

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

SIZE APPEAL OF:

U.S. Army Corps of Engineers,

Appellant,

RE: Kaiyuh Services, LLC

Appealed From

Size Determination No. 6-2018-041

SBA No. SIZ-5915

Decided: May 31, 2018

APPEARANCES

Matthew J. Harris, Esq., Assistant District Counsel, St. Paul, Minnesota, for Appellant

Robert K. Tompkins, Esq., Rodney M. Perry, Esq., Holland & Knight LLP, Washington, D.C., for Kaiyuh Services, LLC

Sam Q. Le, Esq., Office of General Counsel, U.S. Small Business Administration, Washington, D.C.

DECISION

I. Introduction and Jurisdiction

On February 28, 2018, the U.S. Small Business Administration (SBA) Office of Government Contracting Area VI (Area Office) issued Size Determination No. 6-2018-041 concluding that Kaiyuh Services, LLC (Kaiyuh) is a small business. The U.S. Army Corps of Engineers (Appellant) maintains 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 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 after receiving the size determination, so the appeal is timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Solicitation, Protest, and Remand

On August 8, 2017, Appellant issued Invitation for Bids (IFB) No. W912ES-17-B-0005 for the Conway Lake Habitat Rehabilitation and Enhancement Project. The Contracting Officer (CO) set aside the procurement entirely for small businesses, and assigned North American Industry Classification System (NAICS) code 237990, Other Heavy and Civil Engineering Construction. NAICS code 237990 ordinarily is associated with a size standard of \$36.5 million average annual receipts, but the IFB indicated that the procurement fit within the exception for Dredging and Surface Cleanup Activities, which utilizes a \$27.5 million size standard. In addition, Footnote 2 in the size standard table states:

2. *NAICS code 237990* — Dredging: To be considered small for purposes of Government procurement, a firm must perform at least 40 percent of the volume dredged with its own equipment or equipment owned by another small dredging concern.

13 C.F.R. § 121.201 n.2. The IFB did not require that bidders submit a technical proposal or otherwise describe how they would performing the project. Bids were opened on September 7, 2017, and the CO announced that Kaiyuh was the apparent awardee.

On October 27, 2017, the CO filed a size protest against Kaiyuh, and forwarded the matter to the Area Office for review. The protest alleged that Kaiyuh is not a small business because Kaiyuh does not meet the 40% requirement in Footnote 2. On January 11, 2018, the Area Office issued Size Determination No. 6-2018-022, sustaining the protest and concluding that Kaiyuh is not an eligible small business for this procurement.

Kaiyuh appealed Size Determination No. 6-2018-022 to OHA, and on February 8, 2018, SBA moved to remand the matter to the Area Office for a new size determination. OHA granted the motion the next day, vacating Size Determination No. 6-2018-022. *Size Appeal of Kaiyuh Services, LLC*, SBA No. SIZ-5885 (2018).

B. The Instant Size Determination

On February 28, 2018, the Area Office issued Size Determination No. 6-2018-041, reversing its prior position and concluding that Kaiyuh is an eligible small business.

With regard to Kaiyuh's compliance with Footnote 2, the Area Office found that Kaiyuh will subcontract at least 40% of the volume dredged to a small dredging company, Water Works Docks & Boat Lifts, Inc. (Water Works). The Area Office based this conclusion on information submitted during the remand. Specifically, Kaiyuh submitted to the Area Office a sworn declaration from its General Manager, Mr. David Roels, as well as a copy of the subcontract between Kaiyuh and Water Works. (Size Determination No. 6-2018-041, at 5-6.) The Area Office found that “[a]ccording to the Roels Declaration and Subcontract No. 01-0028-19,

[Kaiyuh] will use Water Works, a small business subcontractor, to satisfy the 40 percent dredging requirement in Footnote 2.” (*Id.* at 7.)

The Area Office noted that Kaiyuh itself would not perform any of the dredging on the project, but determined that Footnote 2 “does not conclusively require self-performance by the bidder.” (*Id.* at 6.) Furthermore, Kaiyuh and Water Works are “similarly situated entities” for purposes of the limitations on subcontracting, and these requirements are grounded in the Small Business Act. Insofar as Footnote 2 does require the prime contractor to self-perform at least 40% of the dredging, the Small Business Act takes precedence. “Footnote 2 exists only in regulation, and [the Area Office] must implement the statutory policy in [the Small Business Act] to treat the work of similarly situated subcontractors as if it were performed by the prime contractor.” (*Id.* at 7.)

C. Appeal

On March 15, 2018, Appellant filed the instant appeal.

Appellant highlights that on September 19, 2017, the CO asked if Kaiyuh owned dredging equipment and, if not, who would be doing the required dredging work. (Appeal at 3.) Kaiyuh responded that it did not own hydraulic dredging equipment and that it would subcontract the placement work to J. F. Brennan Co. (Brennan), a large business, but that Kaiyuh would supervise the work. (*Id.* at 4.) After speaking with Appellant's contract specialist about the requirements of Footnote 2, Kaiyuh modified its response to state that it would comply with Footnote 2 by performing 40% of the dredging with its own equipment, and later modified that to state it owned equipment for mechanical dredging and would do 50% of the dredging with its own dredge plant and employees. (*Id.* at 5.)

Following the CO's October 27, 2017 size protest, in which the CO alleged that Kaiyuh cannot satisfy Footnote 2 because Brennan is a large business, Kaiyuh told the Area Office that it would subcontract 50% of the dredging to Brennan and 50% to Water Works, a small business. (*Id.* at 5-6.) Appellant did not learn of this subcontracting plan until the Area Office issued Size Determination No. 6-2018-022 on January 11, 2018. (*Id.* at 6 & n.3.) After the Area Office recommenced the size investigation following remand, Kaiyuh submitted to the Area Office the Roels Declaration and a subcontract with Water Works, effective October 13, 2017. (*Id.* at 7.) Appellant observes that “the subcontract is undated and it is unclear when it was signed. The declaration and subcontract are silent regarding any dates prior to October 13, 2017.” (*Id.*, internal citations omitted.)

Appellant contends, first, that the Area Office clearly erred in determining that a small business offeror may satisfy the requirements of Footnote 2 by subcontracting all of the dredging work to a similarly situated entity. Appellant rejects the Area Office's rationale that the limitations on subcontracting provision of the Small Business Act, as amended by the National Defense Authorization Act of 2013, permits a small business prime contractor to subcontract the performance of dredging work to a similarly situated entity, in the same way that this provision permits that prime contractor to make any dollar amount of expenditure for work subcontracted

to a similarly situated entity without that amount having to be counted against the limitation on subcontracting. (*Id.* at 10-11, citing 15 U.S.C. § 657s.)

Instead, Appellant draws a distinction between expenditures for subcontracting, which § 657s addresses, and the actual performance of the work, on which § 657s is silent. (*Id.* at 11.) Footnote 2 requires the small business prime contractor itself to perform 40% of the volume of dredging work, but does not limit the dollar amount of the work subcontracted out, so there is no conflict between Footnote 2 and § 657s. (*Id.*) Likewise, in *Size Appeal of Brusco Tug & Barge*, SBA No. SIZ-3692 (1992), OHA distinguished between performance and expenditure in holding that Footnote 2's 40% rule does not pertain to the costs of dredging. (*Id.*)

In Appellant's view, the pertinent portion of the statute is § 657s(d)(3), which authorizes SBA to determine the limitation on subcontracting for construction contracts, and under which SBA has set that limit at 85% of the amount paid by the Government to the prime contractor, excluding amounts paid to similarly situated subcontractors. (*Id.* at 12-13, citing 13 C.F.R. § 125.6(a)(3).) In that rulemaking, SBA made no change to Footnote 2, so the limitation on subcontracting for dredging remains a performance standard, not an expenditures standard. (*Id.* at 13.)

The Area Office ignored the plain language of Footnote 2, which states that “a firm must perform” at least 40% of the volume dredged, either with its own equipment or with equipment owned by another small dredging concern. (*Id.* at 14.) Further, the use of the phrase “another small dredging concern” necessarily connotes that the prime contractor also must be a small dredging concern. (*Id.* at 16.) In addition, the Area Office's interpretation creates the absurd result that a golf course construction company (also in NAICS code 237990), or even an office of lawyers (in an entirely unrelated NAICS code), could meet the requirements of Footnote 2 if it were a small business and if the subcontractor performs at least 40% of the volume dredged with its own equipment or equipment owned by a small business. (*Id.* at 14-17.)

Second, Appellant contends, the Area Office clearly erred in finding that Kaiyuh intended to subcontract 40% of the dredging work to a small business as of September 7, 2017, the date to determine size. (*Id.* at 17.) OHA has long held that the approach described in the bid or proposal is controlling, and that changes of approach created in response to a protest may not be used to contradict the bid or proposal. (*Id.*) In accordance with this precedent, “the Area Office should have looked at all the evidence available to determine how Kaiyuh intended to perform the work required by the contract as of September 7, 2017, the date on which size must be determined.” (*Id.* at 18.) Instead, the Area Office improperly relied on Kaiyuh's subcontract with Water Works and the Roels Declaration, which constitute a different approach from Kaiyuh's initial statement that it would subcontract all of the dredging to Brennan and self-perform none of it. (*Id.* at 18-19.) Appellant maintains the Area Office should have accorded greater weight to Kaiyuh's earlier statements including its submissions to the CO on September 14 and 20, 2017, and should have concluded that Kaiyuh is ineligible because, as of September 7, 2017, Kaiyuh planned to subcontract all of the dredging work to Brennan, a large business. (*Id.*)

D. Kaiyuh's Response

On April 10, 2018, Kaiyuh responded to the appeal. Kaiyuh asserts that Appellant has not met its burden of proving error in the size determination. Therefore, OHA should deny the appeal. (Kaiyuh Response at 3.)

Kaiyuh first highlights that Kaiyuh itself is “indisputably small” under the \$27.5 million annual size standard, and that Appellant does not contest this fact. (*Id.* at 3, 10.) Second, Kaiyuh contends, the appeal incorrectly suggests that Footnote 2 includes a requirement that the small business prime contractor must self-perform at least 40% of the dredging work with its own employees. (*Id.* at 2.) In actuality, Footnote 2 speaks only to the ownership of the dredging equipment used, and makes no reference to employees or to self-performance. (*Id.* at 4-6.) Also, while OHA has not ruled on the precise question presented here, OHA's decisions in *Size Appeal of Brusco Tug & Barge*, SBA No. SIZ-3692 (1992) and *Size Appeal of American Construction Co., Inc.*, SBA No. SIZ-5420 (2012) describe Footnote 2 as pertaining to the ownership of dredging equipment, not the performance of the dredging. (*Id.* at 6-7.) Additionally, Kaiyuh points to SBA's commentary about Footnote 2 in the *Federal Register*, where SBA rejected an employee-based self-performance requirement for dredging after inviting and considering public comments on the issue. (*Id.* at 5, citing 78 Fed. Reg. 77,334, 77,339 (Dec. 23, 2013).)

Third, Kaiyuh maintains that neither it nor any other bidder was asked to or did address its specific approach to performance in its bid. (*Id.* at 3-4.) Thus, the bids contained no information from which compliance with Footnote 2 could be ascertained. (*Id.* at 10-11.) Footnote 2 also does not require the prime contractor to set out in their bid or proposal how they will meet the 40% requirement, and while Appellant could have added this requirement to the instant IFB, it did not do so. (*Id.*) As for the CO's communications with Kaiyuh after bid opening, the CO's initial communication failed to mention Footnote 2, and the CO's subsequent questions mischaracterized already-dredged material that needed only to be moved as being part of the dredging work. (*Id.* at 11.) Nevertheless, Kaiyuh consistently responded that it would perform in conformance with regulatory requirements. (*Id.*)

Kaiyuh also contends that Kaiyuh's compliance with the limitations on subcontracting rule is an element of responsibility, and therefore, improperly raised in a size protest and size appeal. (*Id.* at 8-9, citing 13 C.F.R. § 125.6(e)(2).) Kaiyuh rejects Appellant's golf course and law office hypotheticals as inapposite and nonsensical, and asserts that the Area Office appropriately relied upon the Roels Declaration and the subcontract with Water Works. (*Id.* at 9—10, 12.)

E. SBA's Response

On April 10, 2018, SBA responded to the appeal. SBA maintains that the size determination is correct and that Kaiyuh is an eligible small business for this procurement. SBA contends that Footnote 2 “is ambiguous”; however, prior OHA case decisions “do not impose self-performance” by the prime contractor. (SBA Response at 5.) Thus, the Area Office's interpretation of the ambiguous regulatory language is neither plainly erroneous nor inconsistent with the footnote. (*Id.* at 12.)

SBA argues that the Area Office was correct to accept as evidence the Roels Declaration, which was sworn under penalty of perjury, as well as the signed subcontract, citing *Size Appeal of Kaiyuh Services, LLC*, SBA No. SIZ-5581 (2014), where, like here, the solicitation did not call for the submission of detailed proposals and the prime contractor's presentation to the Area Office was its first opportunity to describe its subcontracting approach. (*Id.* at 14.) OHA has also held that where a proposal does not include specific information, an area office may rely on documents created after proposal submission to determine whether the offeror would comply with a contract performance requirement. (*Id.* at 16, citing *Size Appeal of Precision Lift, Inc.*, SBA No. SIZ-4876 (2007).)

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 that 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 turns upon the meaning of Footnote 2, which states that:

NAICS code 237990 — Dredging: To be considered small for purposes of Government procurement, a firm must perform at least 40 percent of the volume dredged with its own equipment or equipment owned by another small dredging concern.

13 C.F.R. § 121.201 n.2. Specifically, it is necessary to decide whether Footnote 2 requires the prime contractor itself to perform at least 40% of the dredging, or whether the prime contractor need only arrange for a small business to carry out such work. The Area Office found that Kaiyuh is compliant with Footnote 2, because Kaiyuh will subcontract at least 40% of the dredging to Water Works, a small dredging concern. Section II.B, *supra*. Appellant maintains, however, that Footnote 2 requires the prime contractor to self-perform at least 40% of the work. In Appellant's view, because Kaiyuh will subcontract labor to another company, albeit a small business, Kaiyuh does not comply with Footnote 2. Section II.C, *supra*. Both Appellant and Kaiyuh contend that the plain language of Footnote 2 supports their respective positions, whereas SBA asserts that Footnote 2 is ambiguous.

I agree with SBA that Footnote 2 is susceptible to more than one reasonable interpretation, and therefore is ambiguous. It is true, as Kaiyuh emphasizes, that Footnote 2 focuses on ownership of the dredging equipment, and does not purport to address which firm's employees must operate that equipment. Nor does Footnote 2 expressly preclude a prime

contractor from subcontracting some, or all, of the labor associated with the dredging. On the other hand, as Appellant observes, Footnote 2 does state that “a firm must perform” at least 40% of the dredging, either with its own equipment or with the equipment of a small business. Although Footnote 2 does not explain which entity is meant by “a firm”, in context “a firm” is most logically understood to mean the prime contractor. Furthermore, by permitting “a firm” to utilize the equipment of “another small dredging concern”, Footnote 2 implies that both the prime contractor and subcontractor will be small dredging concerns. It is unclear whether a prime contractor which is not itself engaged in dredging can be considered “another small dredging concern.”

Because the plain language of Footnote 2 is inconclusive, it is appropriate to interpret Footnote 2 in light of the regulatory history. *E.g.*, *Size Appeal of Digital Mgmt., Inc.*, SBA No. SIZ-5709, at 13 (2015). In this regard, during its periodic review of the size standards, SBA invited public comments on:

(1) Whether there continues to be a need to retain the current 40 percent equipment requirement; (2) whether the 40 percent equipment requirement should be revised, and if so, the rationale for an alternative percentage; and (3) whether a different and more verifiable requirement based on an alternative measure (such as value of contract or personnel involved) may achieve the same objective of ensuring that small businesses perform significant and meaningful work on Dredging contracts.

77 Fed. Reg. 42,197, 42,208 (July 18, 2012). After reviewing public comments, SBA announced that it would make no changes to Footnote 2. 78 Fed. Reg. 77,334, 77,339 (Dec. 23, 2013).

SBA's commentary is instructive for several reasons. First, SBA repeatedly referred to Footnote 2 as the “40 percent equipment requirement.” This phrasing suggests that SBA envisioned Footnote 2 as merely requiring the use of a small business's dredging equipment, not that the prime contractor also must self-perform at least 40% of the dredging. Second, SBA expressly considered revising Footnote 2 to address the “personnel involved” in performing the work. Because SBA ultimately decided not to implement such a change to Footnote 2, though, it is evident that SBA did not intend Footnote 2 to assess which firm's employees will perform the dredging. Third, SBA stated that the underlying purpose of Footnote 2 is to “ensur[e] that small businesses perform significant and meaningful work on Dredging contracts.” This objective is advanced regardless of whether the dredging is performed by a small business prime contractor or by a small business subcontractor. Thus, the regulatory history of Footnote 2 supports the Area Office's view that a prime contractor need not self-perform at least 40% of the dredging.

As SBA and Kaiyuh observe, the Area Office's interpretation also is consistent with OHA case precedent. In particular, OHA case law confirms that the focus of Footnote 2 is on ownership the dredging equipment, not on performance of the labor. Thus, in *Size Appeal of American Construction Co., Inc.*, SBA No. SIZ-5420, at 6 (2012), OHA found that Footnote 2 “requires that 40 percent of the equipment involved in the act of excavation be that of a small business.” The prime contractor complied with Footnote 2 because it would utilize its own equipment to perform the work. *Id.* Whether or not the prime contractor also would use its own

employees to perform the dredging was not pertinent to the analysis. Similarly, in *Size Appeal of Brusco Tug & Barge*, SBA No. SIZ-3692, at 4 (1992), OHA explained that Footnote 2 “requires the use of a small dredging concern's equipment to perform the dredging of 40 percent of the required yardage.” There, the challenged firm did not comply with Footnote 2 because “all operating equipment for the required dredging” belonged to a large business. *Id.* OHA did not consider whether the prime contractor's employees would operate the equipment. Based on OHA precedent, then, the Area Office appropriately focused on ownership of the dredging equipment, rather than the source of the labor.

The parties also debate whether the Area Office's decision is supported by limitations on subcontracting regulations. Those regulations permit that a small business prime contractor on a construction project may subcontract up to 85% of the value of the work, and, further, that the prime contractor may claim credit for work performed by other small businesses (*i.e.*, by similarly situated subcontractors). 13 C.F.R. § 125.6(a)(3) and (c). I agree with Appellant that Footnote 2 does not directly conflict with the limitations on subcontracting regulations. This is true because the limitations on subcontracting regulations pertain to the value of the work subcontracted, and thus do not address the same issue presented in Footnote 2. Nevertheless, interpreting Footnote 2 as barring a small business prime contractor on a dredging contract from subcontracting labor, even to a similarly situated small business, creates inconsistency between the rules, and therefore is to be avoided.

Because the Area Office reasonably concluded that Kaiyuh need not self-perform the dredging, the remaining question is whether the Area Office properly considered Kaiyuh's subcontract with Water Works and the Roels Declaration. Appellant highlights that both of these documents were created after September 7, 2017, the date of Kaiyuh's bid and self-certification. Further, OHA has long recognized that “changes of approach created in response to a protest may not be used to contradict” the terms of the bid or proposal. *Size Appeal of Tech. Associates, Inc.*, SBA No. SIZ-5814, at 12 (2017); *Size Appeals of ProActive Techs., Inc., et al.*, SBA No. SIZ-5772, at 29 (2016). In the instant case, though, the subcontract and declaration do not contradict Kaiyuh's bid, because Kaiyuh was not required to, and did not, describe in its bid how it would perform the work. Section II.A, *supra*. Accordingly, the Area Office appropriately considered the subcontract and the Roels Declaration.

Appellant also complains that the subcontract and declaration are contrary to Kaiyuh's statements to the CO after bid opening. Kaiyuh disputes this allegation, but even assuming that Kaiyuh did make inconsistent statements to the CO, Appellant has not established that Kaiyuh's earlier statements are more probative, or entitled to greater evidentiary weight, than the subcontract and the sworn Roels Declaration. Further, although inconsistent statements to the CO might conceivably raise concerns about Kaiyuh's capability to perform the contract, such matters are questions of contractor responsibility that are beyond the scope of the size review process. *E.g.*, *Size Appeal of Loyal Source Gov't Servs., LLC*, SBA No. SIZ-5662, at 12 (2015). Viewed strictly from a size standpoint, there was sufficient evidence in the record for the Area Office to conclude that Kaiyuh is compliant with Footnote 2 and is therefore a small business.

IV. Conclusion

Appellant has not proven 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).

KENNETH M. HYDE
Administrative Judge