United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Superior Optical Labs, Inc., Appellant, RE: PDS Consultants, Inc. Appealed From Size Determination No. 1-SD-2020-08	SBA No. SIZ-6066 Decided: August 18, 2020

APPEARANCES

Elizabeth H. Connally, Esq., Connally Law, PLLC, San Antonio, Texas, for Appellant

David S. Gallacher, Esq., Emily S. Theriault, Esq., SheppardMullin, Washington, D.C., for PDS Consultants

DECISION

I. Introduction and Jurisdiction

On February 10, 2020, the U.S. Small Business Administration (SBA) Office of Government Contracting — Area I (Area Office) issued Size Determination No. 01-SD-2020-08 concluding that PDS Consultants, Inc. (PDS) is a small business under the applicable size standard for Department of Veteran Affairs Solicitation No. 36C24419R0102 (Solicitation). On appeal, Superior Optical Labs, Inc. (Appellant) argues that the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse it and find that PDS is other than small. For the reasons discussed *infra*, the appeal is DENIED, and the size determination is AFFIRMED.

OHA decides size determination appeals under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. parts 121 and 134. Appellant filed the instant appeal within fifteen days of receiving the size determination, so the appeal is timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Solicitation and Proposal

On July 18, 2019, the Department of Veterans Affairs, issued the instant Solicitation for the manufacture of prescription eyeglasses. The Contracting Officer (CO) set the procurement aside for service-disabled veteran-owned small businesses. The CO further designated North American Industry Classification System (NAICS) code 339115, Ophthalmic Goods Manufacturing, with a corresponding 1,000 employee size standard as the appropriate code for this procurement. Initial proposals were due on August 19, 2019. (Solicitation, at 1.) However, following numerous amendments extending the deadline for proposals and Amendment 006, which re-opened the Solicitation, allowing only for the revision of pricing based on corrective action from the CO, final proposal revisions were due on September 9, 2019.

The Performance Work Statement (PWS) requires the contractor to provide a wide selection of frames for veterans to choose from. (Solicitation, at 8.) The contractor is also responsible for manufacturing eyeglasses that conform with specific prescriptions and verifying the final spectacles with the prescription. (*Id.*) The Department of Veterans Affairs requested fixed pricing for a variety of units described in the PWS. (*Id.*, at 15.)

PDS submitted its initial proposal on August 21, 2020, stating that it would use Allan Baker, Inc. d/b/a Korrect Optical (Korrect) as the eyeglass manufacturer, as a supplier. (Proposal, at 7.) Combined with PDS's optical shop order entry system, which automates data entry at the point of patient encounter, PDS asserted the entire system would be seamlessly automated for the fabrication of eyewear. (*Id.*, at 8.) PDS submitted its final proposal revision, which included pricing, on September 7, 2019.

B. Protest

On January 9, 2020, the CO announced that PDS was the apparent awardee of the contract. On January 16, 2020, Appellant filed a timely size protest challenging PDS's size. The CO forwarded the protest to the Area Office for review.

Appellants protests PDS's size under NAICS code 339115 as a Service-Disabled Veteran-Owned Small Business (SDVOSB) arguing that PDS (1) is violating the ostensible subcontractor rule because PDS is unusually reliant upon and is thus affiliated with Korrect, a non-SDVOSB entity; (2) is not small in accordance under the applicable size standard because it is in violation of the nonmanufacturer rule and due to its affiliation with Korrect its size is in excess of 500 employees; and (3) PDS and Korrect are affiliated under the totality of the circumstances. (Protest, at 1.)

C. Size Determination

On February 10, 2020, the Area Office issued Size Determination No. 1-SD-2020-08 concluding that PDS is a small business for the instant procurement. (Size Determination, at 1, 6.)

The Area Office first addressed the issue of the date to determine PDS's size. Generally, SBA determines the size of a concern as of the date it submits its self-certification it is small as part of its initial offer, including price. (*Id.*, at 5; citing 13 C.F.R. § 121.404(a).) However, for purposes of compliance with the nonmanufacturer rule (13 C.F.R. § 121.406(b)(1)) and the ostensible subcontractor rule (13 C.F.R § 121.103(h)(4)), size status is determined as of the date of the final proposal revisions. (*Id.*; citing 13 C.F.R. § 121.404(d).) Since PDS's final proposal revision was submitted on September 7, 2019, the Area Office determined PDS's size as of that date. (*Id.*) The Area Office then determined the protest was timely. (*Id.*)

The Area Office also determined that John Loosen and Richard Murray each own 50% of PDS. (*Id.*) John Loosen is the President of PDS and Richard Murray is the Vice President and Chief Executive Officer. (*Id.*) The Area Office found that PDS is the sole owner of Ferris Optical Inc. and I See U Optical, Inc. Furthermore, as of August 28, 2019, PDS became the 100% owner of Korrect. (*Id.*, at 6.) As such, Ferris Optical Inc., I See U Optical, Inc. and Korrect are subsidiaries of PDS. (*Id.*)

The Area Office then determined that for this solicitation, PDS, through Korrect (its wholly owned subsidiary), will be the manufacturer for the eyeglasses covered under this Solicitation. (*Id.*) At the request of the Area Office, PDS provided a breakdown of employee counts by pay period between September 7, 2018 and September 7, 2019 for PDS and each of its affiliates. (*Id.*) The Area Office determined that the average number of employees of PDS and its affiliates for the preceding completed twelve calendar months is less than the 1,000-employee size standard. (*Id.*) As such, the Area Office determined found PDS to be a small business for this procurement. (*Id.*)

D. Appeal

On February 26, 2020, Appellant filed the instant appeal asserting that the Area Office erred in determining that PDS is a small business manufacturer. (Appeal, at 1.)

Appellant first argues the Area Office failed to recognize PDS is not a manufacturer and failed to determine that PDS is also not an eligible nonmanufacturer small business. (*Id.*, at 5.) Appellant relies upon the nonmanufacturer rule (13 C.F.R. § 121.406(b)), which provides that in order to qualify as a small business provider of manufactured products, the contractor must be the manufacturer of the end item provided or otherwise comply with the requirements of the regulation. (*Id.*, at 6.) Appellant notes that under the rule a manufacturer is the concern "which, with its own facilities, performed the primary activities in transforming inorganic or organic substances, including the assembly of parts and components, into the end item being required." (*Id.*) Further, for size purposes there can only be one manufacturer of the end item being acquired. (*Id.*; citing 13 C.F.R. § 121.406(b)(2).) Appellant notes the regulation sets out factors to evaluate to determine whether a concern is the manufacturer of the end item being acquired. (*Id.*; citing 13 C.F.R. § 121.406(b)(2)(i).) Appellant asserts there is no evidence the Area Office undertook such an evaluation. (*Id.*) Appellant argues that the Size Determination clearly acknowledges that PDS will be performing minimal tasks because it clearly states that Korrect will manufacture the eyeglasses for PDS. (*Id.*)

Appellant compares this case to *Size Appeal of Coulson Aviation USA, Inc.*, SBA No. SIZ-5815 (2017), where Coulson Aviation appealed the size determination stating it was not an eligible small business. (*Id.*, at 6-7.) OHA affirmed the area office's determination that Coulson Aviation was not the manufacturer, as it would not be the entity fabricating or assembling the product because its affiliate operated the manufacturing facilities and performed the primary activities to transform the materials into the product. (*Id.*, at 7; citing *Coulson Aviation USA*, at 9 (2017).) Appellant argues that when determining the manufacturer, OHA held that the issue was which concern was physically transforming raw materials into the product. (*Id.*)

Appellant again compares the instant appeal to *Coulson*, arguing PDS will not self-perform most of the contract, and refers to the Size Determination which states that Korrect will be the manufacturer of the eyeglasses. (*Id.*, at 7; citing Size Determination, at 3.) Appellant argues that PDS does not have the facilities or personnel to manufacture eyeglasses and at best will be able to provide contract management services, which is not part of the "primary and vital requirements" of the contract. (*Id.*) Appellant asserts PDS has admitted that it will not be the entity manufacturing the eyeglasses, as Korrect will provide the manufacturing requirements and the Area Office has acknowledged that fact. (*Id.*, at 8.)

Because PDS is not the manufacturer of the eyeglasses, Appellant argues that it can only qualify as a small business if it satisfies the requirements of the nonmanufacturer rule.

Appellant notes that SBA calculates the number of employees for a concern by adding the average number of employees of the concern to the average number of employees of the affiliate concern. (*Id.*, at 9; citing 13 C.F.R. § 121.106(b)(4)(i).) The Area Office calculated PDS's size by aggregating the number of its employees with those of its affiliates, including Korrect. However, Appellant maintains the Area Office used the wrong size standard to determine PDS's size. The Area Office used the 1,000-employee size standard for NAICS code 339115, rather than the 500-employee size standard applicable to the nonmanufacturer rule. Because Korrect alone has over 500 employees and Korrect and PDS are affiliated by virtue of PDS's ownership of Korrect, Appellant asserts that PDS is other than small for this procurement because it exceeds the 500 employee size standard set forth in the nonmanufacturer rule. (*Id.*)

Further, Appellant asserts that the Area Office erroneously concluded Korrect's status as a wholly owned subsidiary of PDS exempted PDS from provisions of the nonmanufacturer rule. (*Id.*) Appellant argues that neither the Small Business Act, nor SBA's implementing regulations, nor the decisions of OHA exempt a concern from compliance with the nonmanufacturer rule when it uses its wholly owned subsidiary as its manufacturer. (*Id.*) Thus, Appellant argues that the Area Office's decision is contrary to the regulations and is clearly erroneous. (*Id.*)

Appellant further argued that PDS' use of Korrect violated the ostensible subcontractor rule, because the prime contractor will have no role in manufacturing the end item being procured. While PDS states it is working toward dissolving Korrect, changes in approach after the date to determine size have no bearing on compliance with the ostensible subcontractor rule. (*Id.*, at 11.)

E. PDS' Response

On July 22, 2020, PDS filed a response to the instant appeal. PDS claims that it is a manufacturer and that the nonmanufacturer rule does not apply. (Response, at 3.) More specifically, PDS states that before submitting its final proposal update on September 7, 2019, PDS purchased Korrect, including all Korrect's manufacturing assets and leases as reflected in the Stock Purchase Agreement and the Bill of Sale and Assignment and Assumption Agreement. (*Id.*) PDS argues that since it is the eyeglass manufacturer under the Solicitation, the Area Office did not commit a clear error in reaching its conclusion. (*Id.*)

PDS notes that for size purposes, there is "only one manufacturer of the end item being acquired." (*Id.*; citing 13 C.F.R. § 121.406(b)(2).) The manufacturer is the concern which with its own facilities, performs the primary activities in transforming inorganic or organic substances, including the assembly of parts and components, into the end item being acquired. (*Id.*) Per the regulations, SBA evaluates the factors outlined in 13 C.F.R. § 121.406(b)(2)(i) in determining whether a concern is the manufacturer. (*Id.*) PDS further explains that the phrase "with its own facilities" includes leased facilities, citing *Size Appeal of Lynxnet LLC*, SBA No. SIZ-5971, at 11 (2018), ("in the absence of a requirement in the solicitation, the phrase 'its own facilities' in the regulation means that the contractor need only occupy and control the facilities, if not as the owner, then as the lessor or tenant. Thus, the fact . . . facility will be leased has not mearing on the adequacy of the contractor's manufacturing facilities.") So long as the lease is in place at the time of the final proposal, leasing the means of production is sufficient. (*Id.*, at 4; citing *Size Appeal of Technology Assocs., Inc.*, SBA No. SIZ-5814 (2017).)

The final proposal revision was submitted on September 7, 2019, which PDS argues is the relevant date for determining the applicability of the nonmanufacturer rule. (*Id.*) On August 28, 2019, before submitting the final proposal revision, PDS purchased Korrect, including all its leases and assets. (*Id.*) PDS argues it is manufacturing "through Korrect" in the sense that PDS obtained Korrect's leases and obtained ownership of all assets, including manufacturing equipment. (*Id.*, at 5.)

As of September 7, 2019, when PDS submitted its final proposal revisions, PDS avers it was the manufacturer and did not intend to subcontract the manufacturing work to Korrect. (*Id.*) PDS instead intended to be: (1) the sole entity adding value to the end item/ eyeglasses; (2) the sole entity manufacturing the eyeglasses; and (3) the company using its own facilities and equipment, production or assembly line processes; packaging and boxing operations; labeling of products; and product warranties per 13 C.F.R. § 121.406(b)(2)(i). (*Id.*) PDS, therefore, claims that the nonmanufacturer rule does not apply because PDS was the intended manufacturer on September 7, 2019. (*Id.*)

PDS distinguishes the facts in the instant appeal from *Coulson*. Section II.D., *supra*. PDS argues that unlike in *Coulson*, PDS did not intend to subcontract to its affiliate, Korrect, when it submitted its final proposal. (*Id.*, at 6.) PDS claims it intended to be the eyeglass manufacturer and the VA was aware of that fact. (*Id.*) PDS asserts it will be the entity fabricating eyeglasses, particularly where Korrect does not operate PDS' manufacturing facilities and Korrect cannot perform the primary activities to transform the materials, after transferring all assets and leases

on August 28, 2019. (*Id.*) In reference to Appellants reference in *Coulson*, "[i]n determining who the manufacturer was, OHA noted that the pertinent question was, which concern was physically transforming raw materials into the product. . . ." (*Id.*; citing Appeal, at 7.) Here, PDS argues that it is the concern, not Korrect. (*Id.*)

PDS avers that as it is the only manufacturer as of September 7, 2019, not the manufacturer reseller as Appellant alleges, the nonmanufacturer rule is inapplicable under 13 C.F.R. § 121.406(b). (*Id.*)

PDS then argues that it will not subcontract the work to Korrect, so the ostensible subcontractor rule does not apply. (*Id.*, at 8.) Additionally, PDS states as a legal matter, the ostensible subcontractor rule does not apply to the procurements assigned to a manufacturing NAICS code. (*Id.*; citing *CVE Protest of Superior Optical Labs, Inc.*, SBA No. CVE-157-P (2020).)

As a factual matter, PDS argues that since it owns Korrect and the manufacturing equipment formerly owned by Korrect; PDS also controls the leases for Korrect's former manufacturing facilities. (*Id.*) Given the corporate structure, PDS acknowledges that the parties are affiliated, but not in the way Appellant claims. (*Id.*) More specifically, PDS argues that Korrect is not an ostensible subcontractor because PDS is the actual eyeglass manufacturer under the Solicitation. (*Id.*) Further, on September 7, 2019, PDS argues that the CO was aware and the lack of subcontract with Korrect demonstrates that PDS would be the manufacturer. (*Id.*)

F. SBA Response

On July 22, 2020, the SBA Office of General Counsel responded to the instant appeal. SBA attaches a copy of a U.S. Government Accountability Office (GAO) decision, *In the Matter of Superior Optical Labs, Inc.*, B-418618 (2020). The GAO decision references *Size Appeal of Mistral, Inc.*, SBA No. SIZ-5877 (2018), for the proposition that using another firm's facilities does not by itself trigger the nonmanufacturer rule. (SBA Response, at 1.) SBA maintains this is an accurate interpretation of OHA's statement in *Mistral* that a manufacturer "need only occupy and control the facilities, if not as an owner, then as a lessor or tenant." (*Id.*; citing *Mistral*, at 12.)

SBA Office of General Counsel further argues that Appellant has not presented sufficient evidence to disturb the Size Determination. (*Id.*) More specifically, SBA argues that the Appellant's ostensible subcontractor analysis comes to the same result as the Area Office because if found to be an ostensible subcontractor, Korrect would be in a joint venture with PDS. (*Id.*) SBA argues that even if Korrect and PDS were affiliates, together they would still be under the contract's size standards. (*Id.*, at 2.) Furthermore, as parties to a joint venture can share manufacturing responsibilities and the joint venture will be considered the manufacturer under SBA's definition, SBA argues that Size Determination should be upheld. (*Id.*; citing *Size Appeal of Lynxnet, LLC*, SBA No. SIZ-5971 (2018).)

G. The Acquisition

In a Bill of Sale and Assignment and Assumption Agreement (Bill of Sale) dated August 28, 2019, PDS purchases all of the assets of Korrect. The document defines "assets" as "all of the assets, including, but not limited to leases, rights to control access and control property where manufacturing is taking place and the capital equipment necessary to manufacture." (Bill of Sale, at 1.)

The Stock Purchase Agreement (Agreement) was dated August 28, 2019. Under this Agreement, PDS agrees to purchase one hundred percent of the issued and outstanding stock in Korrect. PDS is purchasing all of Korrect's equity. (Agreement, at 1, 11.) The Agreement states that Korrect is primarily engaged in the business of "manufacture, distribution and sale of eyeglasses and related optical products, including operation of retail eyewear stores. . . ." (*Id.*, at 1.) The Agreement specifically includes a warranty that leases pursuant to which Korrect uses or occupies real property are valid, in full force and effect, and that Korrect enjoys peaceful and undisturbed possession of the property. (*Id.*, at 22.)

III. Discussion

A. Preliminary Matters

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

Generally, OHA determines the size status of a concern, including its affiliates, as of the date the concern submits a written self-certification that it is small to the procuring activity as party of its initial offer (or other formal response to a solicitation) which includes price. 13 C.F.R. § 121.404(a). However, for purposes of compliance with the nonmanufacturer rule (13 C.F.R. § 121.406(b)(1)) and the ostensible subcontractor rule (13 C.F.R. § 121.103(h)(4)), size status is determined as of the date of the final proposal revisions. 13 C.F.R. § 121.404(d). Because PDS submitted its final proposal revision on September 7, 2019, and Appellant alleges violations of those rules, PDS's size must be determined as of that date.

However, on August 28, 2019, prior to submitting its final proposal revision, PDS purchased Korrect, including all Korrect's manufacturing facilities and assets. (*Id.*) The details of the acquisition are in the Stock Purchase Agreement and the Bill of Sale and Assignment Agreement. Thus, as of September 7, 2019, despite the statement in its final proposal revision, PDS now directly owned and controlled all of the assets which Korrect would have used to manufacture the eyeglasses. Therefore, as of that date, PDS itself was the manufacturer of the eyeglasses. PDS would not have been providing a product manufactured by Korrect, but by itself,

nor would it have been subcontracting with Korrect. PDS would be performing the contract directly. For size purposes, there is "only one manufacturer of the end item being acquired." 13 C.F.R. § 121.406(b)(2). The manufacturer is the concern which "with its own facilities, performs the primary activities in transforming inorganic or organic substances, including the assembly of parts and components into the end item being acquired." (*Id.*) Here, it is PDS, with its own facilities, that will perform the primary activities in transforming the inorganic or organic substances into the end item being acquired and intended to do so on September 7, 2019.

The phrase "with its own facilities" includes leasing the facilities since businesses frequently rent or lease facilities to manufacture the product being sold by the procuring agency. *Size Appeal of Lynxnet LLC*, SBA No. SIZ-5971, at 11 (2018) (". . .in the absence of a requirement in the solicitation, the phrase "its own facilities" in the regulation **means that the contractor need only occupy and control the facilities**, if not as an owner, then as a lessor or tenant. Thus, the fact the . . . facility will be leased has no bearing on the adequacy of the contractor's manufacturing facilities.") (emphasis in original); *see also Size Appeal of Mistral, Inc.*, SBA No. SIZ-5877, at 12 (2018). The lease, however, must be in place at the time of the final proposal. *See Size Appeal of Technology Assocs., Inc.*, SBA No. SIZ-5814, at 12 (2017), Here, the Korrect leases were in place and assigned to PDS, and as such, I find that the leased facilities do not preclude PDS from being the manufacturer.'

I agree with PDS's contention on appeal that on September 7, 2019, PDS was to be the sole entity adding value to the end item, the sole entity manufacturing the eyeglasses, and the company using its own facilities and equipment, production or assembly line processes; packaging and boxing operations; labeling of products; and product warranties in accordance with 13 C.F.R. § 121.406(b)(2)(i). Therefore, as PDS was clearly the intended manufacturer on September 7, 2019, there was no violation of the nonmanufacturer rule.

The ostensible subcontractor rule is not utilized for procurements assigned a manufacturing NAICS code; instead, such procurements are governed by the nonmanufacturer rule, 13 C.F.R. § 121.406:

> In classifying the procurement as a manufacturing/supply procurement, the procuring agency must have determined that the "principal nature" of the procurement was supplies. As a result, any work done by a subcontractor on the services portion of the contract cannot rise to the level of being "primary and vital" requirements of the procurement, and therefore cannot be the basis o[f] affiliation as an ostensible subcontractor.

76 Fed. Reg. 8, 222, 8225 (Feb. 11, 2011). *See also Size Appeal of Marwais Steel Co.*, SBA No. 3884, at 5 (1994).

In this case, the instant procurement was assigned a manufacturing NAICS code, 391115, Ophthalmic Goods Manufacturing, and neither party disputes that the primary purpose of the procurement is manufacturing the production of eyeglasses. Thus, the ostensible subcontractor rule is inapplicable here. *CVE Protest of Superior Optical Labs, Inc.*, SBA No. CVE-157-P (2020). However, even if it were, PDS is no longer using Korrect as a subcontractor, but,

because it now directly possesses all of Korrect former assets, will perform the contract itself. Further, the Area Office correctly concluded that when the size of PDS and Korrect is aggregated, they do not exceed the applicable size standard. Appellant's argument that PDS is thus other than small under the ostensible subcontractor rule is utterly meritless.

Additionally, while Appellant argues that there is no evidence to demonstrate that the Area Office provided an analysis under 13 C.F.R. § 121.406, I find to the contrary. It is clear in the size determination that the Area Office considered the rule. (Size Determination, at 5.) While the Area Office may not have specifically outlined its reasoning for concluding that PDS is the manufacturer of the end item, such analysis was not necessary since PDS acquired Korrect, including all assets and leases.

IV. Conclusion

Appellant has failed to demonstrate clear error in the size determination. I, therefore, must DENY this appeal and AFFIRM the Size Determination. This is the final decision of the Small Business Administration. 13 C.F.R. § 134.316(d).

CHRISTOPHER HOLLEMAN
Administrative Judge