United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Swift & Staley, Inc., Appellant, Appealed From Size Determination No. 3-2021-026	SBA No. SIZ-6125 Decided: November 1, 2021

APPEARANCES

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DECISION[1]

I. Introduction

This dispute arises from a decision of the U.S. Court of Federal Claims (Court), vacating and remanding the U.S. Small Business Administration (SBA) Office of Hearings and Appeals (OHA) decision in *Size Appeal of Swift & Staley, Inc.*, SBA No. SIZ-6095 (2021). In its decision, the Court found that OHA erred in concluding that the challenged firm, Swift & Staley, Inc. (SSI), should be attributed a proportionate share of the receipts of a populated joint venture, Portsmouth Mission Alliance, LLC (PMA). (Court's Order and Opinion at 7-8.) In particular, OHA failed to consider that as of the date of SSI's self-certification for the subject procurement, PMA no longer met the regulatory definition of a joint venture as set forth at 13 C.F.R. § 121.103(h). (*Id.*) The Court instructed OHA, however, to assess on remand whether "other regulatory grounds [exist] that may require SSI to assume a share of PMA's receipts." (*Id.* at 9.)

[1] This decision was originally issued under a protective order. After receiving and considering one or more timely requests for redactions, OHA now issues this redacted decision for public release.

To assist OHA on remand, OHA directed SBA's Office of Government Contracting — Area III (Area Office) to prepare an amended version of the original size determination, consistent with the Court's decision. On September 8, 2021, the Area Office completed its revised determination, identified as Size Determination No. 3-2021-062. The Area Office concluded that SSI is not small under the $41.5 million size standard applicable to this procurement.

OHA invited interested parties to submit comments on the new size determination. In addition, because OHA's review of the record raised a potential issue of affiliation through negative control, OHA requested that interested parties also address this question. OHA received comments from SSI; from intervenor Akima Intra-Data, LLC (Akima); and from SBA.[2]

Having reviewed the entire record, and after considering all comments from interested parties, OHA finds that SSI is affiliated with PMA through negative control under 13 C.F.R. § 121.103(a)(3). As a result, pursuant to 13 C.F.R. §§ 121.103(a)(6) and 121.104(d), PMA's entire receipts must be added to those of SSI for purposes of calculating size. The combined receipts of SSI and PMA exceed the applicable $41.5 million size standard, so the Area Office correctly concluded in the new size determination that SSI is not small.

For purposes of completeness, and in order to fully accomplish the Court's instructions on remand, OHA also has conducted a detailed review of the tax returns of both SSI and PMA. OHA's analysis of such information is included in this remand decision. OHA finds that the receipts of SSI alone do not exceed the size standard. Accordingly, insofar as the Court concludes that SSI and PMA are not affiliated, and that PMA's receipts therefore need not be combined with SSI's under §§ 121.103(a)(6) and 121.104(d), SSI then would be an eligible small business for the instant procurement.

II. Background

A. Prior Proceedings

On February 3, 2020, the U.S. Department of Energy issued Request for Proposals (RFP) No. 89303319REM000057 for Infrastructure Support Services at the Paducah Gaseous Diffusion Plant in Paducah, Kentucky. The Contracting Officer (CO) set aside the procurement entirely for small businesses, and assigned North American Industry Classification System (NAICS) code 561210, Facilities Support Services, with a corresponding size standard of $41.5 million average annual receipts. Initial proposals, including price, were due April 16, 2020, and there were no subsequent proposal revisions. SSI and Akima submitted timely offers.

After SSI was selected for award, Akima filed a size protest challenging SSI's size. Akima's protest alleged that SSI is not small for the instant procurement because SSI's own

[2] SBA did not participate in the original proceedings, but intervened for the first time on remand. Pursuant to 13 C.F.R. § 134.210(a), "SBA may intervene as of right at any time in any case until 15 days after the close of record, or the issuance of a decision, whichever comes first."

receipts, combined with SSI's proportionate share of PMA's receipts under 13 C.F.R. § 121.103(h), exceed the size standard.

The CO forwarded the protest to the Area Office for review. In response, SSI maintained that, because PMA no longer meets the regulatory definition of a joint venture at 13 C.F.R. § 121.103(h), "***none of PMA's annual receipts* should be attributed to [SSI]**." (E-mail from D. Cook to J. Abioye (Jan. 7, 2021) (emphasis SSI's).) SSI acknowledged that, under the legal interpretation it was advocating, participants in a joint venture "do risk being treated as affiliates with each other and with the JV if any of the 'general principles of affiliation' at 13 C.F.R. § 121.103(a) are present." (*Id.*) SSI maintained, however, that the particular facts presented in this case would not warrant a finding that SSI and PMA are affiliated. (Protest Response at 3-4.) SSI highlighted that it owns only a minority ([xx]%) interest in PMA, and only [xx] of PMA's [xx] Board members is an SSI employee, so SSI does not affirmatively control PMA. (*Id.*) In addition, SSI continued, "while minority shareholders can, in some situations, exert negative control over a business, nothing in PMA's operating agreement permits [SSI] to take actions like preventing a quorum or blocking actions by [PMA's Management Board]." (*Id.* at 3, citing 13 C.F.R. § 121.103(a)(3).)

On January 13, 2021, the Area Office issued its original size determination, No. 3-2021-026, concluding that, under § 121.103(h), SSI must be attributed its proportionate share of PMA's receipts for purposes of determining size. Because SSI holds a [xx]% ownership interest in PMA, the Area Office used that percentage to calculate SSI's proportionate share. The Area Office noted that SSI does not affirmatively control PMA through ownership, but the Area Office otherwise did not address possible affiliation between SSI and PMA. (Size Determination No. 3-2021-026, at 6.) SSI appealed Size Determination No. 3-2021-026 to OHA, and on April 20, 2021, OHA denied the appeal and affirmed Size Determination No. 3-2021-026. *Size Appeal of Swift & Staley, Inc.*, SBA No. SIZ-6095 (2021).

B. The Court's Decision

On August 20, 2021, the Court issued its decision. The Court agreed with SSI that joint venture partners are not required to assume a proportionate share of a joint venture's receipts, unless that joint venture meets the definitional requirements of 13 C.F.R. § 121.103(h). (Court's Order and Opinion at 7-8.) In the instant case, because PMA is a populated joint venture, a type of entity that, since 2016, is no longer recognized as a valid joint venture under SBA rules, SSI should not be attributed a proportionate share of PMA's receipts for size purposes. (*Id.*) OHA's decision to the contrary therefore was erroneous.

The Court observed, however, that SSI still might be required to accept a portion of PMA's receipts under alternate regulatory grounds. (*Id.* at 9.) The Court remanded the matter to OHA to determine whether there are "other regulatory grounds—not addressed by the OHA decision—that may require SSI to assume a share of PMA's receipts." (*Id.*)

C. Size Determination No. 3-2021-062

On August 27, 2021, OHA directed the Area Office to prepare an amended version of Size Determination No. 3-2021-026, in accordance with the Court's decision. On September 8, 2021, the Area Office issued Size Determination No. 3-2021-062. The Area Office concluded that SSI is not small under the size standard associated with the instant procurement. (Size Determination No. 3-2021-062, at 8.)

The Area Office noted that SSI owns [xx]% of PMA, a populated joint venture established in 2015. (*Id.* at 4.) The remaining [xx]% of PMA is owned by North Wind Dynamics, LLC (North Wind). (*Id.*)

The Area Office explained that, under the Court's ruling, PMA did not meet the regulatory definition of a joint venture as of April 16, 2020, the date of SSI's self-certification. (*Id.* at 7.) As a result, "when applying the Court's decision, PMA is not a joint venture on the date size is determined so no part of the regulations related to joint ventures can be applied, which include the calculation of receipts under 13 C.F.R. § 121.103(h)(5)." (*Id.*)

The Area Office determined, however, that "PMA is a source which generates revenue for SSI which must be included in SSI's calculation of average annual receipts in accordance with 13 C.F.R. § 121.104(a)." (*Id.*) Under SBA regulations, "receipts" are defined broadly as encompassing:

> **all revenue in whatever form received or accrued from whatever source**, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances.

(*Id.*, quoting 13 C.F.R. § 121.104(a) (emphasis added by Area Office).)

The Area Office asserted that, except for "transactions between the firms," SSI's tax returns do not already reflect receipts from PMA. (*Id.*) The Area Office therefore added "the applicable receipts from PMA" to SSI's own receipts. (*Id.* at 8.) The Area Office found that these amounts together exceed the size standard, so SSI is not small. (*Id.*)

On September 8, 2021, OHA issued an order circulating Size Determination No. 3-2021-062 to interested parties and inviting comments. On September 15, 2021, OHA issued a second order requesting that interested parties also address "whether [SSI] may be affiliated with [PMA] through negative control, based on provisions in PMA's Operating Agreement." (Order at 1.) OHA further noted that, although SSI had requested that the Area Office be afforded an opportunity to clarify or supplement Size Determination No. 3-2021-062, the Area Office declined to do so. (*Id.*)

D. PMA's Operating Agreement

The record before OHA includes a copy of PMA's Operating Agreement, which SSI provided to the Area Office in response to Akima's size protest.[3] The Operating Agreement became effective January 16, 2015, and identifies North Wind and SSI as PMA's two Members. (PMA's Operating Agreement at 3 and Exh. A.) North Wind holds a [xx]% membership/ownership interest, and SSI the remaining [xx]% interest. (*Id.*)

Article V of PMA's Operating Agreement vests control over PMA business decisions in a Management Board appointed by the Members, North Wind and SSI. (*Id.* at 12.) The Management Board makes decisions by majority vote, but section 5.1.6 of the Operating Agreement stipulates that certain types of transactions instead require the unanimous, written, advance approval of both North Wind and SSI:

> **5.1.6. Approval of Certain Transactions**
>
> Notwithstanding rights of the Management Board set forth in this Agreement, the following actions by the Company and/or the Management Board must be approved by North Wind and Swift & Staley in writing in advance of any such action:
>
> (a) the sale, exchange or other disposition of all or substantially all of the assets of Company (either in one transaction or a series of related transactions);
>
> (b) the merger, consolidation or statutory share or unit exchange of the Company with any other Person;
>
> (c) the reorganization of the Company;
>
> (d) the initiation of voluntarily bankruptcy proceedings by the Company;
>
> (e) the commencement of any litigation by or on behalf of the Company;
>
> (g) the entering into of any real property lease by the Company with rental payments in excess of $[xx] during any calendar year;

[3] On remand, and in response to OHA's inquiry about negative control, SSI submitted an additional copy of PMA's Operating Agreement and two resolutions of PMA's Board, identified as Resolutions 19-01 and 20-01. Unlike the Operating Agreement itself, the two resolutions were not part of the record originally before the Area Office. Neither resolution, however, purports to amend the terms of PMA's Operating Agreement, and OHA therefore does not find either resolution relevant to the issues now before OHA. Further, Resolution 20-01, even if it otherwise were relevant, was not effective until July 24, 2020, and thus would not have been in effect as of April 16, 2020, when SSI self-certified as small for the instant procurement.

(h) the entering into of any guarantee of any obligation of a third party in excess of $[xx] by the Company or any pledge or other encumbrance of any property of the Company valued at more than $[xx];

(i) the pledging of any assets of the Company to secure lending facilities;

(k) the approval of any capital or other expenditures or other investments in excess of $[xx] by the Company (other than in accordance with the operating budget of the Company approved by the Members);

(l) the grant or issuance of any equity incentives by the Company;

(m) the entering into or the amendment of any contract or agreement between the Company, on the one hand. and any Member or member of the Management Board or any of their Affiliates or the family members of such Affiliates, on the other hand;

(n) the amendment of this Agreement;

(o) the admission of any additional Members to the Company;

(p) any additional Capital Contributions in excess of the Maximum Annual Additional Capital Contribution provided in Section 3.2:

(r) any transaction causing the Company to incur any indebtedness beyond that approved by the Members in the annual operating budget or any business plan adopted and approved by the Members;

(t) any distributions in kind to a Member or Interest Holder;

(u) the appointment of the Program Manager provided in Section 5.2.1;

(v) any change in the tax elections or accounting principles used by the Company;

(w) the final proposal submitted in response to RFP No. DE-SOL-0006421.

(*Id.* at 13-14 (paragraphs (f), (j), (q), and (s) omitted in original).)

Section 5.3 of the Operating Agreement addresses meetings and decisions of the Members. According to section 5.3.1, "[a]ll [M]embers must be present, in person or in proxy, for meetings of the Members." (*Id.* at 15.) Section 5.3.2 states that, except for transactions "[s]ubject to Section 5.1.6," matters before the Members are decided by majority vote of the ownership interests. (*Id.*)

E. SSI's Comments

On September 27, 2021, SSI filed comments in response to OHA's orders. SSI argues that Size Determination No. 3-2021-062 is contrary to the Court's decision; that SSI's own receipts do not exceed the applicable size standard; that the question of affiliation through negative control is not appropriately before OHA for review; and that, in any event, SSI cannot exert negative control over PMA.

SSI first argues that, in Size Determination No. 3-2021-062, the Area Office apparently concluded that SSI should be attributed its proportionate share of PMA's average annual receipts under § 121.103(h). (SSI's Comments at 3.) Such a position, though, conflicts with the Court's decision, which held that PMA is no longer a joint venture under § 121.103(h) and that SSI therefore is not required to assume a proportionate share of PMA's average annual receipts. (*Id.* at 3-6.) Size Determination No. 3-2021-062 also appears to suggest that SSI's own annual receipt figures do not include revenues derived from its minority ownership interest in PMA. (*Id.* at 6-7.) OHA can readily ascertain, however, based on SSI's tax returns and other information in the record, that SSI's average annual receipts do already include revenue associated with SSI's ownership interest in PMA. (*Id.* at 7.)

SSI argues that its receipts fall below the $41.5 million threshold applicable to the instant procurement. (*Id.* at 7-8.) Specifically, after combining "total income" and "cost of goods sold," and deducting permissible exclusions, SSI's average annual receipts over the pertinent five-year period are only $[xx]:

TABULAR OR GRAPHIC MATERIAL SET FORTH AT THIS POINT IS NOT DISPLAYABLE

(*Id.* at 8.) Because SSI's average annual receipts are within the size standard, SSI is small. (*Id.*)

Next, SSI argues that the question of affiliation through negative control is not appropriately before OHA. (*Id.* at 9.) Akima did not raise this issue in the initial size protest, and OHA's rules of procedure stipulate that OHA "will not decide substantive issues raised for the first time on appeal." (*Id.*, quoting 13 C.F.R. § 134.316(c).) OHA has consistently interpreted this provision as restricting its ability to review substantive legal issues that were not part of the underlying size determination. (*Id.*) Further, in *Size Appeal of Chu & Gassman, Inc.*, SBA No. SIZ-5394 (2012) (PFR), OHA recognized that affiliation through negative control is a substantive legal question that cannot properly be considered for the first time on appeal. (*Id.* at 10.)

In the instant case, Akima's protest did not allege affiliation between SSI and PMA, through negative control or otherwise. (*Id.*) Similarly, the initial size determination focused on whether SSI was required to accept a proportionate share of PMA's average annual receipts under § 121.103(h), and the Area Office remained silent with regard to provisions in PMA's

Operating Agreement, even though SSI provided that document to the Area Office for review. (*Id.*) Neither OHA nor the Court, in their respective decisions, devoted significant attention to affiliation through negative control, and such matters are mentioned only in passing in the revised size determination, No. 3-2021-062. (*Id.* at 10-11.) As such, SSI maintains, negative control is a new issue that is not appropriately before OHA at this stage. (*Id.*)

Even if OHA reaches the issue of negative control, OHA should find that SSI cannot exercise negative control over PMA. (*Id.*) Negative control arises only when one concern has the power to block "ordinary actions" of another concern. (*Id.* at 11-12.) The power to block "extraordinary actions" does not support a finding of negative control. (*Id.* at 12.)

Here, PMA's Operating Agreement does not provide SSI the ability to exert negative control over routine, day-to-day activities of PMA. (*Id.* at 13.) Section 5.1.2 of the Operating Agreement describes the powers of PMA's Management Board, and broadly states that "all matters and questions of policy and management shall be decided by the majority vote or unanimous written consent of the Management Board." (*Id.*) There is no dispute that SSI holds just [xx] of [xx] PMA Board seats, so SSI cannot block the Board's decisions. (*Id.*)

Section 5.1.6 of PMA's Operating Agreement identifies certain activities that must be approved by both North Wind and SSI, and SSI allows that "SSI could, in theory, block activities that fall under Section 5.1.6." (*Id.*) SSI maintains, however, that the transactions discussed in section 5.1.6 are not ordinary business activities. (*Id.*) Rather, section 5.1.6 deals with extraordinary activities, such as a sale, exchange, or disposition of all of PMA's assets; a reorganization of PMA; or the initiation of voluntary bankruptcy. (*Id.*) "Accordingly, to the extent SSI has the ability to exert control over these decisions by refusing to provide advance approval, such control is expressly not the type which gives rise to affiliation under 13 C.F.R. § 121.103(a)(3)." (*Id.*, emphasis SSI's.)

F. Akima's Comments

On September 27, 2021, Akima filed comments in response to OHA's orders. Akima argues that SSI is affiliated with PMA through negative control. (Akima's Comments at 2.) In the alternative, Akima maintains, the Area Office reasonably concluded that SSI is not small on the basis of its tax returns. (*Id.* at 10.)

Akima contends that the Court's decision "supplanted" the commonly-understood interpretation of SBA's joint venture regulations. (*Id.* at 2.) The Court remanded the matter to OHA to consider the implications of the Court's decision, including the question of affiliation. (*Id.* at 2-3.) Accordingly, OHA "must now determine whether affiliation exists between SSI and PMA." (*Id.* at 3.) At issue in particular is "Section 5 of PMA's Operating Agreement, which has not been amended or altered since its creation in 2015." (*Id.*)

Akima observes that control, and hence affiliation, may be positive or negative. (*Id.*, citing 13 C.F.R. § 121.103(a)(3).) Negative control "exists when a minority owner can block ordinary actions essential to operating the company." (*Id.*, quoting *Size Appeal of Southern Contracting Sols. III, LLC*, SBA No. SIZ-5956, at 10 (2018).) Further, an operating agreement

may create negative control if it gives a minority owner "the power to block action by the concern's management or majority member." (*Id.* at 4, quoting *Southern Contracting*, SBA No. SIZ-5956, at 10.) In prior decisions, "OHA has deemed a number of business decisions 'ordinary,' including, but not limited to, incurrence of debt and the payment of dividends, such that the requirement of minority member approval for such actions constitutes negative control and results in affiliation." (*Id.* at 4, citing *Size Appeal of BR Constr., LLC*, SBA No. SIZ-5303, at 7 (2011).)

Conversely, a minority owner's ability to block certain actions will not lead to a finding of negative control and affiliation "if those supermajority provisions are crafted to protect the investment of the minority shareholders, and not to impede the majority's ability to control the concern's operations or to conduct the concern's business as it chooses." (*Id.* at 4-5, quoting *Southern Contracting*, SBA No. SIZ-5956, at 10.) OHA refers to such investment-related actions as "extraordinary actions." (*Id.* at 5.) OHA's distinction between "ordinary actions" and "extraordinary actions" has been upheld by the Court. (*Id.*, citing *Team Waste Gulf Coast, LLC v. United States*, 135 Fed. Cl. 683 (2018).)

Akima then points to section 5.1.6 of PMA's Operating Agreement, which requires that several types of transactions "must be approved by North Wind and Swift & Staley in writing in advance of any such action." (*Id.* at 4, quoting Operating Agreement at 13.) Although North Wind is the majority owner of PMA and affirmatively controls PMA's Management Board, the actions enumerated in section 5.1.6 still require SSI's consent. (*Id.*) Further, in Akima's view, many of the actions specified in section 5.1.6 are "ordinary" business decisions under OHA case precedent. (*Id.*) "Because these actions cannot be taken without SSI's approval, SSI exercises negative control over PMA, which gives rise to a finding of affiliation." (*Id.*)

Akima highlights that section 5.1.6(e) of the Operating Agreement requires SSI's consent for "the commencement of any litigation by or on behalf of [PMA]." (*Id.* at 5, quoting Operating Agreement at 13.) OHA case law establishes that the ability to initiate a lawsuit is an "ordinary" business decision, such that the ability of a minority owner to prevent a concern from bringing a lawsuit constitutes negative control. (*Id.*, citing *Southern Contracting*, SBA No. SIZ-5956, at 12.)

PMA's Operating Agreement also requires SSI's approval for "encumbrance of any property of [PMA] valued at more than $[xx]," "the grant or issuance of any equity incentives by [PMA]," and "[a]ny transaction causing [PMA] to incur any indebtedness beyond that approved by Members in the annual operating budget." (*Id.* at 6, quoting Operating Agreement at 14.) Each of these actions is "ordinary" under OHA case law. (*Id.*, citing *BR Constr.*, SBA No. SIZ-5303, at 8 and *Size Appeal of Carntribe-Clement 8AJV # 1, LLC*, SBA No. SIZ-5357, at 15 (2012).)

Section 5.1.6 of the Operating Agreement also requires that SSI must approve the "appointment of the Program Manager" who oversees PMA's principal contract. (*Id.*, quoting Operating Agreement at 14.) Akima contends that negative control exists when a minority owner's consent is required for hiring employees. (*Id.* at 7, citing *Southern Contracting*, SBA No. SIZ-5956, at 12.)

PMA's Operating Agreement also requires SSI's consent for "the pledging of any assets of [PMA] to secure lending facilities." (*Id.*, quoting Operating Agreement at 14.) Such actions are "tantamount to PMA taking out a loan," and under OHA case law, incurring debt is an "ordinary" business decision. (*Id.*, citing *BR Constr.*, SBA No. SIZ-5303, at 7.) Alternatively, such actions are akin to a sale or encumbrance of assets, which also are "ordinary" business decisions, except in situations involving a sale of all or substantially all of a concern's assets. (*Id.*, citing *Carntribe-Clement*, SBA No. SIZ-5357, at 15 and *Southern Contracting*, SBA No. SIZ-5956, at 11.)

Finally, PMA's Operating Agreement requires SSI's approval for "any distributions in kind to a Member or Interest Holder." (*Id.* at 7-8, quoting Operating Agreement at 14.) OHA has held, and the Court previously has agreed, that requiring a minority owner's consent for distributions gives rise to negative control. (*Id.*)

Akima concludes that seven of the actions specified in section 5.1.6 of PMA's Operating Agreement are "ordinary" business actions which require the approval of SSI, the minority owner. (*Id.* at 8.) Because "SSI exercises extensive negative control of PMA," SSI and PMA are affiliated, and SSI must therefore be attributed "*all* of PMA's receipts" for purposes of calculating size. (*Id.*, emphasis Akima's.) Akima claims that the combined average annual receipts of SSI and PMA over the relevant five-year period are $[xx], well in excess of the applicable $41.5 million size standard. (*Id.* at 9.) OHA must therefore conclude that SSI is not small for the instant procurement. (*Id.*)

Akima alternatively argues that the Area Office appropriately found SSI not small based on SSI's tax returns. (*Id.* at 10.) According to its new size determination, the Area Office verified that "other than transactions between the firms, [SSI's] receipts from the firm PMA are not included in SSI's tax returns." (*Id.*, quoting Size Determination No. 3-2021-062, at 7.) Consequently, insofar as the Area Office "incorporated or added distributions and other reasonable sums from PMA's receipts to SSI's receipts for purposes of determining size," the Area Office did so under the rational belief that such amounts were not already reflected in SSI's own tax returns. (*Id.*) Even if OHA finds that SSI and PMA are not affiliated, then, OHA should uphold Size Determination No. 3-2021-062. (*Id.* at 11.)

G. SBA's Comments

On October 1, 2021, SBA filed its comments.[4] SBA argues that the Area Office properly found that SSI is not a small business for the instant procurement.

SBA argues, first, that it was "not unreasonable" for the Area Office to include receipts from PMA's tax returns in calculating SSI's size. (SBA's Comments at 3.) Although the Court found that PMA is not a joint venture under § 121.103(h), and that SSI therefore cannot be attributed its proportionate share of PMA's receipts under the joint venture regulations, "that

[4] SBA did not meet the deadline to submit comments originally specified by OHA, but on September 29, 2021, SBA requested an extension of time to file its comments due to unforeseen circumstances. OHA granted the extension that same day.

does not mean that the receipts from PMA are wholly removed from the calculation of SSI's size." (*Id.* at 4.) Instead, PMA still is a source that generates revenue for SSI, and those receipts must be considered under 13 C.F.R. § 121.104(a). (*Id.* at 4-5.) SBA claims that "there was not an error in law due to including the proportionate share of SSI's revenue from PMA when determining size." (*Id.* at 5.) Further, "[t]he language [of the regulations] does not discriminate based on type or current validity of the joint venture but rather states that to calculate size, a concern must include its proportionate share of joint venture receipts." (*Id.*)

SBA also contends that PMA's Operating Agreement "establishes SSI has the power to control PMA" through negative control. (*Id.* at 6.) SBA highlights that section 5.1.6 of PMA's Operating Agreement requires SSI's advance written approval before PMA may undertake various actions. (*Id.*) The Operating Agreement provides that SSI must consent to the commencement of any litigation by or on behalf of PMA. (*Id.*) In addition, SSI's approval is required for the encumbrance of property; the grant or issuance of any equity incentives by PMA; and transactions causing PMA to incur indebtedness beyond amounts approved in the annual operating budget. (*Id.* at 6-7.) These types of actions have long been deemed by OHA to be ordinary business decisions. (*Id.* at 7, citing *Size Appeal of Carntribe-Clement 8AJV # 1, LLC*, SBA No. SIZ-5357 (2012).) Consequently, SSI has the power to exert negative control over PMA. The presence of negative control results in affiliation, and because PMA and SSI are affiliated, all of PMA's receipts are attributable to SSI. (*Id.*) As such, SSI is not small for the instant procurement. (*Id.*)

III. Discussion

In its decision, the Court found that PMA, although originally established as a joint venture in 2015, no longer is a "joint venture" within the meaning of 13 C.F.R. § 121.103(h), and consequently, SSI cannot be attributed a "proportionate share" of PMA's receipts under that same rule. Section II.B, *supra*. The Court remanded the matter to OHA, however, to examine "other regulatory grounds—not addressed by the OHA decision—that may require SSI to assume a share of PMA's receipts." *Id.*

After obtaining and considering comments from interested parties, and having reviewed the complete record, OHA believes the principal legal implication stemming from the Court's decision is that SSI and PMA could be affiliated. An analysis of the question of affiliation therefore is essential to resolution of this case.

As the Court observed in its decision, "affiliation" is a term of art under SBA regulations, arising when one concern controls, or has the power to control, another. Court's Order and Opinion at 2; *see also* Federal Acquisition Regulation (FAR) 2.101. OHA generally has concluded, in prior decisions, that a participant in a joint venture is not affiliated with the joint venture itself. *E.g., Size Appeal of Barlovento, LLC*, SBA No. SIZ-5191 (2011). In the instant case, though, the Court essentially determined that PMA ceased to be a "joint venture," as that term is defined and described at § 121.103(h), after SBA's 2016 rulemaking. Section II.B, *supra*. Because the Court's interpretation of § 121.103(h) is binding here, PMA must be considered a separate business entity than SSI, and not a joint venture.

Accordingly, under the Court's decision, SSI and PMA potentially could be affiliated, just as any two separate business concerns may, in theory, be affiliates, depending on the nature of the relationship between them. Notably, as Akima highlights in its comments on remand, SSI itself acknowledged the possibility that SSI could be affiliated with PMA, if PMA is not a "joint venture" under SBA regulations. In response to the initial size protest, for example, SSI contended that, pursuant to its legal arguments, joint venture participants "do risk being treated as affiliates with each other and with the JV if any of the 'general principles of affiliation' at 13 C.F.R. § 121.103(a) are present." Section II.A, *supra*.

In the instant case, as discussed in greater detail below, and beginning with the premise that PMA is a separate business concern rather than a "joint venture," the record establishes that SSI and PMA are in fact affiliated, because SSI has the power to exert negative control over PMA. 13 C.F.R. § 121.103(a)(3). Consequently, under 13 C.F.R. §§ 121.103(a)(6) and 121.104(d), PMA's entire receipts must be added to those of SSI in determining size. The combined receipts of SSI and PMA substantially exceed the applicable size standard, so SSI is not small.

In order to thoroughly address the Court's instructions on remand, OHA also has analyzed the tax returns of SSI and PMA, and OHA's analysis of that information is included in this remand decision. OHA finds that the receipts of SSI alone do not exceed the size standard. Further, SSI's receipts, as reflected in its tax returns, are inclusive of income generated from PMA. Accordingly, if the Court were to conclude that SSI and PMA are not affiliated, SSI then would be an eligible small business for the instant procurement.

A. Affiliation Through Negative Control

As an initial matter, OHA must determine whether questions of affiliation and negative control are properly before OHA at this time. SSI maintains, in its comments on remand, that OHA should not review such matters, because there was no significant discussion of negative control in prior proceedings, and because OHA's rules of procedure at 13 C.F.R. § 134.316(c) provide that OHA "will not decide substantive issues raised for the first time on appeal." Section II.E, *supra*.

I find SSI's arguments unpersuasive for several reasons. First, the regulation referenced by SSI, 13 C.F.R. § 134.316(c), is not strictly applicable here, because the instant case does not arise directly from an "appeal" but rather from remand by the Court. The fundamental issue, then, is not how OHA might ordinarily treat new issues presented in the context of a typical size appeal, but instead whether questions of affiliation and negative control are within the scope of the Court's remand. In this regard, the Court broadly instructed that OHA examine "other regulatory grounds—not addressed by the OHA decision— that may require SSI to assume a share of PMA's receipts." Section II.B, *supra*. Potential affiliation between SSI and PMA, through negative control or otherwise, is plainly an independent "regulatory ground" which "may require SSI to assume a share of PMA's receipts." Accordingly, given the scope of the Court's remand, it is appropriate, if not mandatory, that OHA consider potential affiliation through negative control.

Second, and contrary to SSI's suggestions, the record reflects that questions of affiliation and negative control were, in fact, raised in prior proceedings. As noted above, SSI itself argued, in response to the initial size protest, that SSI and PMA could be affiliated, insofar as PMA is not a "joint venture" under SBA regulations. Section II.A, *supra*. The Area Office addressed affiliation, albeit briefly, in both of its determinations, and the Court likewise discussed general principles of affiliation. Court's Order and Opinion at 2. Even the exact issue of affiliation through negative control, based on PMA's Operating Agreement, was previously raised by SSI in response to the protest, as SSI maintained that "nothing in PMA's operating agreement permits [SSI] to take actions like preventing a quorum or blocking actions by [PMA's Board]." Section II.A, *supra*. OHA therefore cannot conclude that affiliation and negative control are new issues presented for the first time on remand.

Third, even if OHA were to agree that affiliation and negative control are not properly before OHA at this time, it does not follow that OHA could appropriately ignore or disregard such issues. Instead, in situations where OHA concludes that an SBA determination is flawed, but that additional development of the factual record is necessary, OHA then typically will remand such a matter to the original decision-maker for further investigation and review. *E.g., Size Appeal of HWI Gear, Inc.*, SBA No. SIZ-6072 (2020). If, on the other hand, OHA concludes that an SBA determination is flawed because principles of law were incorrectly applied or interpreted, OHA can, and will, reverse such a determination, after ensuring that interested parties have fair opportunity to be heard on the issues. *E.g., Size Appeal of Telesis Corp.*, SBA No. SIZ-6113 (2021). In the instant case, the Area Office previously assembled the relevant factual record, including PMA's Operating Agreement, in preparing the original size determination, and the facts of this case, in any event, are essentially undisputed. OHA nonetheless, however, afforded the Area Office the opportunity to reexamine the original size determination based on any new or changed circumstances. Section II.C, *supra*. The remaining issues presented in this case are matters of law (*i.e.*, the legal implications arising from the existing, undisputed factual record), and thus may properly be decided by OHA without need for further investigation. In addition, by requesting comments from interested parties specifically on the issue of negative control through PMA's Operating Agreement, OHA ensured that all parties had adequate notice of the issue, and each party did, in fact, address this matter in its respective comments. Accordingly, OHA may, at this stage of the proceedings, properly consider the legal question of affiliation through negative control.

Having concluded that the issue of affiliation through negative control is appropriately before OHA for review, OHA must determine whether negative control is present in the instant case. SBA's regulations governing affiliation provide, in pertinent part, that:

> Control may be affirmative or negative. Negative control includes, but is not limited to, instances where a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

13 C.F.R. § 121.103(a)(3). In prior decisions, OHA has held that negative control exists "when a minority owner can block ordinary actions essential to operating the company." *Size Appeal of Southern Contracting Sols. III, LLC*, SBA No. SIZ-5956, at 10 (2018) (citing *Size*

Appeal of Eagle Pharms., Inc., SBA No. SIZ-5023, at 10 (2009)). OHA has deemed several types of actions essential to the daily operation of a company, such that a minority owner's power to block these actions will constitute negative control. Such actions "include borrowing money, increasing employee and officer compensation, purchasing equipment, amending or terminating lease agreements, alienating or encumbering assets, paying dividends, creating debt securities, controlling operating budgets or incentive plans, and the choosing [of] independent auditors." *Size Appeal of Carntribe-Clement 8AJV # 1, LLC*, SBA No. SIZ-5357, at 15 (2012); *see also Size Appeal of Team Waste Gulf Coast, LLC*, SBA No. SIZ-5864, at 6-7 (2017); *Size Appeal of BR Constr., LLC*, SBA No. SIZ-5303, at 7-8 (2011); *Eagle Pharms.*, SBA No. SIZ-5023, at 10; *Size Appeal of EA Eng'g, Sci, and Tech., Inc.*, SBA No. SIZ-4973, at 8-9 (2008). In addition, "hiring employees and advisors" and "bringing lawsuits" also are essential to the daily operations of a company. *Southern Contracting*, SBA No. SIZ-5956, at 12; *Size Appeal of DHS Sys. LLC*, SBA No. SIZ-5211, at 8 (2011).

Conversely, a minority owner's ability to veto extraordinary actions outside the ordinary course of business — such as declaring bankruptcy; selling or otherwise disposing of all of the firm's assets; a merger or acquisition; admitting new members; or amending an operating agreement in a manner that materially alters the rights of existing members — will not give rise to negative control, so long as the provisions are crafted to protect the investment of the minority shareholder, and not to impede the majority's ability to control the concern's operations or to conduct the concern's business as it chooses. *Southern Contracting*, SBA No. SIZ-5956, at 11; *Carntribe-Clement*, SBA No. SIZ-5357, at 14-15; *EA Eng'g*, SBA No. SIZ-4973, at 8-9.

In the instant case, PMA's Operating Agreement plainly does give SSI the power to exert negative control over PMA. PMA has two Members, North Wind and SSI, and under section 5.3.1 of the Operating Agreement, "[a]ll [M]embers must be present, in person or in proxy, for meetings of the Members." Section II.D, *supra*. SSI thus could block a meeting of the Members from occurring, and hence any decisions that might be made at such a meeting, by declining to attend the meeting or to participate via proxy. Because SSI has the power "to prevent a quorum or otherwise block action" by PMA's Members, SSI exerts negative control over PMA under the literal text of 13 C.F.R. § 121.103(a)(3).

Apart from SSI's ability to block meetings of the Members, section 5.1.6 of PMA's Operating Agreement requires advance, written approval from both North Wind and SSI in order for PMA to undertake certain types of actions. Section II.D, *supra*. SSI correctly observes that some of the types of actions specified in section 5.1.6 are "extraordinary" in nature, including the addition of new Members, amendment of the Operating Agreement, and the reorganization of PMA. Other types of actions in section 5.1.6, however, are ordinary actions essential to operating PMA. PMA's Operating Agreement requires SSI's advance, written agreement to "the commencement of any litigation by or on behalf of [PMA]"; "the entering into of any real property lease by [PMA] with rental payments in excess of $[xx] during any calendar year"; "the grant or issuance of any equity incentives by [PMA]"; and "any pledge or other encumbrance of any property of [PMA] valued at more than $[xx]." Section II.D, *supra*. Further, SSI's approval is required for "any transaction causing [PMA] to incur any indebtedness beyond that approved by the Members in the annual operating budget or any business plan adopted and approved by the Members." *Id.* This last provision is particularly notable because, as discussed above, SSI

also has the power, under section 5.3.1 of the Operating Agreement, to prevent a meeting of the Members — and hence any annual operating budget "approved by the Members" — from ever occurring in the first instance. Accordingly, SSI has control over several "ordinary" actions essential to the operation of PMA, and thus has the power to exert negative control over PMA. SSI and PMA therefore are affiliated.

B. Calculation of Receipts

As discussed above, and in order to fully implement the Court's instructions to OHA on remand, OHA conducted a detailed review of the tax returns of both SSI and PMA. OHA's analysis of such information is provided herein. OHA finds that SSI, by itself, is a small business. However, SSI is not small if affiliated with PMA.

SBA regulations generally provide that a concern's "receipts" are calculated by combining its "cost of goods sold" with its "total income," as those terms are defined and reported on the concern's federal tax return forms. 13 C.F.R. § 121.104(a). Here, SSI's federal income tax returns — specifically, the Form 1120-S — are in the record for each of the five years in question. SSI's tax returns reflect the following information for "cost of goods sold" (line 2) and "total income" (line 6):

	2015	**2016**	**2017**	**2018**	**2019**
Cost of goods sold (line 2)					
Total income (line 6)					
Total Receipts:					

A concern's average annual receipts are computed by adding its total receipts for each of the years under review, and then dividing that total by the number of years under review. 13 C.F.R. § 121.104(c)(1). Here, SSI's total receipts over the five-year period from 2015-2019 are $[xx]. Dividing this total by five yields average annual receipts of $[xx]. Accordingly, because SSI's own average annual receipts do not exceed the applicable $41.5 million size standard, SSI, by itself, is small.

The consequence of affiliation, however, is that a concern's average annual receipts are combined with those of its affiliates. 13 C.F.R. §§ 121.103(a)(6) and 121.104(d). In the instant case, PMA's tax returns are also in the record. PMA's receipts for the five years in question are reflected in the table below:

	2015	**2016**	**2017**	**2018**	**2019**
Cost of goods sold (line 2)					
Total income (line 8)					
Total Receipts:					

PMA's total receipts over the five-year period from 2015-2019 are $[xx]. Dividing this total by five yields average annual receipts of $[xx] for PMA. Adding SSI's average annual receipts ($[xx]) to those of PMA ($[xx]) results in a combined total of $[xx], and thus

substantially exceeds the $41.5 million size standard. Therefore, while SSI alone is small, SSI is not small if affiliated with PMA.

On remand, the parties debate the extent to which SSI's receipts already reflect income from PMA. OHA finds that SSI's "total income," as reported on line 6 of SSI's tax returns, is already inclusive of SSI's share of PMA's taxable income. More specifically, as is explained in PMA's audited financial statements, although PMA does file its own tax returns separate from those of its two Members, PMA does not itself pay tax. Rather, PMA is taxed as a partnership and its "taxable income is reported directly to the partners through the partnership income tax return." (PMA's 2019 Audited Financial Statements at 14.) During 2016, for example, PMA reported net taxable income (after expenses and deductions) of $[xx]. SSI's share ([xx]%) of this amount is $[xx], and SSI thus reported $[xx] as income from PMA during 2016. Such income from PMA is reflected as part of SSI's "other income" on line 5 of SSI's returns, as well as on an accompanying Statement 1. For the five years in question here, SSI reported its share of PMA's taxable income as follows: [xx] in 2015; $[xx] in 2016; $[xx] in 2017; $[xx] in 2018; and $[xx] in 2019. These amounts are shown on the Statement 1 filed with SSI's returns, and also are reported as part of SSI's "other income" on line 5. Line 5, in turn, becomes part of SSI's "total income" on line 6. By combining line 2 and line 6 to arrive at SSI's total receipts, then, the above totals are already inclusive of SSI's share of PMA's net taxable income.

As explained above, the record reflects SSI did report income from PMA for [xx] of the [xx] years in question. Because OHA has concluded that SSI and PMA are affiliated, and that all of PMA's receipts therefore must be attributed to SSI, it is appropriate to deduct income that SSI derived from PMA, as reported on SSI's returns, so as to avoid double-counting. The amounts at issue here, however — [xx] in 2015; $[xx] in 2016; $[xx] in 2017; $[xx] in 2018; and $[xx] in 2019 — are not of sufficient magnitude to affect the outcome. Even if such amounts are deducted, the combined receipts of SSI and PMA are still well above the size standard.

In its comments on remand, SBA contends that SSI still may be charged with its proportionate share of PMA's entire receipts (not merely net taxable income), pursuant to 13 C.F.R. § 121.104(a). This argument, though, lacks foundation in the regulatory text. Unlike § 121.103(h), which pertains specifically to joint ventures, § 121.104(a) is silent as to joint ventures and likewise does not contemplate that one concern may be attributed a proportionate share of another concern's receipts. On the contrary, § 121.104(a) stipulates that calculation of a concern's receipts is determined by assessing that concern's own "revenue" as reflected on that concern's own federal income tax returns. Accordingly, OHA agrees with SBA that SSI must include income generated from PMA, even if such revenue is merely pass-through income for tax purposes as appears to be the case here, to the extent that such revenues were reported as income on SSI's tax returns. Given, however, that the Court has found that PMA currently does not qualify as a joint venture under SBA rules and instead is in the nature of a separate stand-alone business, and given further that SSI's tax returns do not reveal revenues from PMA beyond SSI's [xx]% share of PMA's net taxable income, OHA does not believe there is any regulatory mechanism to broadly attribute PMA's receipts to SSI for purposes of calculating SSI's size, unless those two concerns are affiliated. Nor does SBA point to any prior precedent for assigning the receipts of one stand-alone business to a second stand-alone business, in the absence either of affiliation or of a joint venture relationship.

SBA also suggests that SSI must accept its proportionate share of PMA's receipts under § 121.103(h), because the text of that rule "does not discriminate based on type or current validity of the joint venture but rather states that to calculate size, a concern must include its proportionate share of joint venture receipts." Section II.G, *supra*. This argument, though, is at odds with the Court's underlying decision. OHA understands the Court to have held that, although PMA originally was created as a joint venture and thereafter continued to operate as a joint venture, PMA nonetheless ceased to be a "joint venture" in a definitional sense after the 2016 revisions to § 121.103(h). Section II.B, *supra*. As has been explained above, the Court's decision is controlling here, and OHA thus must accept the premise, for purposes of this remand, that SSI is not required to include its proportionate share of PMA's receipts under § 121.103(h). Accordingly, while SBA may be free to advance its arguments with regard to § 121.103(h) to the Court, or in a subsequent appeal, OHA is not at liberty to adopt such an interpretation here.

OHA is aware that SSI itself, in communications with the Area Office, reported somewhat different (lower) values for its total receipts than the amounts shown in the tables above. Specifically, SSI represented that its total receipts were $[xx] in 2015; $[xx] in 2016; $[xx] in 2017; $[xx] in 2018; and $[xx] in 2019. SBA regulations, however, instruct that although receipts generally are determined by adding "cost of goods sold" and "total income," there are certain permissible exclusions, such as, for example, net capital gains or losses and taxes collected for and remitted to a taxing authority. 13 C.F.R. § 121.104(a). In the instant case, SSI informed the Area Office, during the initial size review, that SSI had in some instances made proposed adjustments to "cost of goods sold" and/or "total income" to reflect other exclusions to which SSI believed it was entitled. For purposes of this analysis, it is unnecessary to decide whether these other claimed adjustments were proper. This is true because, as demonstrated by the discussion *infra*, even assuming SSI were not eligible for any of these adjustments, SSI still would qualify as small unless it is affiliated with PMA, and, conversely, still would not qualify as small if it is affiliated with PMA.

Lastly, Akima, in its comments on remand, highlights that SSI stated, on SSI's completed SBA Form 355, that SSI's self-reported average annual receipts "do not include any amounts attributable to PMA." Section II.F, *supra* (citing SSI's response to Form 355 question 12.) Akima urges that OHA should conclude that SSI is "bound by its earlier statements." *Id.* This argument fails for two reasons. First, when read in context, SSI's remark appears to have indicated merely that SSI did not include any proportionate share of PMA's receipts — as normally would have been expected and indeed required under § 121.103(h) — consistent with SSI's legal argument that PMA was no longer a "joint venture" in a definitional sense. SSI's remark, then, does not appear to have meant that SSI's self-reported receipts included literally no income from PMA, even if reported by SSI itself as part of "total income" on SSI's own tax returns. Moreover, and irrespective of what SSI may have intended by its remark, the amounts of income generated from PMA can easily be ascertained from SSI's tax returns: [xx] in 2015; $[xx] in 2016; $[xx] in 2017; $[xx] in 2018; and $[xx] in 2019. As noted above, these amounts are not large enough to affect the outcome of this case. Thus, even if OHA were, for example, to add these amounts to the receipts that SSI self-reported on its SBA Form 355, the combined totals would not exceed the $41.5 million size standard.

In sum, and as discussed in detail above, OHA finds that SSI's receipts are inclusive of income derived from PMA, specifically SSI's share of PMA's net taxable income. Because SSI's own receipts do not exceed the size standard, SSI, by itself, is small. However, SSI does exceed the size standard, and therefore is not small, if affiliated with PMA.

IV. Conclusion

SSI is affiliated with PMA through negative control, and the combined receipts of SSI and PMA exceed the applicable $41.5 million size standard. The Area Office, therefore, ultimately was correct in concluding that SSI is not a small business for the instant procurement. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(d).

KENNETH M. HYDE
Administrative Judge