

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

DECISION FOR PUBLIC RELEASE

SIZE APPEAL OF:

Newport Materials, LLC,

Appellant,

Appealed From
Size Determination No. 1-SD-2015-49

SBA No. SIZ-5733

Decided: April 21, 2016

APPEARANCES

Allen A. Pemberton, Esq., Tyler Evans, Esq., Covington & Burling LLP, Washington, D.C., for Appellant

DECISION¹

I. Introduction and Jurisdiction

This appeal arises from a size determination issued by the U.S. Small Business Administration (SBA) Office of Government Contracting, Area I (Area Office) concluding that Newport Materials, LLC (Appellant) is not a small business under the size standard associated with the subject procurement. Appellant maintains that the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse or remand. 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.

¹ This decision was originally issued under the confidential treatment provision of 13 C.F.R. § 134.205. Appellant indicated that it did not wish to propose redactions to the decision. OHA now issues the decision for public release.

II. Background

A. Procedural History

On July 27, 2015, the U.S. Department of the Air Force (Air Force) issued Invitation for Bids (IFB) No. FA2835-15-B-0002 for the repair/replacement of roadways, curbing, and sidewalks, including required demolition and earthwork. The IFB contemplated award of a single indefinite-delivery, indefinite-quantity (ID/IQ) contract, with a guaranteed minimum of \$2,500 and a maximum total value of \$23 million. The Contracting Officer (CO) set aside the procurement entirely for small businesses and assigned North American Industry Classification System (NAICS) code 237310, Highway, Street, and Bridge Construction, with a corresponding size standard of \$36.5 million average annual receipts. Bids were opened September 2, 2015.

The Air Force announced that Appellant was the apparent awardee, and RC&D, Inc. (RC&D), a disappointed bidder, filed a protest challenging Appellant's size. The Area Office determined that RC&D's protest was untimely. However, on September 23, 2015, the Area Director initiated her own protest of Appellant's size pursuant to 13 C.F.R. § 121.1001(a)(1)(iii).

On November 9, 2015, the Area Office issued Size Determination No. 1-SD-2015-49 concluding that Appellant is not a small business. Appellant appealed to OHA, and on December 29, 2015, OHA remanded the matter to the Area Office for further analysis. *Size Appeal of Newport Materials, LLC*, SBA No. SIZ-5702 (2015). OHA explained that SBA had requested the remand in order to address "several errors in the calculation of receipts which cannot be corrected with the documentation that is in the agency record." *Id.* at 1.

B. The Instant Size Determination

On February 23, 2016, the Area Office reissued Size Determination No. 1-SD-2015-49, and again found that Appellant is not a small business.

The Area Office explained that Appellant is 100% owned by Mr. Richard A. DeFelice, who also owns 100% of Newport Construction Corporation (Newport Construction), D&D Dining Restaurant d/b/a Valentino's Restaurant (D&D Dining), and Valentino's Italian Market of Nashua, LLC d/b/a Valentino's Market (Valentino's Market). In addition, Mr. DeFelice owns 50% of 540 Groton Road LLC (540 Groton), Groton Road Materials (540 Materials), and WorldTech Engineering (WorldTech). (Size Determination at 5-6.)

The Area Office explained further that Mr. DeFelice previously owned 100% of Four Acres Transportation, Inc. (Four Acres). On January 13, 2015, Mr. DeFelice transferred his interest to Newport Construction, so Four Acres is now a wholly-owned subsidiary of Newport Construction. (*Id.* at 5.) From 2010 through 2014, Newport Construction operated a joint venture with LM Heavy Civil Construction, LLC (LM Heavy). Under this arrangement, Newport Construction was entitled to 70% of the joint venture's profits. (*Id.* at 10-11.)

The Area Office determined that Mr. DeFelice has the power to control Appellant, Newport Construction, D&D Dining, Valentino's Market, 540 Groton, 540 Materials, WorldTech, and Four Acres by virtue of his ownership interests. (*Id.* at 6, citing 13 C.F.R. § 121.103(c)(1).) These companies are therefore affiliated because all are controlled by Mr. DeFelice.

The Area Office proceeded to calculate the average annual receipts of Appellant and its affiliates based on the tax returns filed by Appellant and its affiliates for the years 2014, 2013, and 2012. In computing receipts, the Area Office included Newport Construction's 70% share of the receipts from its joint venture with LM Heavy and deducted the amount Newport Construction included in its 2012 tax return as income from its joint venture with LM Heavy. (*Id.* at 10-11.)

Appellant maintained that Four Acres' receipts should be excluded from the calculations as inter-affiliate transactions because "Four Acres' only purpose (and only source of receipts/revenue) is to facilitate payroll activity for Newport Construction and it is a dollar-for-dollar transaction from Newport Construction's account to Four Acres to perform payroll activity." (*Id.* at 7.) The Area Office rejected this argument for three reasons. First, the Area Office explained, not all inter-affiliate transactions are excludable, only those where the concerns in question are eligible to file a consolidated tax return. (*Id.*, citing *Size Appeals of G&C Fab-Con, LLC*, SBA No. SIZ-5649 (2015) and *Size Appeal of Tenax Aerospace, LLC*, SBA No. SIZ-5701 (2015).) Here, Four Acres and Newport Construction are legally prohibited from filing a consolidated tax return because they are both S corporations. (*Id.* at 8, citing 26 U.S.C. § 1504.) Second, the exclusion applies only to transactions between the challenged firm and an affiliate, not to transactions among affiliates of the challenged firm, as is the case here since Appellant is not a party to the transactions. (*Id.* at 9, citing *G&C Fab-Con* and *Tenax Aerospace*.) Third, the exclusion is intended to prevent double-counting of receipts received by both a parent company and its subsidiary. (*Id.* at 10, citing *Size Appeal of Columbus Techs.*, SBA No. SIZ-4831 (2007) and *G&C Fab-Con*.) Here, though, Four Acres did not become a subsidiary of Newport Construction until January 13, 2015. As Newport Construction and Four Acres were not parent and subsidiary when the transactions occurred, the transactions between them are not excludable.

The Area Office found that the combined average annual receipts of Appellant, Newport Construction, D&D Dining, Valentino's Market, 540 Groton, 540 Materials, WorldTech, and Four Acres exceed the \$36.5 million size standard for the instant procurement. Therefore, Appellant is not a small business.

C. Appeal

On March 10, 2016, Appellant appealed the size determination to OHA and requested an oral hearing. In the appeal, Appellant focuses exclusively on Four Acres' receipts and the Area Office's decision that they should not be excluded. Appellant contends that the Area Office misapplied OHA case law, because key factors distinguish this case from the cases cited by the Area Office.

Appellant challenges the Area Office's statement that the exclusion applies only to transactions between the challenged firm and its affiliates. The applicable regulation states that the exclusion applies to “proceeds from transactions between a concern and its domestic or foreign affiliates.” (Appeal at 7, quoting 13 C.F.R. § 121.104(a).) Appellant argues, however, that language elsewhere in the size regulations suggests that an “affiliate” can qualify as “a concern.” (*Id.*, citing 13 C.F.R. § 121.103(a)(1) (“Concerns and entities are affiliates of each other . . .”).) Appellant also finds support for this proposition in the size determination itself. The regulation governing revenue from a joint venture provides that “a *concern* must include in its receipts its proportionate share of joint venture receipts. . . .” (*Id.* at 8, quoting 13 C.F.R. § 121.103(h)(5) (emphasis Appellant's).) Appellant reasons that if Newport Construction were merely an “affiliate” of Appellant's and not a “concern” in its own right, the Area Office would not have been justified in considering Newport Construction's proportionate share of joint venture receipts. (*Id.*)

Alternatively, to the extent OHA finds that this issue has already been decided in *Tenax Aerospace* and *G&C Fab-Con*, Appellant argues OHA should construe these cases “as requiring a protested concern to be a party to a transaction only when a protested concern and its affiliates are not subject to common and complete ownership.” (*Id.* at 9.) Unlike the situations in *Tenax Aerospace* and *G&C Fab-Con*, the firms at issue here (Appellant, Four Acres, and Newport Construction) were all wholly-owned by Mr. DeFelice, so there is no possibility that multiple owners would benefit by excluding transactions among these firms. Limiting *Tenax Aerospace* and *G&C Fab-Con* in this manner, Appellant continues, would still spare SBA from “delving in to far-flung dealings between third parties that lack a direct and substantial relationship to a protested concern.” (*Id.*)

Appellant argues that its proffered interpretation of *Tenax Aerospace* and *G&C Fab-Con* is also consistent with the purpose of the inter-affiliate transaction exclusion, which Appellant asserts, is “to prevent double counting of receipts among consolidated concerns.” (*Id.* at 9, citing 69 Fed. Reg. 29,192 (May 21, 2004).) Four Acres, Appellant emphasizes, did not independently generate revenues. Instead, Four Acres “received weekly transfers of funds from Newport Construction sufficient to cover [its] payroll activities”, which Four Acres then paid out to covered Newport Construction employees. (*Id.* at 12.) The Area Office's inclusion of payments that Newport Construction made to Four Acres resulted in the exact type of double-counting that the exclusion for inter-affiliate transactions is designed to address.

Next, Appellant contends that the Area Office erred when it determined that the exclusion does not apply because Newport Construction and Four Acres did not have a parent-subsidary relationship from 2012 through 2014. Appellant highlights that Newport Construction was Four Acres' parent company as of the date for determining size, and before that they were sibling companies commonly and completely owned by Mr. DeFelice. (*Id.* at 11-12.)

In any event, Appellant argues, the Area Office misapplied OHA's reasoning in *Tenax Aerospace* and *G&C Fab-Con* by requiring Newport Construction and Four Acres to have a parent-subsidary relationship. Appellant contends that the facts of this case are distinguishable because Newport Construction and Four Acres are affiliated based on common ownership, whereas the firms at issue in *Tenax Aerospace* and *G&C Fab-Con* were affiliated through

identity of interest and common management. The distinction matters because, where firms are affiliated based on common ownership, the revenue ultimately “goes into the pockets” of a single individual and not “different owners.” (*Id.* at 13, quoting *G&C Fab-Con*, SBA No. SIZ-5649, at 6.) In the instant case, Appellant maintains, it should not be necessary that the companies have a parent-subsidary relationship because inter-affiliate transactions do not benefit different owners. (*Id.* at 14, citing *Size Appeal of Chu & Gassman, Inc.*, SBA No. SIZ-5394 (2012) (PFR).) Accordingly, the holding that the exclusion for inter-affiliate transactions applies only where the concerns share a parent-subsidary relationship “must be understood to refer to situations in which different parties could enjoy the benefits of inter-affiliate transactions.” (*Id.*)

Appellant lastly addresses the Area Office's determination that the exclusion does not apply because Newport Construction and Four Acres are ineligible to file a consolidated tax return due to their status as S-corporations. The firms, Appellant emphasizes, are both completely owned by the same individual; it is merely their corporate form which bars them from filing a consolidated tax return. The inability to file a consolidated tax return should not prevent the exception from applying here because this would create an arbitrary result unrelated to the purpose of the rule. For example, the exclusion applies to “proceeds from transactions between a concern and its . . . foreign affiliates”, but foreign corporations are generally prohibited from filing consolidated tax returns. (*Id.* at 16-17, quoting 13 C.F.R. § 121.104(a) (emphasis Appellant's).) Therefore, Appellant urges, OHA should conclude that concerns may still be eligible for the exclusion notwithstanding that they are prohibited from filing a consolidated tax return.

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. Request for an Oral Hearing

OHA may conduct an oral hearing “upon concluding that there is a genuine dispute as to a material fact that cannot be resolved except by the taking of testimony and the confrontation of witnesses.” 13 C.F.R. § 134.222(a)(2). An oral hearing is seldom necessary for size appeals, however, because OHA does not conduct its own investigation into the size of a challenged firm. Rather, OHA's role is to determine “whether the area office committed any clear error of fact or law, based on the contemporaneous record available to the area office.” *Size Appeal of DefTec Corp.*, SBA No. SIZ-5540, at 7 (2014). Here, an oral hearing is not required to resolve this dispute. The sole issue presented in the case is the applicability of the inter-affiliate transaction exception, and Appellant raises only legal arguments, not questions of fact. Accordingly, because no material facts are in dispute, Appellant's request for an oral hearing is DENIED.

C. Analysis

Relying upon OHA precedent, the Area Office determined that the exclusion for inter-affiliate transactions is not applicable in this case, for three reasons. First, the exclusion only applies to concerns that are eligible to file a consolidated tax return. *Tenax Aerospace*, SBA No. SIZ-5701, at 16; *G&C Fab-Con*, SBA No. SIZ-5649, at 8-9. In the instant case, Newport Construction and Four Acres are not eligible to file such a return due to their status as S corporations, so the exclusion does not apply. Second, the exclusion for inter-affiliate transactions applies only to transactions between the challenged concern and its affiliates. *Tenax Aerospace*, SBA No. SIZ-5701, at 16; *G&C Fab-Con*, SBA No. SIZ-5649, at 7 (“by its plain language, the exception does not apply to transactions to which the challenged firm is not a party.”). Here, the exclusion does not apply because the transactions in question were between Newport Construction and Four Acres, and did not involve Appellant itself. Third, “the exclusion applies only to transactions between a parent company and its subsidiary.” *Size Appeal of Orion Construction Corp.*, SBA No. SIZ-5694, at 9 (2015); *accord Tenax Aerospace*, SBA No. SIZ-5701, at 16; *G&C Fab-Con*, SBA No. SIZ-5649, at 9. Although Newport Construction and Four Acres became parent and subsidiary in January 2015, the firms did not have such a relationship at the time the transactions occurred (*i.e.*, 2012 through 2014). As a result, the exclusion does not apply.

Appellant does not dispute the Area Office's factual findings. Rather, Appellant maintains that the OHA decisions cited by the Area Office are distinguishable from the instant case and should not be controlling. Appellant highlights in particular that *G&C Fab-Con* involved affiliation through common management — rather than common ownership — as well as receipts retained by different majority owners. Conversely, Newport Construction and Four Acres are both owned by Mr. DeFelice, so there is no possibility that multiple owners would benefit by excluding transactions between Newport Construction and Four Acres.

The problem for Appellant is that OHA considered, and rejected, substantially similar arguments in *Tenax Aerospace* and *Orion Construction*. Indeed, the challenged firm in *Tenax Aerospace* made virtually the same argument that Appellant raises here, asserting that “*G&C Fab-Con* is distinguishable because affiliation was found based on common management, not common ownership, and the receipts in question did not ultimately go to the same owner, as they do here.” *Tenax Aerospace*, SBA No. SIZ-5701, at 5. OHA denied the appeal and affirmed the size determination, concluding that the exclusion for inter-affiliate transactions did not apply. *Id.* at 16-18. Likewise, in *Orion Construction*, the companies in question were wholly owned by a husband and wife, who were treated as a single entity due to their identity of interest. *Orion Construction*, SBA No. SIZ-5694, at 2-3. OHA cited *G&C Fab-Con* in concluding that the challenged firm could not avail itself of the exclusion for inter-affiliate transactions. *Id.* at 9. Accordingly, in both *Tenax Aerospace* and *Orion Construction*, OHA found that the exclusion for inter-affiliate transactions was not applicable, notwithstanding that affiliation was based on ownership, and notwithstanding that the transactions did not benefit different owners. I therefore find no basis to distinguish the instant case from OHA precedent.

Appellant also argues that the Area Office's decision elevates form over substance, results in double-counting, and constitutes poor public policy. OHA has long held, however, that exclusions from receipts are strictly construed, and “there is no general ‘catch-all’ exclusion for double-counting in the regulation.” *Size Appeal of The Assoc. Constr. Co.*, SBA No. SIZ-5314, at 6 (2011). Arguments as to which policy objectives should, ideally, be reflected in SBA regulations are beyond the scope of OHA's review, and should instead be directed to SBA policy officials. OHA does not set agency policy, but rather determines whether an area office has committed clear errors of fact or law in reaching its decision. No such error has been shown here.

IV. Conclusion

Appellant has not demonstrated that the size determination is erroneous. I therefore DENY the appeal and AFFIRM the 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