requiring that a challenged concern be primarily engaged in generating, transmitting or distribution electrical energy at the time its size status is determined. These arguments provide support for the most recent revision of the regulation, but that revised regulation is not applicable in this case, because its January 22, 2014, effective date is after September 27, 2013, the date on which Appellant's size was determined.

Accordingly, I conclude that Appellant was not primarily engaged in the generation, transmission or distribution for electric power, as of the date its size was determined. The Area Office thus did not err in finding Appellant other than small. I affirm the size determination and deny the appeal.

IV. Conclusion

The record on appeal supports the Area Office's conclusion that Appellant is not a small business. The size determination is AFFIRMED and the appeal is DENIED.

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

CHRISTOPHER HOLLEMAN  
Administrative Judge