Cite as: *Size Appeal of First Nation Group d/b/a Jordan Reses Supply Co., LLC*, SBA No. SIZ-5807 (2017)

United States Small Business Administration
Office of Hearings and Appeals

REDACTED DECISION FOR PUBLIC RELEASE

SIZE APPEAL OF: First Nation Group d/b/a Jordan Reses Supply Company, LLC, Appellant, Appealed From Size Determination No. 3-2016-091	SBA No. SIZ-5807 Decided: January 27, 2017

APPEARANCES

Jonathan T. Williams, Esq., Peter B. Ford, Esq., Michelle E. Litteken, Esq., Julia Di Vito, Esq., PilieroMazza PLLC, Washington, D.C., for Appellant

DECISION[1]

I. Introduction and Jurisdiction

On October 14, 2016, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area III (Area Office) issued Size Determination No. 3-2016-091 concluding that First Nation Group d/b/a Jordan Reses Supply Company, LLC (Appellant) is a small business but is not eligible for the subject procurement. Appellant contends that the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse. For the reasons discussed *infra*, the appeal is granted in part and dismissed in part.

OHA decides appeals of size determinations under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. parts 121 and 134. Appellant timely filed the instant appeal on October 31, 2016.[2] 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. OHA afforded counsel an opportunity to file a request for redactions if desired. Counsel submitted a timely request for redactions, which OHA considered in redacting the decision. OHA now publishes a redacted version of the decision for public release.

II. Background

A. Solicitation and Protest

On August 11, 2016, the U.S. Department of Veterans Affairs (VA) issued Request for Quotations (RFQ) No. VA250-16-Q-0477 for 50 Continuous Positive Airway Pressure (CPAP) machines. The Contracting Officer (CO) set aside the procurement entirely for service-disabled veteran-owned small businesses (SDVOSBs), and assigned North American Industry Classification System (NAICS) code 339112, Surgical and Medical Instrument Manufacturing, with a corresponding size standard of 1,000 employees. The RFQ was structured as a simplified acquisition of commercial items pursuant to Federal Acquisition Regulation subparts 12.6 and 13.5. Quotations were due August 17, 2016. Appellant, a CPAP distributor, submitted a timely quotation of $21,750 for CPAP machines made [outside the United States] by [xxxx], a large business.

On August 22, 2016, VA announced that Appellant was the apparent awardee. That same day, Medical Place, Inc. (MPI), a disappointed offeror, protested Appellant's size, arguing that Appellant is the product of a merger with a "multi-million dollar company". (Protest at 1.) VA awarded the contract to Appellant on September 12, 2016. On September 13, 2016, the Area Office determined that MPI lacked standing to protest because it is not an SDVOSB. However, seeing merit in MPI's allegations, the Area Director adopted MPI's protest pursuant to 13 C.F.R § 121.1001(a)(1)(iii).

B. Size Determination

On October 14, 2016, the Area Office issued Size Determination No. 3-2016-091, finding that Appellant is a small business but is not eligible for the instant procurement.

The Area Office explained that, on April 1, 2016, First Nation Security, LLC (First Nation) acquired Jordan Reses Supply Company, LLC (Jordan Reses), and the firms merged on August 1, 2016, with Appellant as the surviving entity. Prior to the acquisition, Jordan Reses was owned by Patton Holdings, Inc. (PHI) and [xxxx]. (Size Determination at 2.) After the acquisition, Jordan Reses's former CEO became Appellant's president, and the former executive vice president retained his position.

Appellant's ownership is divided into two categories: Class A (voting) and Class B (non-voting). Ms. Cheryl L. Nilsson, a service-disabled veteran and Appellant's CEO and managing member, owns 100% of Class A and 51% of Class B. The remaining 49% of Class B is owned

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[2] Ordinarily, a size appeal must be filed within 15 calendar days of receipt of the size determination. 13 C.F.R. § 134.304(a). Here, Appellant received the size determination on October 14, 2016. Fifteen calendar days after October 14, 2016 was October 29, 2016. Because October 29, 2016 was a Saturday, the appeal petition was due on the next business day: Monday, October 31, 2016. 13 C.F.R. § 134.202(d).

by PHI. The Area Office determined that Ms. Nilsson has the power to control Appellant as a result of her ownership. (*Id.* at 3, citing 13 C.F.R. § 121.103(c)(1).)

PHI is 100% owned by [Owner]. PHI, [Owner], [xxxx], and [xxxx] "have ownership interests in many entities." (*Id.*) "The entities that [Owner] has at least a 50% ownership interest or, where no one person holds at least 50% ownership interest, and [Owner] hold[s] the largest block of ownership interest [are] also considered to be affiliates of [PHI]." (*Id.* at 3-4, citing 13 C.F.R. § 121.103(a)(1), (c)(1), and (c)(2).) However, "the total number of employees for all these entities [is] not over 500 employees." (*Id.* at 4.)

The Area Office then determined that Appellant and PHI are affiliated under the totality of the circumstances, 13 C.F.R. § 121.103(a)(5), based on the terms of their merger and the circumstances that led to it. (*Id.* at 4-9.) The Area Office posited that First Nation's acquisition of Jordan Reses was in response to the Supreme Court's decision in *Kingdomware v. United States*, 579 U.S. __ (2016). As a result of that decision, VA must set aside procurements for veteran-owned small businesses (VOSBs) and SDVOSBs if it expects to receive two or more offers from such firms. Jordan Reses, which prior to *Kingdomware* derived 99% of its revenue from government contracts, was not owned by a veteran. *Kingdomware* therefore threatened its business model. (*Id.* at 5.)

Prior to the merger, Jordan Reses was valued at $[xxxx]. It had $[xxxx] in outstanding debt, so its outstanding equity was $[xxxx]. As part of the merger, on April 1, 2016, First Nation executed an unsecured note for $[xxxx], payable to PHI. The interest rate was [xx]%, half of which is payable in cash each quarter. The other [xx]% is "paid in kind" by increasing the note's principal. (*Id.* at 6.) The note had a nine-year term, so at the time of maturity, the principal amount would be over $[xxxx]. Given First Nation's pre-merger income and equity, "it would be virtually impossible for First Nation to obtain a loan from a bank or other commercial lenders for $[xxxx]," the Area Office reasoned. (*Id.* at 6.) Therefore, "[t]he note is not commercially reasonable." (*Id.* at 7.)

The Area Office observed that OHA has affirmed findings of affiliation based on a debtor-creditor relationship when the agreement is not made at arm's-length. (*Id.* at 7-8, discussing *Size Appeal of Heritage of America, LLC*, SBA No. SIZ-5017 (2008) and *Size Appeal of Lajas Indus., Inc.*, SBA No. SIZ-4263 (1997).) Here, the note's value is 250 times greater than First Nation's pre-merger assets and 40 times greater than its pre-merger income. Ms. Nilsson went from operating an [xxxx] firm while making [xxxx] for herself to making $[xxxx] as "CEO of a company that generates $[xxxx] annually". (*Id.* at 9.) Jordan Reses's former CEO is now Appellant's president, and the former executive vice president retained his position. PHI has done well under this arrangement, too. It will receive [xxxx] and [xxxx] of $[xxxx]. In 2014, for example, it received [xxxx]. As an SDVOSB with much of the same leadership as before, the merged entity will continue to generate the revenues as in the past. As a result, the Area Office perceived "little risk" that Appellant would be unable to service the $[xxxx] note. (*Id.* at 9.) Based on these factors, Appellant and PHI are affiliated under the totality of the circumstances. (*Id.* at 8-9.)

This affiliation does not render Appellant other than small, though, because Appellant and PHI together have fewer than 500 employees. (*Id.* at 10.) Nevertheless, the Area Office determined, Appellant is ineligible for award of the instant procurement because it is not manufacturing the CPAP machines and does not qualify as a nonmanufacturer. On this point, SBA regulations provide:

> 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.

(*Id.* at 9, quoting 13 C.F.R. § 121.406(b)(1).) The Area Office determined that Appellant meets the first three elements of the test, but not the fourth. The fourth element is not met because the CPAP machines Appellant quoted are made [outside the United States] by a large business, and no waiver has been issued. As a result, Appellant does not meet the fourth element of the nonmanufacturer rule and is ineligible for award of the subject contract. (*Id.* at 10.)

The Area Office noted that SBA regulations permit an exception to the nonmanufacturer rule for small business set-asides under $150,000. (*Id.* at n.4, citing 13 C.F.R. § 121.406(d).) However, the Area Office reasoned, the exception does not apply in this case because the instant RFQ was set aside for SDVOSBs rather than all small businesses.

C. VA Actions After Issuance of the Size Determination

On October 20, 2016, after reviewing Size Determination No. 3-2016-091, the CO notified Appellant that the award stemming from the RFQ was canceled. The CO further stated that VA was making arrangements to return any CPAP machines that Appellant had already delivered. (E-mail from D. Maxwell to C. Nilsson (Oct. 20, 2016).)

On October 26, 2016, VA removed Appellant from its VetBiz Vendor Information Pages (VIP) database of verified SDVOSBs and VOSBs. In a letter to Appellant, VA stated that the removal was based upon Size Determination No. 3-2016-091, specifically the finding that Appellant is affiliated with PHI. (Letter from T. McGrath to C. Nilsson (Oct. 27, 2016), at 1-2.) The nonmanufacturer rule issue "was not the basis for [VA] removing [Appellant] from the VetBiz VIP database." (*Id.* at 2.)

D. Appeal

On October 31, 2016, Appellant filed its appeal of the size determination with OHA. Appellant maintains that the Area Office committed errors of fact and law, so OHA should reverse the size determination.

Appellant argues that it has standing to bring this appeal because it is adversely affected by the size determination. Although the Area Office determined that Appellant is a small business, the finding that Appellant did not comply with the nonmanufacturer rule caused Appellant to be ineligible for the subject contract. Moreover, the finding of affiliation with PHI led VA to remove Appellant from the VetBiz VIP database. As a result of this removal, Appellant is no longer eligible to compete for SDVOSB set-asides conducted by VA. (Appeal at 6-7.)

Appellant argues that the Area Office should not have found that Appellant and PHI are affiliated. Appellant is controlled solely by Ms. Nilsson. PHI, by contrast, is "a non-voting, non-participating minority owner with no ability or desire to control the company." (*Id.* at 1.) Appellant argues that, in order to find affiliation, the Area Office was required to find facts demonstrating that PHI has the power to control Appellant, but the Area Office made no such finding. (*Id.* at 7.)

Further, findings of affiliation based on the totality of the circumstances must be rooted in at least two independent factors of affiliation listed in 13 C.F.R. § 121.103. (*Id.*, citing *Size Appeal of Woods Hole Group, Inc.*, SBA No. SIZ-5009 (2008).) The Area Office did not identify any such grounds here. (*Id.* at 8.)

Instead of looking into indicia of control, the Area Office relied on "unsupported, erroneous, and irrelevant information and opinions, which are directly contradicted by extensive facts in the record." (*Id.* at 11.) For instance, Appellant maintains, First Nation and Jordan Reses merged because the firms wished to accelerate their growth in the medical industry, build a sustainable enterprise, and pursue shared charitable goals. (*Id.* at 9.) The notion that *Kingdomware* motivated the merger is baseless. Further, *Kingdomware* was decided on June 16, 2016. Although First Nation and Jordan Reses formally merged on August 1, 2016, First Nation acquired Jordan Reses as a wholly-owned subsidiary on April 1, 2016, and the two firms were engaged in merger preparations and discussions for months before that. (*Id.* at 3, 10.) Logically, then, *Kingdomware* could not have motivated the merger because "[d]uring the vast majority of this time, the outcome of the *Kingdomware* case was unknown." (*Id.* at 10.)

Further, the Area Office incorrectly assumed that PHI would continue to receive [xxxx]. Similarly, Ms. Nilsson's $[xxxx] salary is in line with her salaries prior to her employment at First Nation. (*Id.*)

The Area Office's reliance on the $[xxxx] note between Appellant and PHI is unwarranted for several reasons. First, the note does not permit PHI to control Appellant, and the Area Office did not conclude that such control existed or explain why. (*Id.* at 11-12.) Appellant

insists that the note and other merger transaction documents were carefully "structured to ensure Ms. Nilsson's total control [of Appellant] and that [PHI] is only a passive owner." (*Id.* at 3.)

Second, the Area Office's reliance on *Heritage* and *Lajas* is misplaced because those cases are distinguishable from the instant one. *Heritage* involved unsecured loans, which were not in writing and which were used for ongoing financial support. The loans were several times greater than the firm's income, and one of the lenders was the challenged firm's vice president and CEO. Similarly, *Lajas* also involved loans for ongoing financial support, which were necessary for the firm's continued operation. Unlike those cases, the note here is in writing and was consideration for First Nation's acquisition of Jordan Reses. Appellant has made all scheduled payments. There is no ongoing financial support from PHI; rather, PHI is merely a passive, non-voting minority owner, and neither PHI nor [Owner] is an officer or involved in Appellant's management. Appellant and PHI have no other business arrangements. In addition, the note is only a fraction of Appellant's post-merger revenues, and it is subordinated to Appellant's commercial loans. Instead of relying on *Heritage* and *Lajas*, Appellant argues the Area Office should have considered *Size Appeal of Washington Patriot Construction, LLC*, SBA No. SIZ-5491 (2013) and *Size Appeal of Zeiders Enterprises, Inc.*, SBA No. SIZ-2729 (1987), cases in which OHA found there was not affiliation when the area offices could not explain how there was the power to control. (*Id.* at 13-14.)

Third, the note is a legitimate, arm's-length debt. The Area Office's comparison of the note's value to First Nation's assets and income before the merger is erroneous because it was consideration for the acquisition of Jordan Reses, a company with annual revenue over $[xxxx]. Instead, the Area Office should have compared the note's value with Appellant's assets and income after the acquisition. Viewed in this light, the note is commercially reasonable and further distinguishable from the facts in *Heritage*. Payment-in-kind, Appellant explains, is effectively deferred interest. Where the debt is subordinated, as it is here, it is appropriate and commercially reasonable. (*Id.* at 14-16.)

Appellant then turns to the finding that Appellant does not qualify as a nonmanufacturer. Appellant argues that the nonmanufacturer rule does not apply to this procurement, because the RFQ did not contain a clause pertaining to the nonmanufacturer rule. Alternatively, Appellant argues that the procurement was a small business set-aside under $150,000, and thus eligible for the exception at 13 C.F.R. § 121.406(d). (*Id.* at 17.)

Appellant further contends that the nonmanufacturer rule does not apply to SDVOSB set-asides conducted by VA under the Vets First Contracting Program, because the statute creating the program does not contain a provision pertaining to the nonmanufacturer rule. As a result, there is no statutory basis for applying the nonmanufacturer rule here. Further, when a procurement does not exceed the simplified acquisition threshold, applying the nonmanufacturer rule contravenes VA policy. (*Id.* at 18, citing VA Procurement Policy Memorandum (2016-05).)

Accompanying its appeal, Appellant moved to supplement the record. Specifically, Appellant seeks to introduce a declaration from Ms. Nilsson explaining the harm to Appellant arising from Size Determination No. 3-2016-091, and responding to certain findings in the size

determination. Appellant also moves to introduce a copy of the VA's October 27, 2016 letter removing Appellant from the VetBiz VIP database.

The October 27, 2016 letter is already in the record and therefore need not be admitted as new evidence. *E.g., Size Appeal of Emergency Pest Control, Inc.*, SBA No. SIZ-5797, at 5 (2016). As Appellant argues, the declaration pertains to events that occurred after the size determination was issued, and responds to matters raised for the first time in the size determination. (Motion at 3.) Accordingly, for good cause shown, Appellant's motion is GRANTED and the declaration is ADMITTED into the record. 13 C.F.R. § 134.308(a)(2); *Size Appeal of Strata-G Solutions, Inc.*, SBA No. SIZ-5563, at 5 (2014) (admitting evidence probative of an issue unknown to the proponent before receiving the size determination).

E. Appeal Supplement

On November 16, 2016, after reviewing the Area Office file and prior to the close of record, Appellant moved to supplement its appeal, arguing that the file "reveals circumstances and documents not previously known to [Appellant] and that confirms [Appellant's] contentions in this proceeding." (Motion at 1.) OHA routinely permits parties to supplement their pleadings after viewing the Area Office files for the first time. *E.g., Size Appeal of GiaCare and MedTrust, JV, LLC*, SBA No. SIZ-5690, at 7 (2015). Appellant's motion therefore is GRANTED.

In its appeal supplement, Appellant postulates that the basis for the size determination is a 266-page report found in the record. Appellant argues that it was improper for the Area Office to give weight to this report, which Appellant maintains consists of hearsay and unsubstantiated allegations, instead of Appellant's sworn statements and supporting evidence. (Supp. Appeal at 4, citing 13 C.F.R. § 121.1009(d) and *Size Appeal of Hallmark-Phoenix Joint Venture*, SBA No. SIZ-4870 (2007).) It was also improper that the Area Office did not afford Appellant the opportunity to respond to the report's allegations. (*Id.*, citing *Size Appeal of Trailboss Enters., Inc.*, SBA No. SIZ-5442 (2013), *recons. denied*, SBA No. SIZ-5450 (2013) (PFR).) In addition, to Appellant, it appears that the Area Office exceeded its authority by examining SDVO eligibility issues rather than size issues.

Appellant also complains that the Area Office had questions regarding PHI's [xxxx] and the applicability of the nonmanufacturer rule, but did not seek answers from Appellant. (*Id.* at 4-5.)

F. OHA's Order and Appellant's Comments

On November 15, 2016, the CO informed OHA that he canceled the award to Appellant on October 20, 2016. (Memo from D. Maxwell to P. Lee (Nov. 15, 2016).) Because the nonmanufacturer rule applies only in conjunction with a particular procurement, OHA directed Appellant to submit comments as to whether the nonmanufacturer issue is moot.

Appellant responded to OHA's order on November 28, 2016. Appellant acknowledges that "OHA usually does not hear appeals involving an alleged violation of the [nonmanufacturer rule] if the underlying contract is canceled." (Comments at 2.) Nevertheless, Appellant

maintains, "there are unique circumstances in this case and, based on those circumstances, a genuine purpose would be served by OHA's consideration of the [nonmanufacturer rule] issue here." (*Id.* at 1.)

Appellant offers three reasons why this case is atypical and should not be dismissed as moot. First, in future acquisitions of CPAP machines, if an area office were to find a violation of the nonmanufacturer rule, "the VA procuring official would likely cancel the contract, as occurred here, so VA could obtain the necessary supplies from a different source." (*Id.* at 2.) If such a scenario arises, and if OHA were to dismiss all such cases as moot, it would become impossible to challenge an area office's future findings pertaining to future procurements of CPAP machines. Second, Appellant states that it had delivered 25 CPAP machines at the time VA canceled the contract, but VA subsequently returned only 24 of the machines. Thus, "[a]rguably, the contract is not entirely canceled so long as one of the products remains with the VA." (*Id.*) Third, Appellant argues that the finding that Appellant did not qualify as a nonmanufacturer may impact Appellant beyond the instant contract. Appellant represents that VA officials have suggested that Appellant may be ineligible for future orders of CPAP machines as a result of the finding that Appellant does not qualify as a nonmanufacturer. (*Id.*)

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

This case presents a peculiar situation in which Appellant disputes the Area Office's determination that Appellant is ineligible under the nonmanufacturer rule, notwithstanding that the underlying contract award has since been canceled. Appellant also challenges the finding that Appellant is affiliated with PHI, although the Area Office ultimately found that Appellant is still a small business.[3] As discussed below, the issue of whether Appellant is ineligible under the nonmanufacturer rule is moot, and that portion of appeal is dismissed. With regard to affiliation, Appellant has persuasively shown that it is not affiliated with PHI. The appeal therefore is granted to that extent, but I affirm the Area Office's conclusion that Appellant is a small business.

[3] Appellant has standing to challenge the finding of affiliation with PHI because, although Appellant was determined to be a small business despite this affiliation, Appellant is nevertheless "adversely affected" by this finding under 13 C.F.R. § 134.302(a). As Appellant explains, the affiliation finding caused VA to remove Appellant from the VetBiz VIP database, preventing Appellant from competing for other VA procurements.

1. Nonmanufacturer Rule

By regulation, OHA cannot adjudicate issues which have become moot. 13 C.F.R. § 134.316(c). Contract-specific matters, such as whether a firm is eligible as a nonmanufacturer, are rendered moot when the procuring agency cancels the contract. *See, e.g., Size Appeal of Tridentis, LLC*, SBA No. SIZ-5607 (2014); *Size Appeal of HRCI-MPSC PASS, LLC*, SBA No. SIZ-5500 (2013); *Size Appeal of Navarro Research and Eng'g, Inc.*, SBA No. SIZ-5473 (2013); *Size Appeal of Saint George Indus., LLC*, SBA No. SIZ-5440 (2013). In this case, the CO canceled the award to Appellant on October 20, 2016, shortly after the size determination was issued. Sections II.C and II.F, *supra*. Because Appellant is no longer the awardee of this procurement, it is unnecessary to decide whether or not Appellant would have been in compliance with the nonmanufacturer rule. Accordingly, the issue of whether Appellant is ineligible under the nonmanufacturer rule is moot.

Appellant urges that OHA nevertheless should explore the nonmanufacturer issue based on the "unique circumstances" of this case. Section II.F, *supra*. Appellant, though, has not shown that any special circumstances actually exist. Appellant's concerns that VA procurement officials might repeatedly cancel future orders of CPAP machines, or might bar Appellant from future CPAP orders based on prior violation of the nonmanufacturer rule, are speculative and premature. Similarly, Appellant's contention that the instant award is "not entirely canceled" — because, according to Appellant, VA still retained one of Appellant's CPAP machines as of late November 2016 — is contradicted by the CO's statements and the documentation in the record establishing that the award was, in fact, canceled on October 20, 2016. I therefore see no reason to depart from the general rule that a contract-specific matter becomes moot when the underlying contract is canceled.

2. Totality of the Circumstances

I agree with Appellant that the Area Office clearly erred in finding Appellant affiliated with PHI under the totality of the circumstances, 13 C.F.R. § 121.103(a)(5). "Under this regulation," OHA has explained, "SBA may find businesses affiliated where the interactions between them are so suggestive of reliance as to render the businesses affiliates."*Size Appeals of Med. Comfort Sys., Inc., et al.*, SBA No. SIZ-5640, at 15 (2015). OHA has repeatedly held, though, that "[a]s in all affiliation analysis, the touchstone issue is control. A connection between two concerns does not necessarily cause affiliation. There must be an element of control present." *Id.* (quoting *Size Appeal of Carwell Prods., Inc.*, SBA No. SIZ-5507, at 11 (2013)); *see also Size Appeal of Q Integrated Cos.*, SBA No. SIZ-5778, at 13 (2016) ("A review of the totality of the circumstances may lead an area office to conclude one concern has the power to control the other, and that both are affiliated."). "Stated differently, in order to find affiliation through the totality of the circumstances, 'an area office must find facts and explain why those facts caused it to determine one concern had the power to control the other."' *Med. Comfort*., SBA No. SIZ-5640, at 15 (quoting *Size Appeal of Faison Office Prods., LLC*, SBA No. SIZ-4834, at 11 (2007)). OHA has made clear that "[a] finding of affiliation under the totality of the circumstances will be overturned if the record does not support the conclusion that any such power to control exists." *Size Appeal of Global, A 1st Flagship Co.*, SBA No. SIZ-5462, at 11

(2013) (citing *Size Appeal of Summit Techs. & Solutions, Inc.*, SBA No. SIZ-5132 (2010) and *Size Appeal of Diverse Constr. Group, LLC*, SBA No. SIZ-5112 (2010)).

In the instant case, the principal problem with the Area Office's analysis is the absence of any findings demonstrating that PHI has the power to control Appellant, or *vice versa*. The Area Office appears to have based its decision primarily on the $[xxxx] note that First Nation made payable to PHI. The note is subordinated and unsecured, however, so it is unclear how PHI could use its status as a lender to control Appellant. Nor did the Area Office identify any unusual provisions in the note that might give rise to any power to control.

It is true that the value of the note is substantial, and OHA has recognized that concerns may be affiliated under the totality of the circumstance when one is heavily indebted to another. *E.g., Size Appeal of Eng'g Logistics*, SBA No. SIZ-5587 (2014). Appellant's ability to make payments on the note, though, must be assessed as of the date to determine size, in this case August 17, 2016. Section II.A, *supra*. Here, the merger between First Nation and Jordan Reses was already complete by August 17, 2016, and the Area Office found that Appellant has post-merger revenues of $[xxxx] annually, leaving "little risk" that Appellant would be unable to service the $[xxxx] debt. Section II.B, *supra*. Accordingly, based on the Area Office's own findings, no justification exists to conclude that PHI could exert financial control over Appellant as of August 17, 2016.

Notably, the Area Office also found no other strong indicia of affiliation. The Area Office determined that Appellant is controlled by Ms. Nilsson, not by PHI. *Id.* PHI is a minority owner of Appellant's Class B stock, but this stock carries no voting rights and thus affords PHI no ability to control Appellant or to interfere with Ms. Nilsson's control. *Id.* In addition, the Area Office found no indication that PHI or [Owner] holds a managerial interest in Appellant, or that Appellant and PHI have other significant business dealings. *Id.* In short, then, the record does not support the conclusion that PHI has the power to control Appellant, either through the note or otherwise, as of the date to determine size.

As Appellant correctly observes, the two OHA cases relied upon in the size determination — *Size Appeal of Heritage of America, LLC*, SBA No. SIZ-5017 (2008) and *Size Appeal of Lajas Industries, Inc.*, SBA No. SIZ-4263 (1997) — are readily distinguishable. In *Heritage*, in addition to loans that were commercially unreasonable, OHA found "continuing contractual relationships because of the loans" and that the challenged firm was "utterly dependent upon [its lender] for survival (a strong indicia of control)". *Heritage*, SBA No. SIZ-5017, at 5. Likewise in *Lajas*, an area office determined that the challenged firm was financially dependent on its lender as of the date to determine size, and that "conditions of the loans demonstrate a financial dependence by one firm on the other". *Lajas*, SBA No. SIZ-4263, at 7. As discussed above, the Area Office here did not find facts similar to *Heritage* or *Lajas* that would demonstrate financial dependence such that PHI could control Appellant as of the date for determining size.

IV. Conclusion

Appellant has demonstrated that the Area Office clearly erred in finding that Appellant is affiliated with PHI. Accordingly, the affiliation finding is REVERSED and the appeal is

GRANTED to this extent. Because the nonmanufacturer issue is moot, that portion of the appeal is DISMISSED. I AFFIRM the Area Office's conclusion that Appellant is a small business under a 500-employee size standard. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(d).

KENNETH M. HYDE
Administrative Judge