United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Washington Patriot Construction, LLC, Appellant, Appealed From Size Determination No. 6-2013-008	SBA No. SIZ-5447 Decided: February 11, 2013

APPEARANCE

Jonathan A. DeMella, Esq., Dorsey & Whitney LLP, Seattle, Washington, for Appellant

DECISION[1]

I. Introduction and Jurisdiction

On November 16, 2012, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area VI (Area Office) issued Size Determination 6-2013- 008, finding that Washington Patriot Construction, LLC (Appellant) is not an eligible small business. Specifically, the Area Office determined that Appellant is affiliated with Wade Perrow Construction, LLC (WPC) through common ownership and management, negative control, and the totality of the circumstances. 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 timely filed the instant appeal on December 3, 2012.[2] Accordingly, this matter is properly before OHA for decision.

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[1] This decision was initially issued under a protective order. Pursuant to 13 C.F.R. § 134.205, I afforded counsel an opportunity to file a request for redactions if desired. OHA considered Appellant's request in redacting the decision. OHA now publishes a redacted version of the decision for public release.

[2] Ordinarily, an appeal petition must be filed within fifteen calendar days of receipt of the size determination. 13 C.F.R. § 134.304(a). In this case, the size determination was issued on November 16, 2012. Fifteen calendar days after November 16, 2012 was December 1, 2012.

II. Background

A. Solicitation and Protest

On August 18, 2012, the U.S. Army Corps of Engineers issued solicitation W912DW-12 R-0035 seeking a contractor to construct an access control point at Joint Base Lewis-McChord North, Washington. The Contracting Officer (CO) set aside the procurement entirely for service disabled veteran-owned small business concerns (SDVO SBCs), and assigned North American Industry Classification System (NAICS) code 236220, Commercial and Institutional Building Construction, with a corresponding size standard of $33.5 million in average annual receipts. Appellant submitted its offer on September 17, 2012, self-certifying as a small business.

On September 19, 2012, the CO announced that Appellant was the apparent awardee. O September 21, 2012, Government Contracting Services, LLC (GCS), a disappointed offeror, protested Appellant's size. [3] GCS alleged that Appellant is not a small business due to affiliation with WPC. Specifically, GCS theorized Appellant and WPC are affiliated because Appellant's managing members also govern WPC. GCS further alleged that Appellant is dependent upon WPC for bonding.

B. Appellant's Operating Agreement

On October 31, 2012, Appellant responded to the protest allegations and submitted a copy of its operating agreement to the Area Office. The operating agreement contains the following provisions pertinent to this appeal:

> 2.2 Percentage Interests. The Members will have the following Percentage Interests in [Appellant], which will apply to ownership of capital and interests in profits and losses:
>
> | Member | Percentage Interest |
> |---|---|
> | Mickey Traugutt | 51% |
> | [WPC] | 49% |

Because December 1, 2012 was a Saturday, the appeal petition was due on the next business day: Monday, December 3, 2012. 13 C.F.R. § 134.202(d).

[3] GCS also challenged Appellant's eligibility as an SDVO SBC, an issue which SBA addressed by separate determination. *Matter of Gov't Contracting Servs., LLC*, SBA No. VET-230 (2012).

Manager	
Mickey Traugutt	51%
Wade Perrow	18.375%
Elizabeth Perrow	18.375%
Dan McKinney	12.25%

> By signing this Operating Agreement, the above Members and Managers acknowledge, warrant, and represent that [Appellant] is intended to operate as a Service-Disabled Veteran-Owned (SDVO) Small Business Concern in accordance with 13 C.F.R. § 125.9, as amended, and the respective Membership Interests shall be maintained in accordance with the aforementioned intent.

(Operating Agreement § 2.2 (emphasis in original).)

> The operating agreement provides further:
>
> 4.1 Management of the Company. As a Service-Disabled Veteran-Owned Small Business Concern, the Members and Managers intend this Article and applicable Articles of this Agreement to be construed in such a manner as to comply with the SBA management and control requirements regarding Mickey Traugutt's control of [Appellant]. See 13 C.F.R. § 125.10(a), as amended. Notwithstanding the foregoing, [Appellant] will be managed exclusively by the Managers. A Manager need not be a Member. Except as expressly set forth otherwise in this Agreement, the Managers (acting for and on behalf of [Appellant]) will have the right, power, and authority to do any and all things necessary to carry out the business of [Appellant]. No person dealing with a Manager, where such Manager is acting within the apparent scope of his authority as a Manager, will be required to determine the Manager's authority to execute any document on behalf of [Appellant] or make any undertaking on behalf of [Appellant], or to determine any facts or circumstances bearing upon the existence of such authority. All decisions made for and on behalf of [Appellant] by any Manager, and which are in accordance with this Agreement, will bind [Appellant]. Provided, that any disagreement between or among Managers over a decision on Company matters, will be resolved by vote of a majority of Managers.

(*Id.* § 4.1.)

Section 4.2(b) of the operating agreement states that:

> A Manager may be removed only for acting in bad faith in office, and will be presumed to have acted in good faith unless the party or parties asserting to the contrary can show by clear, cogent and convincing evidence that the Manager acted in bad faith.

(*Id*. § 4.2(b).)

Regarding succession of managers, the operating agreement states, "If MICKEY TRAUGUTT should cease to be a Manager of [Appellant], then a successor qualified Service-Disabled Veteran shall be elected by the remaining Managers. . . . If, despite these procedures for identifying successor Managers, there is a vacancy in the office of Manager, then the vacancy will be filled by vote of a majority of the Percentage Interests." (*Id.* § 4.3.)

The operating agreement states further:

> 8.2 Actions of Company. Except as otherwise provided herein, any action identified herein as requiring the agreement, vote or consent of the Members or Managers, as applicable, will require the affirmative agreement, vote or consent of the Members or Managers, as applicable, (in writing or at a meeting described in Section 5.3) owning 51% of the outstanding Percentage Interests. Only those Percentage Interests held by voting Members (and excluding Percentage Interests held by transferees who have not been admitted as Members of [Appellant] pursuant to the provisions of Article VI), will be considered outstanding for purposes of this Section.

(*Id*. § 8.2.)

C. Size Determination

On November 16, 2012, the Area Office issued its determination finding that Appellant is not a small business due to affiliation with WPC.

The Area Office explained that Mr. Michael "Mickey" Traugutt is president and 51% owner of Appellant; WPC owns the remaining 49%. WPC in turn is owned (through certain intervening concerns) by Mr. Wade Perrow and Mrs. Elizabeth Perrow, a married couple, and by Mr. Dan McKinney. Mr. McKinney and the Perrows are also managers of WPC. The Area Office found that Mr. McKinney and the Perrows have the power to control WPC. Further, due to common investments and the family relationship between the Perrows, the Area Office concluded that Mr. McKinney and the Perrows share an identity of interest. 13 C.F.R. § 121.103(f).

Next, the Area Office explained that Mr. Traugutt, Mr. McKinney, and Mr. and Mrs. Perrow are Appellant's managers. The Area Office reasoned that Mr. McKinney and the Perrows, as three of Appellant's four managers, have the power to control Appellant. Because Mr. McKinney and the Perrows also control WPC, the Area Office concluded that Appellant and WPC are affiliated through common management. *Id*. § 121.103(e).

The Area Office determined that WPC and Appellant are also affiliated through negative control. In particular, section 2.2 of the operating agreement identifies the four managers of the

Appellant, and section 4.1 of the operating agreement states that any "disagreement between or among Managers over a decision on Company matters, will be resolved by vote of a majority of Managers." The Area Office found that three managers are needed to constitute a majority. (Size Determination at 4.) Thus, in light of the identity of interest among the Perrows and Mr. McKinney, the Area Office determined that they have the ability to exercise negative control over Appellant. 13 C.F.R. § 121.103(a)(3).

Lastly, the Area Office determined Appellant and WPC are affiliated under the totality of the circumstances. *Id.* § 121.103(a)(5). The Area Office cited the following considerations: (1) [XXXXXXXXXXXXXXXXXXXXXXX]; (2) [XXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX]; (3) [XXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX]; (4) [XXXX XXXXXXXXXXXXXXXXXXXXXX]; (5) [XXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXX]; (6) [XXXXXXXXXXXXXXXXXXXXXXXXX]; and (7) [XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX]. The Area Office concluded that these factors collectively show [XXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX]. (Size Determination at 4.) WPC also has an indirect economic interest in assisting Appellant to obtain contracting revenue. The Area Office remarked that "the economic ties between the owners of [Appellant] and WPC, and the perceived influence that these managers can exert upon [Appellant's] decision-making, put into question Mr. Traugutt's ability to control [Appellant] and his ability to conduct business at [Appellant] independently." (*Id.* at 5.)

The Area Office then aggregated Appellant's average annual receipts with those of WPC and determined that their combined average annual receipts exceed the applicable size standard. As a result, Appellant is not a small business.

D. Appeal

On December 3, 2012, Appellant filed the instant appeal with OHA. Appellant contends that the size determination is clearly erroneous and should be reversed.

Appellant argues that the determination that Appellant and WPC are affiliated through common management is based on a flawed interpretation of the operating agreement. Appellant asserts that, contrary to the size determination, Mr. Traugutt has unfettered control over Appellant as a result of his 51% ownership and 51% management interest. Appellant explains that its managers do not have equal votes in Appellant's decision-making process; rather, voting interests are weighted in favor of Mr. Traugutt as described in § 2.2 of the operating agreement. Further, the operating agreement states that it is intended "to be construed in such a manner as to comply with the SBA management and control requirement regarding [Mr.] Traugutt's control of [Appellant]." (Operating Agreement § 4.1.) Accompanying its appeal petition, Appellant seeks to introduce declarations from each of its four managers. The managers are unanimous that, in drafting the operating agreement, they intended to vest exclusive control of Appellant in Mr. Traugutt.

Next, Appellant contends that the finding of negative control is based on the same erroneous interpretation of the operating agreement. Because Mr. Traugutt's 51% ownership and voting interest allow him sole control over Appellant, any ability on the part of the other three managers to exercise negative control is illusory. *Size Appeal of EA Eng'g, Sci. and Tech., Inc*., SBA No. SIZ-4974 (2008).

Appellant contends that the finding of affiliation based on the totality of the circumstances is also erroneous. Appellant first addresses the findings that WPC's principals own a significant share of Appellant and that they constitute a majority of Appellant's managers. Appellant reiterates its argument that these findings are based on a misinterpretation of the operating agreement.

Appellant then takes issue with the findings that [XXXXXXXXXXXXXXXXXXXXXXXXX], that [XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX], that [XXXXXXXXXXXXXXXXXXXXXXXXXX], and that [XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX]. Appellant contends these dealings result from arms-length transactions based on market rates, and do not suggest that WPC can control Appellant. As for the fact that [XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX], Appellant contends this finding is irrelevant and precedes the date of self-certification.

Appellant acknowledges that [XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX], but insists that [XXXXXXXXXXXXXXXXXXXX]. Appellant also observes that SBA regulations do not prohibit a service-disabled veteran from [XXXXXXXXXX].

E. Motion to Supplement the Record

With its appeal, Appellant moved to introduce additional evidence. Specifically, Appellant seeks to admit declarations from the Perrows and Messrs. Traugutt and McKinney. Appellant contends that this evidence will clarify Appellant's management structure and the managers' intent in drafting the operating agreement, and provide further detail regarding the bonding assistance. Thus, argues Appellant, the evidence is relevant to the issues on appeal, clarifies facts on appeal, and does not unduly enlarge the issues. As a result, there is good cause to admit it.

III. Discussion

A. Standard of Review

Appellant has the burden of proving, by a preponderance of the evidence, all elements of the appeal. Specifically, Appellant must prove the size determination is based upon a clear error of fact or law. 13 C.F.R. § 134.314. OHA will disturb an area office's size determination only if, after reviewing the record, the administrative judge has a definite and firm conviction that the area office erred in making its key findings of fact or law. *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 11 (2006).

B. New Evidence

OHA's review is based upon the evidence in the record at the time the Area Office made its determination. *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 10-11 (2006). As a result, evidence that was not previously presented to the Area Office is generally not admissible and will not be considered by OHA. *E.g., Size Appeal of Maximum Demolition, Inc.*, SBA No. SIZ-5073, at 2 (2009) ("I cannot find error with the Area Office based on documents the Area Office was unable to review."). New evidence may be admitted on appeal at the discretion of the administrative judge if "[a] motion is filed and served establishing good cause for the submission of such evidence." 13 C.F.R. § 134.308(a)(2). The proponent must demonstrate, however, that "the new evidence is relevant to the issues on appeal, does not unduly enlarge the issues, and clarifies the facts on the issues on appeal." *Size Appeal of Vista Eng'g Techs., LLC*, SBA No. SIZ-5041, at 4 (2009).

In this case, Appellant has not shown good cause to admit new evidence. Appellant offers declarations from each of its four managers in an effort to clarify the operating agreement, and to illuminate the managers' intent in drafting it. It is settled law, however, that when the language of an agreement is clear and unambiguous, extrinsic evidence is not necessary to interpret it. *E.g., McAbee Constr., Inc. v. United States*, 97 F.3d 1431, 1435 (Fed. Cir. 1996). Here, Appellant's operating agreement speaks for itself, and OHA need not delve beyond its actual terms to interpret the agreement. Accordingly, Appellant's motion to admit new evidence is DENIED, and the proffered evidence is EXCLUDED. *Size Appeal of Eagle Consulting Corp., Inc.*, SBA No. SIZ-5267, at 4 (2011*), recons. denied*, SBA No. SIZ-5288 (2011) (PFR) (finding evidence to be inadmissible when it was probative only of issues that OHA did not reach).

C. Analysis

Appellant's arguments in this appeal hinge largely upon its interpretation of Appellant's operating agreement. Specifically, Appellant maintains that the operating agreement vests Mr. Traugutt alone with the power to control Appellant by virtue of his 51% ownership and 51% management interests. Further, although the size determination concluded that Mr. McKinney and the Perrows could block Mr. Traugutt's control over Appellant, Appellant insists that any such appearance is illusory because Mr. Traugutt could overrule any dissent.

Having carefully reviewed the record, I find Appellant's reasoning unpersuasive. The operating agreement specifically designates Mr. Traugutt, Mr. McKinney, and the Perrows as Appellant's managers, and makes clear that a manager may be removed only for "acting in bad faith in office." (Operating Agreement §§ 2.2 and 4.2(b).) Thus, despite his majority ownership of the company, Mr. Traugutt cannot simply remove managers that disagree with him. *Cf., Size Appeal of Envtl. Quality Mgmt., Inc.*, SBA No. SIZ-5429 (2012) (appearance of negative control was illusory because majority owner could unilaterally remove directors without cause).

Moreover, section 4.1 of the operating agreement specifies that disagreements among the managers will be resolved by "vote of a majority of Managers." Notably, the agreement does not

state that Mr. Traugutt alone will resolve all disputes. Nor does the agreement state that disagreements will be resolved according to managers' weighted voting interests. This latter omission is significant because the agreement elsewhere does identify situations when voting occurs based on weighted interests. E.g., Operating Agreement §§ 4.3, 5.3, 6.2, 6.6, and 7.1. The operating agreement is also clear where a majority of the members is required. See §§ 2.1, 4.6, and 6.8. Accordingly, I must agree with the Area Office that, under the plain language of Appellant's operating agreement, contested managerial decisions require approval by three of the four managers. It follows that Mr. McKinney and the Perrows have the power to negatively control Appellant, by refusing their consent on disputed issues. *E.g., Size Appeal of Carntribe-Clement 8AJV #1, LLC*, SBA No. SIZ-5357, at 13 (2012) ("Negative control exists if a minority owner can block ordinary actions essential to operating the company."); *Size Appeal of BR Constr., LLC*, SBA No. SIZ-5303 (2011).

Appellant contends that section 4.1 of the operating agreement should be interpreted in light of sections 2.2 and 8.2. Section 2.2 states that Appellant is intended to operate as an SDVO SBC. Section 8.2 states:

> Except as otherwise provided herein, any action identified herein as requiring the agreement, vote or consent of the Members or Managers, as applicable, will require the affirmative agreement, vote or consent of the Members or Managers, as applicable, (in writing or at a meeting described in Section 5.3) owning 51% of the outstanding Percentage Interests.

(Operating Agreement § 8.2). I find no merit to Appellant's arguments. Merely stating that Appellant is intended to operate as an SDVO SBC does not establish that Appellant is, in actuality, structured in a manner consistent with the affiliation regulations. Appellant's contention regarding the application of section 8.2 is also unavailing, because that section begins with the caveat "Except as otherwise provided herein. . . ." Section 4.1 does specifically provide otherwise by stating that disagreements are to be resolved by a "majority of the Managers."

Appellant's interpretation of the agreement is also flawed because it creates the absurd result that Appellant would be conducting "votes" on disputed issues, even though (in Appellant's view) such votes are always resolved in favor of Mr. Traugutt. The operating agreement, however, does not state that Mr. Traugutt has final authority on all issues. Indeed, the very fact that the operating agreement calls for votes on disputed issues suggests that Mr. Traugutt will not necessarily always prevail.

Thus, I find the Area Office correctly concluded that, notwithstanding Mr. Traugutt's 51% ownership and 51% management interests, the operating agreement enables Mr. McKinney and the Perrows to thwart Mr. Traugutt's control over Appellant in cases of disagreement. Because Appellant is affiliated with WPC on this basis, it is unnecessary to decide whether Appellant and WPC also are affiliated on additional grounds.

IV. Conclusion

For the reasons discussed supra, the appeal is DENIED and the size determination is AFFIRMED. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(d).

KENNETH M. HYDE
Administrative Judge