United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Johnson Development, LLC, Appellant, Appealed From Size Determination No. 03-2017-041	SBA No. SIZ-5863 Decided: October 27, 2017

APPEARANCES

Carl A. Gebo, Esq., Gebo Law Group LLC, Atlanta, Georgia, for Appellant

Diana Parks Curran, Esq., Hadeel Masseoud, Esq., Curran Legal Services Group, Inc., Johns Creek, Georgia, for Appellant

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DECISION[1]

I. Procedural History and Jurisdiction

On July 7, 2017, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area III (Area Office), issued Size Determination No. 03-2017-041, finding Johnson Development, LLC (Appellant), is not an eligible small business for U. S. Department of Veterans Affairs Solicitation No. VA-101-15-R-0181, the procurement at issue.

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 that Appellant is an eligible small business for the instant procurement. For the reasons discussed *infra*, I DENY the appeal and AFFIRM the size determination.

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

[1] I originally issued this Decision under a Protective Order. *See* 13 C.F.R. § 134.205. After reviewing the Decision, the parties informed OHA they had no requested redactions. Therefore, I now issue the entire Decision for public release.

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. The Solicitation, Award, and Protest

On December 31, 2015, the U.S. Department of Veterans Affairs, Office of Construction and Facilities Management, in Washington, D.C. (DVA), issued Solicitation No. VA101-15-R-0181 (RFP) for lease of clinic space. The Contracting Officer (CO) designated it under North American Industry Classification System (NAICS) code 531190, Lessors of Other Real Estate Property, with a corresponding $38.5 million annual receipts size standard. Offers were due April 7, 2016. The procurement is unrestricted; however, Evaluation Factor #4 provides credits for offerors that are small businesses, veteran-owned small businesses, or service-disabled veteran-owned small businesses. (RFP 2.4.4.) Appellant received credit for its small business size status under Evaluation Factor #4. (CO's June 2, 2017 letter.) Therefore, because status as a small business is beneficial to the offeror, SBA has jurisdiction over size protests and appeals. 13 C.F.R. § 121.1001(a)(7); *Size Appeals of Pacific Power, LLC*, SBA No. SIZ-5520 (2013).

On May 16, 2017, the DVA notified SMN, LLC (SMN), an unsuccessful offeror, that it had awarded the contract to Appellant. On May 22, 2017, SMN filed a size protest with the CO, alleging Appellant is not an eligible small business concern because Appellant is affiliated with numerous other entities, including through Martin B. Cleage, and that the combined receipts of Appellant and its affiliates exceeds the size standard. SMN also alleged that Appellant is affiliated with B.L. Harbert International, LLC (Harbert), a large concern, under the ostensible subcontractor rule. The CO referred the protest to the Area Office for a size determination.

On June 9, 2017, the Area Office notified Appellant of the protest, and requested that it submit a response to the protest, a completed SBA Form 355, and certain other information as of April 27, 2016, the date of its self-certification as a small business with its initial offer including price. On June 12, 2017, Appellant submitted various documents to the Area Office along with its response to the protest allegations.[2] SBA made additional requests for information by phone or email on June 14, 16, 20, 21, 23, and 28. Appellant provided additional information on June 15, 19, 20, 22, 23, and 28.

Regarding the Foundation, Appellant explained that under the tax code, the Foundation "cannot have Members or Shareholders nor can it benefit any of its officers, directors or trustees and in [e]ffect is public community property". (Email of June 20, 2017, 5:29 pm, from D. Weaver to Y. Bascumbe.) Thus, Appellant argues, the Foundation is not an affiliate of Appellant. Appellant also noted that all contributions to it come from the Johnsons. (*Id.*)

As for both real estate taxes and intercompany receipts, Appellant explained that most of the affiliates are single-purpose entities that own real estate and have no employees. (Letter of

[2] Appellant challenged SMN's standing to protest. Appellant has since dropped this argument, and I will not consider it here.

June 19, 2017, from D. Weaver to M. Baltzgar, at 1-2.) Appellant, through Johnson Property Services, LLC (JPS), collects rent from the affiliates' tenants. Part of the rent is collected in a central account and used to pay the affiliates' annual real estate taxes. As for intercompany receipts, Appellant again noted the affiliates have no employees to maintain and manage the buildings. "To pay for cost of employees and their overhead expenses, each of the affiliated companies pays [Appellant] a portion of its gross receipts for each companies' respective operating expenses related to services provided by [Appellant] and its subsidiary, [JPS]." (*Id.*) Based on these exclusions, Appellant asserted its 3-year average annual receipts is $34,385,661 - qualifying Appellant as a small business under the $38.5 million size standard. (*Id.* at 4.)

Following additional questions from the Area Office, on June 22, Appellant explained the eight types of exclusions from receipts it was claiming: Development Fees (typically around 2% of the initial project); Project Management Fees (costs Appellant's construction managers incur during construction, 1.5% to 2.5% of the project); Guaranteed Payments from LLCs (for development costs such as for soil studies or design fees); Construction Savings Fee (one-time incentive fees); Asset Management Fees (ongoing cost of the management on behalf of the different owners of each entity, 1.0% to 1.5% of owners' distributions); Intercompany Overhead Allocation (costs of general overhead of JPS, Johnson Federal Properties, LLC (JFP), and Appellant, including executive compensation); Property Management Fees (for maintenance, repairs, etc., 3.5% to 4.5% of the gross rent collected); and Leasing Compensation Fees (for JPS's leasing team and to market a lease). (Letter of June 22, 2017, from D. Weaver to M. Baltzgar.)

On June 23, after additional questions from the Area Office, Appellant provided further explanation. The "overhead allocation" is not collected from affiliated rental entities, but by Appellant from its operating subsidiaries JPS and JFP, all of which are 100% owned by JHH. Cash transfers are made between JD and JPS for these allocations. (Letter of June 23, 2017, from D. Weaver to M. Baltzgar.)

On June 28, after additional questions from the Area Office, Appellant responded that Appellant collects Development Fees and Project Management Fees from the rental entity during construction. (Email of June 28, 2017, from D. Weaver to Y. Bascumbe/M. Baltzgar.) Asset Management Fees are invoiced and paid by check by the rental entity to Appellant. Property Management Fees are invoiced and paid by check by the rental entity to JD's wholly owned subsidiary JPS. These fees are part of the operating expenses of each property and paid by each tenant through their operating expense portion of their rent.

B. The Size Determination

On July 7, 2017, the Area Office issued Size Determination No. 03-2017-041, finding Appellant is not an eligible small business for the subject procurement. The Area Office noted that Appellant was not licensed because the state of Texas does not license general contractors. Appellant also denied SMN's allegation that Mr. Cleage is an officer with significant control over Appellant. Mr. Cleage retired in February, 2015, and was never involved in Appellant's management. (Size Determination at 3.)

The Area Office found that as of the date size is determined, Appellant was owned by Johnson Healthcare Holdings, LLC (JHH).[3] JHH was owned 90% by James M. Johnson and 10% by his wife, Sallie R. Johnson. (*Id.* at 4.) Their children are Milton Johnson and Sumner J. Rives. The Area Office found an identity of interest among the four family members based on the family relationship so they may be treated as one party with the interests aggregated. (*Id.* at 5.) The Area Office found Appellant affiliated with 31 other companies (including JHH), and Appellant conceded its affiliation with these firms.[4] (*Id.* at 5-6.)

The Area Office also found Appellant affiliated with the James Milton and Sallie R. Johnson Foundation (the Foundation). Ms. Rives is President and Johnson family members are directors and the only contributors. Appellant had argued the Foundation's revenues should be excluded because it is a nonprofit which cannot have Members or Shareholders, or benefit any of its officers, directors or trustees. The Area Office found the Foundation is affiliated with Appellant due to familial identity of interest, and because the receipts of nonprofit affiliates must be counted to determine a concern's size, included the Foundation in its calculation of Appellant's size. (*Id.* at 6.)

The Area Office found Appellant was not affiliated with Harbert under the ostensible subcontractor rule. (*Id.* at 7-8.)

The Area Office noted that Appellant had argued that real estate or property taxes collected by its affiliates should be excluded as "taxes collected for and remitted to a taxing authority." The Area Office disagreed, because the regulation provides that taxes such as sales taxes which are collected for and remitted to a taxing authority are exempt. Real estate taxes are an expense associated with owning property, not a tax collected from customers and passed to a taxing authority. (*Id.* at 8-9.)

The Area Office further noted Appellant had argued that items claimed as "Intercompany Receipts" should be excluded from its receipts because payments made to Appellant by its affiliates are based on percentage fees. Appellant had stated that most of its receipts are overhead charges to its affiliates. The Area Office had requested of and received from Appellant an itemization of intercompany receipts, with an explanatory narrative, but concluded that certain of the payments Appellant sought to exclude would not result in double-counting of receipts, and

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[3] JHH was dissolved on January 4, 2017. James M. Johnson currently owns 100% of Appellant.

[4] Johnson Property Services, LLC; Johnson Healthcare Holdings, LLC; Johnson Investment Company, LTD; Central Shelby GP, LLC; Johnson Investment Company, GP, Inc.; Johnson Federal Properties, LLC; Johnson Federal Properties Savannah, LLC; Johnson Federal Properties Lafayette, LLC; JD 2011, LLC; Lenoir City MOB, LLC; Sevierville MOB, LLC; Saxony MOB, LLC; Northwest Center, LLC; Highland Community MOB, LLC; Highland Community II MOB, LLC; Chatt East, LLC; Chatt North, LLC; Singing River MOB, LLC; Colonial Pinnacle MOB, LLC; SV Six Unit 2, LLC; SV Six Unit 3, LLC; JAX MOB, LLC; Mid T MD, LLC; SVPOBV, LLC; SVPOB7, LLC; SV-ADC, LLC; Waco MOB, LLC; 150 Office Development, LLC; Walker Med Tower, LLC; SMC MOB, LLC; SMC MOB II, LLC.

thus should not be excluded from calculating receipts. While Appellant receives payments from its affiliates, they do not receive payments on the same charges from a third party. For example, Appellant receives payment for overhead charges only once. (*Id.* at 9.)

The Area Office concluded that the only items which might be properly excluded as otherwise double-counted were the Asset Management Fees and Property Management Fees embedded in the rent collected. However, the Area Office questioned even these items because they are collected through the operating expense portion of the rent. The Area Office ultimately chose not to exclude these two items, because even if it were to exclude them, Appellant would still exceed the size standard and so the issue is moot. (*Id.*)

The Area Office found that other fees such as Development Fees, Project Management Fees, Guaranteed Payments from LLCs, Construction Savings Fee, Leasing Compensation Fees, Intercompany Overhead Allocation, could not be excluded because they do not represent double-counting of revenues. The Area Office found that Intercompany Overhead Allocations are payments to Appellant from its wholly owned subsidiaries. Appellant had argued that these allocations reflect corporate overhead costs it paid on the subsidiaries' behalf. The Area Office concluded that because the operating subsidiaries do not receive overhead allocation payments there is no double counting of revenue. (*Id.*)

The Area Office reviewed the tax returns for Appellant and its affiliates for 2013, 2014, and 2015, and concluded Appellant was not a small business under the applicable size standard. (*Id.* at 10.)

C. The Appeal

On July 21, 2017, Appellant filed the instant appeal. First, Appellant argues the Area Office erred in finding the Foundation affiliated with Appellant. Appellant emphasizes the Foundation is a non-profit, charitable organization. Appellant points to the Foundation's IRS Determination Letter and its Articles of Incorporation which establish this non-profit status, and prohibit any self-dealing by the Foundation's officers and directors. Appellant asserts the Foundation pays no compensation or benefit or reimbursement of expenses to any Johnson family member or officer or Member of Appellant. (Appeal at 7-8.)

Appellant refers to a letter to the Area Office of June 20, 2017 from Daniel Philanthropy Advisors, LLC, which explained the Foundation's assets are in effect already “contributions for the public benefit”, which must all be distributed. (Id. at 9.) Therefore, Appellant argues it established a clear line of fracture between the Foundation and Appellant because all of the Johnson family members' donations to the Foundation are irrevocable and beyond their control in any way to aid Appellant. Further, the Foundation's charitable mission is a completely different line of business from Appellant. Appellant argues it has established a clear line of fracture with the Foundation, because there is no shared financial assistance, no loans, no subcontracting between them, no similar customers or lines of business, no shared equipment, facilities or employees. (*Id.* at 9-10, citing *Size Appeal of Gregory Landscape Services, Inc.*, SBA No. SIZ-5817 (2017).)

Appellant argues that under the regulation firms owned and controlled by family members are affiliated if they conduct business with each other, and there is no evidence of Appellant and the Foundation doing so. Appellant submits as new evidence Exhibit 3, the affidavit of Milton R. Johnson, Board member and Treasurer of the Foundation to support its argument. (*Id.* at 10.) Appellant argues OHA precedent supports its position. (*Id.*, citing *Size Appeal of MCH Corporation*, SBA No. SIZ-5622 (2014).)

Regarding intercompany transactions, Appellant argues that under the Area Office's reasoning that Asset Management Fees and Property Management Fees are excludable; the Leasing Compensation Fees also must be excludable. (Appeal at 11.) Appellant points to its submissions to the Area Office describing these fees in support of its argument. If, as the Area Office found, fees embedded in the rent collected may be considered double-counted receipts, then the Leasing Compensation Fees must be excluded as well. Appellant seeks to submit as new evidence Exhibit 4, its accountant's affidavit to support its claim. (*Id.* at 11-14.)

Appellant asserts it complied with SBA Size Policy Statement No. 3, 81 Fed. Reg. 32,635 (May 24, 2016), by specifically identifying those revenues it argued should be excluded from the calculation of its receipts, and properly documented those exclusions. (*Id.* at 14-15.) Appellant seeks to admit as new evidence Exhibit 5, the affidavit of James M. Johnson, discussing its interaffiliate transactions. Exhibit 5 also includes Appellant's standard agreements with its affiliates, which include clauses that Appellant must deliver services to the affiliates for which the affiliates agree to make payments of the fess Appellant sought to exclude. These include Leasing Compensation Fees, Property Management Fees, Development Fees, Project Management Fees, Accounting Fees (Other Development Income), Incentive Compensation (Construction Savings Fees), and Acquisition/Sale of Property Service Fees. (*Id.* at 15.)

Appellant concludes by stating that if the Area Office has excluded the Foundation receipts and the fees it has identified from the calculation of Appellant's income, Appellant would be well within the applicable size standard. (*Id.* at 16.)

On July 24, 2017, Appellant filed a Motion to Supplement the Record. Appellant argues the affidavits mentioned in Exhibits 3, 4, and 5 should be admitted into the record. Appellant states it believed it had submitted sufficient documents to the Area Office, and did not realize until receiving the Size Determination that the information in the affidavits would be relevant. Appellant complains that the Area Office did not share any versions of the Size Determination with Appellant, which would have given Appellant some indication of the issues the Area Office was considering. Appellant points to *Size Appeal of National Sourcing, Inc.*, SBA No. SIZ-5305 (2011) in support of its argument the Area Office was required to illuminate the issues in its discussions with Appellant. (Motion at 6.) Appellant maintains the information in the affidavits would not prejudice either party, and they contain information relevant to the appeal.

On August 4, 2017, SMN opposed Appellant's Motion. SMN maintains the Affidavit of Milton Johnson consists of interpretations and argument on documents already in the record. The accountant's affidavit is not based on an examination of Appellant's tax returns accounting records, but upon his examination of the package submitted by Appellant to the Area Office. The affidavit does not clarify the issues, or state whether Appellant was a party to the interaffiliate

transactions. The Affidavit of James Johnson contains no information which could not have been submitted to the Area Office, when Appellant was aware the issue of affiliation was being considered.

On August 8, 2017, SBA also opposed Appellant's Motion. SBA asserts Appellant was in communication with the Area Office and knew there were issues regarding the Foundation and the calculation of its receipts. The evidence in question could have been submitted to the Area Office, and should not be considered now.

On August 10, 2017, SBA amended its Opposition, reasserting its objection. SBA asserts Appellant was well aware the issue of whether it was affiliated with the Foundation was under consideration, and could have submitted to the Area Office the information it seeks to submit now. Similarly, the issues regarding the calculation of Appellant's receipts were discussed with the Area Office, and Appellant could have submitted this information then. The Area Office is not required to share drafts of its decisions with the protested concern or the protestor. SBA maintains the many exchanges the Area Office had with Appellant meets the standard in *National Sourcing*.

On August 15, 2017, Appellant filed a Motion to Reply to SMN's and SBA's oppositions, and also its proposed Reply.

On August 16, 2017, I issued an order setting the briefing schedule for the remainder of this proceeding and deferring my ruling on Appellant's Motion to Supplement the Record until I issue the final decision.

D. SMN's Response to the Appeal

On August 25, 2017, SMN responded to the appeal. SMN first argues that SBA must include the Foundation as an affiliate of Appellant under 13 C.F.R. §§ 121.103(a)(6) and 121.104(a). While Appellant argues there is a clear fracture, the Area Office also found affiliation in the basis of power to control and common management. The rules which govern the Foundation do not change the fact that the Johnson family owns and manages it. (SMN Response at 2-3.)

SMN further argues Appellant cannot exclude interaffiliate transactions to which it was it was not a party. The exclusion only applies to transactions between the challenged concern and its affiliates, not transactions between affiliates of the challenged concern. (*Id.* at 3-4.) SMN noted that Appellant sought to exclude fees paid to JPS and JFP because it and those companies were "one and the same." (*Id.* at 4, citing email of June 20, 2017, D. Weaver to Y. Bascumbe in Response # 6, and *Caroline Hunt Trust Estate v. U.S.*, 470 F.3d 1044 (2006).) However, the exclusion for interaffiliate transactions does not apply to transactions to which the challenged concern was not a party, therefore the Area Office properly included all transactions to which Appellant itself was not a party. (SMN Response at 5.)

SMN then argues that interaffiliate receipts may be excluded only when to include them would result in double-counting of revenue. The Area Office correctly determined that including

the revenue Appellant seeks to exclude would not result in double-counting because the affiliates do not collect fees from a third party and remit them to Appellant. The fees are collected only once by Appellant, JPS and JFP. SMN points to Appellant's explanation on June 23, 2017, that overhead allocations are only charged to and collected by Appellant from its operating subsidiaries. The operating subsidiaries did not receive payments constituting overhead allocations, and so there is no double counting of revenues. (*Id.* at 7.) Appellant is providing a service to its affiliates, for which those affiliates pay in the normal course of business. This payment is recorded as revenue once by Appellant, but not by its affiliates because they do not collect such a fee from their tenants. The affiliates may contract with Appellant for the services, contract them out or perform them in-house. The services are not passed-through and not double-counted. (*Id.* at 7-8.)

SMN points out that the Area Office had first questioned whether the Asset Management Fees and Property Management Fees should be excluded as interaffiliate transactions but then decided this issue was moot because Appellant's receipts exceeded the size standard even if these receipts had been excluded. SMN argues these fees should be included in the calculation of Appellant's receipts because they were not paid to Appellant but to JPS, and because none of these fees represented a pass-through of products or services, but are payments for services. Appellant has presented no evidence these fees are separately charged to tenants and passed through to Appellant. (*Id.* at 8-9.)

SMN argues Appellant may not exclude the other fees: Development Fees, Construction Savings Fees, Acquisition/Sale of Property Fees, Other Development Income, and Guaranteed Payments. SMN maintains there is no double counting by including these fees. Development Fees are paid to perform all the tasks associated with initial development of a project, such as site selection. They are payments for services by Appellant to an affiliate, and are not double-counted. (*Id.* at 10.) Construction Savings Fees are incentive payments, and do not represent double-counting. (*Id.* at 10-11.) Acquisition/Sale of Property Fees were not described in Appellant's submission to the Area Office. (*Id.* at 11.) Other Development Income was not defined or supported. (*Id.* at 11-12.) Guaranteed Payments cover expenses in the early stage of development, prior to an entity being fully organized. There is no indication these payments are passed-through or double-counted. (*Id.* at 12.)

SMN further argues Appellant may not exclude the Overhead Allocation Fee. This is a fee Appellant collected from JFP and JPS. This fee is charged to JFP and JPS, reflecting overhead costs paid by Appellant on their behalf. It does not represent double-counting. (*Id.* at 12-13.)

SMN concludes that Appellant's annual receipts exceed $40 million, and that it is not an eligible small business. (*Id.* at 13-14.)

E. SBA's Response to the Appeal

Also on August 25, 2017, SBA filed its Response to the Appeal. SBA first addresses the issue of the Foundation. Family members are presumed to have identical or substantially identical economic interest and are treated as one party with the interests aggregated. The fact

that James Johnson, Sallie Johnson, Milton Johnson and Sumner Rives are immediate family members creates a presumption that they have an identity of interest between them. The presumption arises, not from the degree of family members' involvement in each other's business affairs, but from the family relationship itself. A challenged concern may rebut the presumption of identity of interest if it is able to show a clear line of fracture among the family members. (SBA Response at 6, citing *Size Appeal of Gregory Landscape Services, Inc.*, SBA No. SIZ-5817 (2017).)

SBA argues the most relevant factor in determining whether there is clear fracture is whether family members participate in multiple businesses together. Here, it cannot be denied that the Johnson family members participate together in both Appellant and the Foundation. When a family member works at a company owned and controlled by other family members, this is grounds for finding no clear fracture. Three of the four members of the Johnson nuclear family control both Appellant and the Foundation. (*Id.* at 7-8, citing *Size Appeal of McLendon Acres, Inc.*, SBA No. SIZ-5222 (2011).) Appellant seeks to show fracture between the concerns rather than the family members, but the core basis for identity of interest is control of both entities by the Johnson family. It is not necessary to find that Appellant and the Foundation do business with each other because the family themselves do business together by operating the concerns together. The fact the family members operate both concerns together creates one of the strongest foundations on which to find identity of interest. (*Id.* at 8-9, citing *Size Appeal of W&T Travel Services, LLC*, SBA No. SIZ-5721 (2016).)

SBA distinguishes *Size Appeal of MCH Corporation*, SBA No. SIZ-5622 (2014), because in that case the owner of the challenged concern had no role in the operation of the non-profit affiliates. (*Id.* at 9-10.) The fact that the Foundation is not organized for profit is irrelevant to the question of whether it is affiliated with Appellant. (*Id.* at 10-11.)

SBA then turns to the issue of interaffiliate transactions. SBA notes the exclusions of certain revenue from the calculation of a concern's receipts are to be strictly interpreted, and the exclusion for interaffiliate transactions is meant to prevent counting revenue more than once. (*Id.* at 11-12, citing *Size Appeal of J.M. Waller Associates, Inc.*, SBA No. SIZ-5108 (2010) and SBA Size Policy Statement No. 3, 81 Fed. Reg. 32,635 (May 24, 2016).)

SBA maintains Appellant never provided to the Area Office the necessary information or detail to establish that the transaction it proposes to exclude from the calculation of its receipts constitutes double-counting of revenue. The explanation is that the affiliates pay those fees for services they cannot perform themselves. This is not evidence of double-counted receipts. (*Id.* at 12-13.)

SBA asserts the appeal misrepresents the Area Office's calculation of Appellant's receipts by asserting that Asset Management Fees and Property Management Fees were excluded in determining Appellant's annual receipts. The Size Determination never states that these fees were excluded in calculating Appellant's receipts. The Size Determination stated very clearly that for the sake of argument, if these fees were excluded, Appellant's receipts would still exceed the size standard. (*Id.* at 14, citing Size Determination at 9.)

SBA further asserts that because Appellant files consolidated tax returns with some of its affiliates, revenue involving one or more of these affiliates is already eliminated in the filing of the returns. (*Id.* at 14.) SBA concludes by asserting Appellant has not challenged any of the Area Office's calculations, except to argue certain categories of revenue should be excluded. Thus, Appellant has not met its burden to prove that the contested fees should be excluded from the calculation of revenue, and the Size Determination should be affirmed. (*Id.* at 15.)

F. Appellant's Reply

On September 1, 2017, Appellant filed its Reply. Appellant noted that the Area Office's worksheet shows deductions applied by the Area Office for Asset Management Fees and Property Management Fees, supporting its argument the Area Office agreed these fees should be excluded. (Appellant's Reply at 2.)

Regarding the Foundation, Appellant maintains there is another line of OHA jurisprudence analyzing clear fracture in the context of family relationships. Appellant argues the appropriate analysis is whether the firms in question share officers employees, facilities, or equipment, have different customers or lines of business, whether there is financial assistance between the firms, and whether the family members participate in multiple businesses together. (*Id.* at 5, citing *Size Appeal of Gregory Landscape Services, Inc.*, SBA No. SIZ-5817 (2017).) Here, Appellant and the Foundation share no facilities, employees, operations, equipment, lines of business, financial assistance, loans, subcontracting or business dealing. (*Id.*) Appellant points to *Size Appeal of Megen-AWA 2, LLC*, SBA No. SIZ-5845 (2017) (*Megen-AWA*) which referred to whether the Appellant had met the burden of rebutting the presumption by showing there was a clear line of fracture between the two concerns at issue. (Reply at 6.) OHA did not mention the degree of estrangement between the family members but focused on the extent of the dealings between the two concerns. (*Id.* at 6.) *Megen-AWA* also did not find identity of interest between the brothers because of joint participation in a charity. (*Id.* at 7.) Appellant also points to *Size Appeal of Lajas Industries, Inc.*, SBA No. SIZ-4285 (1998) where involvement in a non-profit entity was found not to support a finding of identity of interest. (*Id.* at 7.) Appellant maintains that by demonstrating the Foundation is a legitimate charity, it has established a clear fracture between itself and the Foundation. (*Id.* at 7-8.)

Appellant attempts to distinguish cases dealing with nonprofits. In *Size Appeal of Trailboss Enterprises, Inc.*, SBA No. SIZ-5564 (2014), the nonprofit affiliate owned the building out of which the challenged concern operated. In *Size Appeal of ASEE Services Corporation*, SBA No. SIZ-4250 (1997), the challenged concern was a mere paper entity, established to qualify an ineligible non-profit for award. In *Size Appeal of Western River Restoration Partners*, SBA No. SIZ-5695 (2015), the challenged concern did not dispute the affiliation alleged. (*Id.* at 8-9.) Appellant maintains that a review of the Area Office's worksheet shows that if the Foundation is not considered its affiliate, Appellant is a small business. (*Id.* at 9.)

Regarding interaffiliate transactions, Appellant argues Size Policy Statement No. 3 applies here, because it was meant to clarify how the regulation was to be interpreted from the beginning. It was, however, a marked change in the interpretation of the regulation, ending the

requirement that only transaction between a concern and its affiliates with which it filed a consolidated tax return could be excluded. (Reply at 9.) Now the requirement is merely that the transaction be specifically identified by the challenged concern, and that they be properly documented. (*Id.* at 9-10.) Appellant quoted the Size Policy Statement:

> SBA believes the current regulatory language is clear on its face. It specifically excludes all proceeds from transactions between a concern and its affiliates, without limitation. Moreover, the regulatory history supports the position that the exclusion for interaffiliate transactions is available regardless of the manner of affiliation between a concern and its affiliate.

Size Policy Statement No. 3, at 32636.

Appellant maintains the Area Office failed to properly apply the Size Policy Statement. (Reply at 11.) The Area Office "erred by considering the nature of the affiliation between [Appellant] and the affiliates with which the transactions occurred." (*Id.*) Appellant states all the identified affiliates are legitimate candidates for consideration to be involved in interaffiliate transactions, but the Area Office refused even to consider excluding any proceeds resulting from transactions between Appellant and JPS, and JHH, or JFP. (*Id.* at 11.)

Appellant argues it satisfied the requirements of the Policy Notice to have the amounts excluded as interaffiliate transactions, by specifically identifying the transactions to be excluded and by providing documentation. Appellant maintains the Area Office evidenced no issues with the sufficiency of the documentation and excluded Property Management Fees and Asset Management Fees from its calculations. (*Id.*)

Appellant argues the phrase "double-counting" does not appear in 13 C.F.R. § 121.104(a). (*Id.* at 2.) Appellant further asserts the Area Office refused to meaningfully review Appellant's submissions. Appellant's affiliates do not manufacture items. They have no personnel. They collect rent, counted as a receipt to them. The affiliates then pay a portion of those receipts to Appellant, either directly or through its subsidiaries, which are reported as receipts on the affiliates' tax returns. The record reflects the type, and amounts of these transactions as well as from which and to which entity the proceeds flowed. (*Id.*) The Area Office excluded Asset Management Fees and Property Management Fees from its calculation of Appellant's receipts. The same logic requires that the fees embedded in rent also be excluded. (*Id.* at 12-13.)

III. Discussion

A. Standard of Review and New Evidence

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).

OHA generally will not consider evidence not previously presented to the Area Office. 13 C.F.R. § 134.308(a). OHA's review is based upon the evidence in the record at the time the Area Office made its determination. *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 10-11 (2006). As a result, evidence that was not previously presented to the Area Office is generally not admissible and will not be considered by OHA. *E.g., Size Appeal of Maximum Demolition, Inc.*, SBA No. SIZ-5073, at 2 (2009) ("I cannot find error with the Area Office based on documents the Area Office was unable to review.").

I find Appellant's argument that the Area Office should have shared with it drafts of the size determination to be meritless. There is no requirement that the Area Office do so. Appellant's reliance on *Size Appeal of National Sourcing, Inc.*, SBA No. SIZ-5305 (2011) in support of its Motion to Supplement the Record is misplaced. In *National Sourcing*, the appellant thought it had responded sufficiently to an area office's request for information, when the area office concluded it had not, without making that clear to the appellant, and OHA admitted that appellant's new evidence. Here, the Area Office went back-and-forth many times with Appellant trying to elicit the necessary information regarding the intercompany transactions, and the record contains several versions of submitted spreadsheets and tables. Thus, *National Sourcing* is inapposite. I DENY Appellant's motion to admit new evidence on appeal.

Appellant filed a motion for leave to reply and a reply to the oppositions to its motion to supplement the record. SMN and SBA both opposed this Motion. In the interest of judicial economy, I must deny this motion. A reply to a response is not favored in OHA proceedings. 13 C.F.R. § 134.206(e). Also on August 17, 2017, SMN made its motion to supplement the record. I also deny this motion, as it is not relevant to the issues at hand.

B. Analysis

1. The Foundation

The first issue to consider is whether Area Office's finding that the Foundation is affiliated with Appellant was in error. The Foundation was created in 2006. The Directors are James Johnson, his wife Sallie Johnson, their son Milton Johnson and their daughter Sumner Rives. Ms. Rives is President of the Foundation. The record includes a letter from Melissa Daniel of Daniel Philanthropy Advisors asserting that the Foundation organized exclusively for charitable purposes. There is nothing in the record that would support a conclusion that the Foundation is not a legitimate, non-profit charitable organization. Nor did the Area Office find that the Foundation was anything other than a legitimate, non-profit charitable organization.

However, the fact it is a legitimate, non-profit charity does not insulate the Foundation from a finding of affiliation. The regulation provides:

> In determining a concern's size, SBA counts the receipts, employees, or other measure of size of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.

13 C.F.R. § 121.103(a)(6) (emphasis supplied).

In determining whether concerns are affiliated, OHA has consistently found no difference between for profit and non-profit entities. In *Size Appeal of ASEE Services Corporation*, SBA No. SIZ-4250 (1997), a non-profit was found affiliated with its wholly for-profit subsidiary. Appellant argues that it was a paper entity, and so that case is inapposite. However, it was the for-profit concern that was the paper entity. Further, whether either concern was a paper entity or not was irrelevant. The concerns were affiliates, and their receipts were aggregated to determine size. In *Size Appeal of Trailboss Enterprises, Inc.*, SBA No. SIZ-5564 (2014), a charitable foundation controlled by the majority stockholder of the challenged concern and his wife was found affiliated with challenged concern. The fact that the challenged concern's foundation owned the building in which the challenged concern's offices were housed was not the most important factor. The important factor was that the for-profit and non-profit concerns were controlled by the same individuals, and the non-profit concern was treated no differently than the for-profit concerns in determining affiliation. In *Size Appeal of Western River Restoration Partners*, SBA No. SIZ-5695 (2015), the challenged concern's parent was a non-profit, and found to be affiliated with the challenged concern, and its revenues included in the calculation of the concern's annual receipts. While it is true that the appellant in that case did not dispute the finding of affiliation, that does not mean the case is inapposite. Rather, the appellant there conceded an issue that was settled law, and argued instead on how its receipts should be calculated.

The cases Appellant relies upon to the contrary are inapposite. In *Size Appeal of MCH Corporation*, SBA No. SIZ-5622 (2014), OHA found the challenged concern was not affiliated with certain non-profit concerns, because there were no, or only minimal, ties between them. There was no question that had the necessary connections between the firms existed, there would have been a finding of affiliation. In *Size Appeal of Megen-AWA 2, LLC*, SBA No. SIZ-5845 (2017), the participation of two brothers in a charity was found not to be evidence of a lack of a clear fracture between them, but this decision did not find that a non-profit was exempt from a finding of affiliation. In *Size Appeal of Lajas Industries, Inc.*, SBA No. SIZ-4285 (1998) OHA noted that the credibility of the protestor was not enhanced by baseless allegations that the challenged concern was affiliated with non-profit entities with which it did not have common ownership, management, or control.

Therefore, I conclude that under the regulation and settled OHA precedent, non-profit concerns are treated no differently than for-profit concerns in determining the size of a challenged concern. They may be found affiliated under the same criteria as other concerns, whether one concern controls or has the power to control the other. 13 C.F.R. § 121.103(a)(1). Therefore, the fact the Foundation is a legitimate non-profit organization does not exempt it from being found affiliated with Appellant, and from having its receipts included in the calculation of Appellant's annual receipts.

Here, the Area Office found Appellant and the Foundation affiliated under the common management (13 C.F.R. § 121.103(e)) and identity of interest (13 C.F.R. § 121.103(f)) regulations. Appellant's Chairman and CEO is James M. Johnson, who owns 90% of the parent entity, JHH. Sallie Johnson, his wife, owns 10% of JHH. Milton Johnson, their son, is Appellant's President and Chief Investment Officer. The Directors of the Foundation include James, Sallie, and Milton Johnson, together with Sumner Rives, the daughter of James and Sallie, who is also the Foundation's President.

The identity of interest rule provides:

> Affiliation may arise among two or more persons with an identity of interest. Individuals or firms that have identical or substantially identical business or economic interests (such as family members, individuals or firms with common investments, or firms that are economically dependent through contractual or other relationships) may be treated as one party with such interests aggregated. Where SBA determines that such interests should be aggregated, an individual or firm may rebut that determination with evidence showing that the interests deemed to be one are in fact separate.

13 C.F.R. § 121.103(f).[5]

OHA has extensive case precedent interpreting this regulation as creating a rebuttable presumption that close family members have identical interests and must be treated as one person. *See, e.g., Size Appeal of Knight Networking & Web Design, Inc.*, SBA No. SIZ-5561 (2014). OHA has explained that "[t]he regulation creates a rebuttable presumption that family members have identical interests and must be treated as one person, unless the family members are estranged or not involved with each other's business transactions." *Size Appeal of Tenax Aerospace, LLC*, SBA No. SIZ-5701, at 12 (2015) (quoting *Size Appeal of Golden Bear Arborists, Inc.*, SBA No. SIZ-1899 (1984).) "The presumption arises, not from the degree of family members' involvement in each other's business affairs but, rather, from the family relationship itself." *Id.* (quoting *Size Appeal of Gallagher Transfer & Storage Co., Inc.*, SBA No. SIZ-4295 (1998).) The underlying rationale for the rule is that persons will, because of their common interests, act in concert as one. *Size Appeal of RBG Group, Inc.*, SBA No. SIZ-5351, at 7 (2012).

It is not necessary to conclude that one concern exercises near-total control over another in order to find affiliation through family relationships. Rather, the fact of the family relationship creates a presumption that the family members have identical interests and so SBA must treat them as one person. The burden then shifts to the challenged concern to rebut that presumption. *Size Appeal of CTSI-FM, LLC*, SBA No. SIZ-5809, at 9 (2017).

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[5] SBA recently has revised this regulation to include more specific language defining which family relationships give rise to an identity of interest. The revised regulation became effective June 30, 2016. 81 Fed. Reg. 34243 (May 31, 2016). However, because the RFP was issued before June 30, 2016, the prior version of the regulation governs this case. *Size Appeal of GASL, Inc.*, SBA No. SIZ-4191 (1996).

A challenged concern may rebut the presumption of identity of interest if it shows "a clear line of fracture among the family members." *Size Appeal of Carwell Products, Inc.*, SBA No. SIZ-5507, at 8 (2013) (citing *Size Appeal of Tech. Support Servs.*, SBA No. SIZ-4794, at 17 (2006).) "A clear line of fracture exists if the family members have no business relationship or involvement with each other's business concerns, or the family members are estranged." (*Carwell* at 8, citing *Size Appeal of Hal Hays Construction, Inc.*, SBA No. SIZ-5217, at 6 (2011).) "Factors that may be pertinent in examining clear line of fracture include whether the firms share officers, employees, facilities, or equipment; whether the firms have different customers and lines of business; whether there is financial assistance, loans, or significant subcontracting between the firms; and whether the family members participate in multiple businesses together." *Size Appeal of Trailboss Enterprises, Inc.*, SBA No. SIZ-5442, at 6 (2013), *recons. denied*, SBA No. SIZ-5450 (2013) (PFR).

Appellant attempts to demonstrate a clear fracture between the operations of the Foundation and those of Appellant and its for-profit affiliates by pointing out that the Foundation shares no facilities, employees, operations, equipment, lines of business, financial assistance, loans, subcontracting or business dealings with the other entities. Appeal at 9-10; Reply at 5 (citing *Size Appeal of Gregory Landscape Services, Inc.*, SBA No. SIZ-5817 (2017)). In doing so, Appellant has misunderstood the regulation and OHA's case law. The clear fracture contemplated by the regulation and case law is a fracture between the family members themselves. "Because it is the familial relationship that gives rise to the presumption, the inquiry takes place with respect to the family members themselves." *Size Appeal of W&T Travel Services, LLC*, SBA No. SIZ-5721, at 14 (2016). The inquiry required is whether the economic interests of the family members are separated such that there is no longer an identity of interest between them. The real issue is whether the family members have business interests which are distinct from each other, and not intertwined. Here, Johnson family members operate the for-profit entities together. It is therefore evident that there is no clear fracture between them. That fact makes identity of interest between the Johnson family members impossible to refute. In such a case "[I]t is irrelevant whether the business connections between [the concerns] are minimal. Their interests are aggregated because they have mutual involvement in another concern. . . ." *Size Appeal of W&T Travel Services, LLC*, SBA No. SIZ-5721, at 14 (2016).

In order to determine whether the presumption may be rebutted, SBA must examine the business interests of the family members. The family members will act through the businesses they control. There must be an examination of whether these firms have business ties with each other. Appellant relies on *Size Appeal of Megen-AWA 2, LLC*, SBA No. SIZ-5845 (2017) to argue that the issue is whether there are business ties between the alleged affiliates. In *Megen-AWA 2*,, the issue was whether there was a clear line of fracture between two brothers. Each brother controlled a firm. Therefore, the examination required an inquiry into whether there were business ties between the two firms, because the brothers acted through those firms. However, the issue was always, whether there a clear line of fracture between the brothers. The examination of the businesses was necessary to determine whether there was a line of fracture between the brothers. The factors which Appellant mentions such as whether there is shared financial assistance, loans, subcontracting between the firms, similar customers or lines of business, or shared equipment, facilities or employees all are important in evaluating whether

businesses owned by different family members are sufficiently separate to support a finding of a clear line of fracture between the family members. But it is between the family members that the line of fracture must be drawn, if it can be.

Here, Appellant and the Foundation are both controlled by the members of the Johnson family. The members of the Johnson family control the Foundation, and they own and control Appellant. They also participate together in a number of other businesses. Therefore, the Johnson family meets the tests in *Gregory Landscape* and *W&T Travel* in that they participate together in a number of concerns, thereby eliminating the possibility of a clear line of fracture between their interests which might rebut the presumption. The fact that there are no ties between the Foundation and Appellant is irrelevant. The interests of the Johnson family members establish that there is no clear line of fracture between the family members which could rebut the presumption of identity of interest. Therefore, all their interests must be aggregated to determine Appellant's size.

The Area Office also found the Foundation affiliated with Appellant under the common management regulation. This regulation provides:

> Affiliation arises where one or more officers, directors, managing members, or partners who control the board of directors and/or management of one concern also control the board of directors or management of one or more other concerns.

13 C.F.R. § 121.103(e).

OHA has held "[c]ommon management affiliation does not require that individual manager(s) exercise total control of a concern, just that they possess critical influence or the ability to exercise substantive control over a concern's operations." *Size Appeal of CTSI-FM, LLC*, SBA No. SIZ-5809, at 11 (2017). Further, "control of both concerns by the same person(s) is necessary for a finding of affiliation through common management." (*Id.*)

Here, James Johnson is Appellant's Chairman and CEO, and he sits on the Foundation's board. Milton Johnson is Appellant's President and Chief Investment Officer, and he sits on the Foundation's board. They clearly have the ability to influence and control the operations of both Appellant and the Foundation. *See id.; Size Appeal of G&C Fab-Con, LLC*, SBA No. SIZ-5649 (2015). Accordingly, Appellant and the Foundation are affiliated under the common management rule.

Appellant really makes no argument that it does not share common management with the Foundation, but only attempts to establish a clear fracture between the concerns, which is irrelevant to the common management analysis. Thus, the Johnson family clearly controls the Foundation, and they own and control Appellant. The family members are not estranged from each other, and their economic interests are completely intertwined. There is no doubt Appellant is affiliated with the Foundation under both the identity of interest and the common management rule.

Accordingly, I conclude Appellant has failed to establish clear error in the Area Office's conclusion that Appellant is affiliated with the Foundation.

2. Interaffiliate Transactions

SBA's regulations explain how SBA calculates a concern's receipts:

> Receipts means "total income" (or in the case of a sole proprietorship, "gross income") plus "cost of goods sold" as these terms are defined and reported on Internal Revenue Service (IRS) tax return forms . . . Receipts do not include ... taxes collected for and remitted to a taxing authority if included in gross or total income, such as sales or other taxes collected from customers and excluding taxes levied on the concern or its employees; proceeds from transactions between a concern and its domestic or foreign affiliates; . . . For size determination purposes, the only exclusions from receipts are those specifically provided for in this paragraph. All other items, such as subcontractor costs, reimbursements for purchases a contractor makes at a customer's request, and employee-based costs such as payroll taxes may not be excluded from receipts.

13 C.F.R. § 121.104(a) (2016).

In interpreting this regulation, OHA has consistently held that the regulation's exclusions of certain revenue from a concern's receipts must be strictly construed, and all revenues must be counted in determining receipts. *Size Appeal of Western River Restoration Partners*, SBA No. SIZ-5695, at 10 (2015). In 2016, SBA issued a formal interpretive rule on the interaffiliate transactions exclusion. This interpretive rule states:

> SBA will apply the exclusion to properly documented transactions between a concern and its domestic or foreign affiliates, regardless of the type of relationship that resulted in the finding of affiliation. . . .
>
> The intent of this exclusion is to avoid counting the same receipts twice when determining the size of a particular concern. . . .
>
> SBA believes the current regulatory language is clear on its face. It specifically excludes all proceeds from transactions between a concern and its affiliates, without limitation. Moreover, the regulatory history supports the position that the exclusion for interaffiliate transactions is available regardless of the manner of affiliation between a concern and its affiliate. SBA recognized that excluding interaffiliate transactions only when they are identified on a consolidated tax return often perpetuated the double-counting of receipts. . . . SBA did not mean to imply that a concern and its affiliates must be able to file a consolidated tax return in order to receive the exclusion from double-counting interaffiliate transactions. Conversely, SBA was attempting to make clear that it did not support the practice of double-counting receipts between affiliates generally. . . .

> SBA will not restrict the exclusion for interaffiliate transactions to transactions between a concern and a firm with which it could file a consolidated tax return. The exclusion for interaffiliate transactions may be applied to interaffiliate transactions between a concern and a firm with which it is affiliated under the principles in 13 C.F.R. § 121.103. Where SBA is conducting a size determination, SBA requires that exclusions claimed under section 121.104(a) be specifically identified by the concern whose size is at issue and be properly documented. This policy is effective immediately.

Size Policy Statement No. 3, 81 Fed. Reg. 32,635-36 (May 24, 2016) (Statement).

Because the Statement applied to the existing regulatory language and stated that its interpretation is that which should have prevailed all along (even though SBA previously had advocated a different interpretation), the Statement applied immediately to all pending and future size determinations, even those arising from RFPs issued prior to the Statement's issuance. *Size Appeal of Tenax Aerospace, LLC*, SBA No. SIZ-5747 (2016).

One line of precedent the Statement left undisturbed was that the exclusion applies only to transactions between the challenged concern and an affiliate, i.e., to which the challenged concern itself is a party. *Size Appeal of Newport Materials, LLC*, SBA No. SIZ-5733 (2016). The Statement reaffirmed this principle, providing that the exclusion is for "transactions between a concern and a firm with which it is affiliated." Therefore, Appellant's argument that certain transactions between its affiliates to which it was not a party may be excluded is meritless here. Appellant seeks to exclude transactions between JPS, JFP, and its other affiliated properties. (Weaver to Mascumbe, Response No. 6, June 20, 2017.) However, the clear language of the regulation and the Statement do not permit such receipts to be excluded from the calculation of Appellant's receipts.

Further, I must conclude Appellant is being deliberately misleading when it repeatedly states that the Area Office excluded Asset Management Fees and Property Management Fees from the calculation. SBA properly notes that the Area Office excluded these fees from its calculation for the sake of argument. The Area Office did not definitively rule on whether these fees were properly excluded or not. It found that, even if these fees which arguably could be excluded, were excluded, Appellant exceeded the applicable size standard. While this may not be the clearest method of writing the size determination, it is not the definitive ruling which Appellant presents it to be, and it provides no basis for Appellant's contention that the other fees must be excluded, as well.

The clear intent of the Statement, then, "is to avoid counting the same receipts twice when determining the size of a particular concern." The type of transaction contemplated is a parent company purchasing an item manufactured by its subsidiary and then reselling the item to third party. *Size Appeal of Columbus Technologies and Services, Inc.*, SBA No. SIZ-4831 (2007). It does not apply to the one-way reassignment of assets from a subsidiary to a parent. *Id.* The common characteristic of the items whose exclusion from receipts the regulation

permits is that the amounts in question are usually collected for another party. *Size Appeal of Hui O Ana, LLC*, SBA No. SIZ-5262 (2011).

Appellant does not provide the necessary documentation to establish that including the fees it seeks to exclude in the calculation of Appellant's receipts would represent the double counting of receipts. Rather, Appellant discusses how these fees are paid by the affiliates for services they cannot perform themselves. This does not establish that there would double-counting of revenue if the fees were included. The fees Appellant seeks to exclude do not represent cases where both Appellant and its affiliate are paid for the same service, rendered first by one concern to another and then by that concern to a customer, or rental of the same property, so that the inclusion of both transactions in Appellant's receipts would represent double-counting. Appellant provides a service to its affiliates for which it is paid. The affiliates do not in turn collect such a fee from their tenants. Therefore, the fees do not represent the double-counting of receipts.

Appellant's arguments in favor of excluding the receipts in question largely hang on it being its business practice to provide these services to its affiliates, and to be paid for them. Nothing in Appellant's argument establishes that including these fees in the calculation of its receipts would represent the double-counting of receipts. Thus, I conclude the Area Office did not err in including all of these receipts in its calculation of Appellant's size.

IV. Conclusion

Appellant has failed to demonstrate that the size determination is clearly erroneous. Accordingly, the appeal is DENIED, and the size determination is AFFIRMED.

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

CHRISTOPHER HOLLEMAN
Administrative Judge