

SIZE APPEALS OF: KIHOMAC, INC., APPELLANT RE: HONEYCOMB COMPANY OF AMERICA, INC.

SBA No. SIZ-6133, 20212021 WL 6108451 December 15, 2021

Term [Next search term](#)

SBA No. SIZ-6133, 2021 (S.B.A.), 2021 WL 6108451

Small Business Administration (S.B.A.)

Office of Hearings and Appeals

[Size Appeal]

***1** SIZE APPEALS OF: KIHOMAC, INC., APPELLANT

***1** RE: HONEYCOMB COMPANY OF AMERICA, INC.

***1** SBA No. SIZ-6133

***1** Appealed from Size Determination Nos. 3-2021-056 and -057

***1** December 15, 2021

Appearances

***1** Judith B. Kassel, Esq.

***1** Nicole E. Chammas, Esq.

***1** Saul Ewing Arnstein & Lehr LLP

***1** Washington, D.C.

***1** For Appellant

DECISION

I. Introduction and Jurisdiction

***1** On August 16, 2021, the U.S. Small Business Administration (SBA) Office of Government Contracting — Area III (Area Office) issued Size Determinations Nos. 3-2021-056 and 3-2021-057, denying two size protests filed by KIHOMAC, Inc. (Appellant) against Honeycomb Company of America, Inc. (Honeycomb). The protests alleged that Honeycomb is not small due to affiliation with Plexus Capital Partners (Plexus), a venture capital firm. The Area Office concluded, however, that because Plexus is a licensed Small Business Investment Company (SBIC), any Plexus investment in Honeycomb would not give rise to affiliation. Further, Plexus does not, in any event, hold a large enough interest in Honeycomb to control Honeycomb. On appeal, Appellant contends that the Area Office clearly erred in its analysis of these issues and requests that SBA's Office of Hearings and Appeals (OHA) reverse or remand. For the reasons discussed *infra*, the appeals are denied and the size determinations are affirmed.

***1** 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 appeals within fifteen days of receiving the size determinations, so the appeals are timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. The Solicitations

*1 In February 2021, the Defense Logistics Agency (DLA) issued Request for Proposals (RFP) Nos. SPRHA4-21-R-0157 and SPRHA4-21-R-0160, seeking contractors to provide aircraft doors for the A-10 weapon system. Both procurements were set aside entirely for small businesses, and were assigned North American Industry Classification System (NAICS) code 336413, Other Aircraft Part and Auxiliary Equipment Manufacturing, with a corresponding size standard of 1,250 employees. Appellant and Honeycomb submitted timely proposals for each procurement.

B. Protests

*1 On July 22, 2021, the Contracting Officer (CO) informed Appellant that Honeycomb was the apparent awardee for both procurements. (Pre-Award Notification Letter at 1.) On July 26, 2021, Appellant filed protests challenging Honeycomb's size for each procurement. The protests alleged that Honeycomb is not a small business due to affiliation with Plexus, a venture capital firm. The CO forwarded the protests to the Area Office for review.

C. Protest Response

*2 In response to the protests, Honeycomb explained that "Plexus is licensed by the SBA as an SBIC." (Protest Response at 1.) Therefore, the Area Office should find Plexus "exempt from Small Business Affiliation Rules." (*Id.*)

*2 Honeycomb stated that, during 2013, Plexus "provided short term debt financing" to Honeycomb's parent company, Overall-Honeycomb, LLC, to assist with the acquisition of Honeycomb. (*Id.*) The loan from Plexus, however, was fully repaid on December 5, 2013. (*Id.*) Also during 2013, Plexus was granted "stock option warrants for 14,000 shares" in Honeycomb, valid until 2023. (*Id.*) Plexus has not exercised the warrants. (*Id.*) Honeycomb insisted that, apart from the unexercised warrants, Plexus currently holds no ownership interest in Honeycomb, nor does Plexus have "any management authority or influence within [Honeycomb]." (*Id.*) As a result, Honeycomb and Plexus are not affiliated.

*2 Next, Honeycomb explained that Honeycomb and its acknowledged affiliates are well within the 1,250-employee size standard applicable to the instant procurements. (*Id.* at 2.) Indeed, as of the dates of self-certification, Honeycomb and its affiliates together had fewer than 650 employees. (*Id.*) Accompanying the protest response, Honeycomb submitted copies of its articles of incorporation and corporate by-laws; its completed SBA Form 355; a release dated December 5, 2013, reflecting that the loan from Plexus had been fully repaid; and a copy of a "Common Stock Purchase Warrant", dated March 20, 2013, entitling Plexus to purchase up to 14,000 shares of Honeycomb common stock at a designated price. The "Common Stock Purchase Warrant" states that, at the

time the warrant was issued, the 14,000 shares represented 10% of Honeycomb's then-outstanding stock on a fully-diluted basis. (Common Stock Purchase Warrant at 1.)

*2 According to Honeycomb's sworn SBA Form 355, Honeycomb currently is 95% owned by its parent company, Overall-Honeycomb, LLC. (Form 355 at 4.) Plexus does not hold any ownership interest in Honeycomb. (*Id.*) In response to the question of whether it has issued any stock options, Honeycomb responded "yes" and commented that "Plexus Capital has unexercised warrants for 14,000 shares." (*Id.*) Honeycomb responded "no" to all questions concerning whether it has business dealings or other connections with any alleged affiliate. (*Id.* at 7-8.) In an attachment to its SBA Form 355 entitled "Affiliates Info", Honeycomb estimated that Plexus's "unconverted warrants", if exercised, would represent 0.9% of Honeycomb's total outstanding shares. (Form 355, Attachment.)

D. Size Determinations

*3 On August 16, 2021, the Area Office issued Size Determination Nos. 3-2021-056 and 3-2021-057, denying the protests and concluding that Honeycomb is a small business.¹

*3 The Area Office first found that Honeycomb is 98.7% owned by its parent company, Overall-Honeycomb, LLC, which in turn is 88% owned by Mr. Andrew Davis. (Size Determination at 4.) Pursuant to 13 C.F.R. § 121.103(c)(1), Mr. Davis has the power to control Honeycomb based on his ownership interest. (*Id.*) Mr. Davis also owns controlling interests in 12 other firms, and the Area Office found that Honeycomb therefore is affiliated with these firms. (*Id.*)

*3 Next, the Area Office explained that any investment by Plexus in Honeycomb is not grounds for affiliation. (*Id.*) According to SBA regulations:

*3 Business concerns owned in whole or substantial part by investment companies licensed, or development companies qualifying, under the Small Business Investment Act of 1958, as amended, are not considered affiliates of such investment companies or development companies.

*3 (*Id.*, quoting 13 C.F.R. § 121.103(b)(1).) In the instant case, the Area Office reviewed SBA's SBIC directory, which confirms that Plexus is a licensed SBIC. (*Id.*) Accordingly, the Area Office found, any Plexus investment in Honeycomb would be exempt from affiliation analysis.

*3 The Area Office determined, however, that Plexus does not, in any event, have the power to control Honeycomb. (*Id.* at 4-5.) SBA regulations state that an entity:

*3 that owns, or has the power to control, 50 percent or more of a concern's voting stock, or a block of voting stock which is large compared to other outstanding blocks of voting stock, controls or has the power to control the concern.

*3 (*Id.*, quoting 13 C.F.R. § 121.103(c)(1).) Here, according to the information Honeycomb provided to the Area Office, Honeycomb is primarily owned by Overall-Honeycomb, LLC, which in turn is primarily owned by Mr. Davis. (*Id.*) Apart from the unexercised stock warrant, Plexus does not hold any ownership interest in Honeycomb, and "the only financial relationship between [[Honeycomb]] and Plexus was resolved in December 2013 when the loan from Plexus to [Honeycomb] was paid off." (*Id.* at 5.)

*4 The Area Office noted that, while Plexus does not now own any Honeycomb stock, Plexus does hold a warrant entitling Plexus to purchase 14,000 shares of Honeycomb stock. SBA regulations at 13 C.F.R. § 121.103(d)(1) require that the Area Office must treat such a warrant as if it were already exercised. (*Id.*) Here, though, even if the warrant were exercised, this would not grant Plexus the power to control Honeycomb. (*Id.*) Honeycomb's Articles of Incorporation provide that Honeycomb may issue up to 3 million shares of common stock and up to 2 million shares of preferred stock. Moreover, the information provided with Honeycomb's sworn Form 355 "confirms that the outstanding stock options, if realized, would be insufficient to give power to control to Plexus." (*Id.*)

*4 Finally, the Area Office considered whether Honeycomb, together with its affiliates, exceeds the size standard applicable to the instant procurements. Under 13 C.F.R. § 121.106(b)(4)(i):

*4 The average number of employees of a business concern with affiliates is calculated by adding the average number of employees of the business concern with the average number of employees of each affiliate.

*4 (*Id.* at 4.) The Area Office found that the combined employees of Honeycomb and its affiliates do not exceed the 1,250-employee size standard. (*Id.*) Honeycomb is therefore a small business.

E. Appeals

*4 On August 27, 2021, Appellant filed the instant appeals.² Appellant argues that the Area Office clearly erred by finding that Honeycomb is not affiliated with Plexus.

*4 Appellant contends, first, that the Area Office erred in applying the SBIC affiliation exception at 13 C.F.R. § 121.103(b)(1), because the exception is limited to a period of seven years. (Appeal at 3.) OHA case law instructs that exceptions to affiliation are narrowly construed. (*Id.*, citing *Size Appeal of Lance Bailey & Assocs., Inc.*, SBA No. SIZ-4799, at 5 (2006).) Moreover, SBA regulations governing SBICs provide, in pertinent part:

*4 (a) *In general.* You, or you and your Associates (in the latter case, the "Investor Group"), may exercise Control over a Small Business for purposes connected to your investment, through ownership of voting securities, management agreements, voting trusts, majority representation on the board of directors, or otherwise. The period of such Control will be limited to the seventh anniversary of the date on which such Control was initially acquired, or any earlier date specified by the terms of any investment agreement.

...

*5 (d) ***Extension of Control.*** With SBA's prior written approval you, or the Investor Group, may retain Control for such additional period as may be reasonably necessary to complete divestiture of Control or to ensure the financial stability of the portfolio company.

*5 (*Id.* at 4, quoting 13 C.F.R. § 107.865 (emphasis added by Appellant).) With its protests, Appellant included a link to an announcement stating that Plexus and Overall Capital Partners had acquired Honeycomb on March 27, 2013. (*Id.*) Therefore, Appellant maintains, in accordance with § 107.865, any exemption to affiliation should have expired on March 27, 2020. (*Id.*) Further, Appellant asserts that public records reveal that “Plexus'[s] investment in [[Honeycomb] continues to this day” with no intended “exit” date. (*Id.*) In support, Appellant points to a list of Plexus's portfolio companies, which includes Honeycomb and does not specify a particular end date.

*5 The Area Office's conclusion that the “only financial relationship between [[Honeycomb] and Plexus was resolved in December 2013, when the loan from Plexus to [Honeycomb] was paid off,” is flawed, because the Area Office ignored that affiliation may arise for many possible reasons, such as common management or identity of interest. (*Id.* at 4 n.4.) Appellant also argues that, although its protests alleged affiliation between Honeycomb and Plexus due to ownership and control, the Area Office failed to fully investigate these allegations. (*Id.* at 4.)

*5 Appellant next asserts that the Area Office erred in analyzing Plexus's warrants as a percentage of Honeycomb's total authorized shares, rather than as a percentage of issued and outstanding shares. (*Id.* at 5.) To evaluate allegations of control based on stock ownership, SBA regulations provide:

*5 A person (including any individual, concern or other entity) that owns, or has the power to control, 50 percent or more of a concern's voting stock, or a block of voting stock which is large compared to other **outstanding blocks of voting stock**, controls or has the power to control the concern.

*5 (*Id.*, quoting 13 C.F.R. § 121.103(c)(1) (emphasis added by Appellant).) Appellant cites to *Size Appeal of Novalar Pharmaceuticals, Inc.*, SBA No. SIZ-4977, at 12 (2008), where OHA explained that:

*5 Under the SBA's size regulations, a concern will be found affiliated with a single shareholder (or a group of shareholders) on the basis of stock ownership even though the block of stock in question is less than 50% of the concern's voting stock, if that minority block of stock is “large compared to **other outstanding blocks** of voting stock.” 13 C.F.R. § 121.103(c)(1).

*6 (*Id.* at 5 (emphasis added by Appellant).) In the instant case, the Area Office, according to its own analysis, did not use the number of outstanding shares to determine the percentage of shares associated with Plexus's warrants. (*Id.* at 5-6.) As a result, the Area Office's finding that “the 14,000 shares available to Plexus” does not amount to a finding of control is “fatally flawed as it is based on a faulty premise.” (*Id.* at 6.) Further, Appellant asserts, the Area Office's conclusion that Honeycomb is 98.7% owned by Overall-Honeycomb, LLC is “likely wrong”. (*Id.*)

*6 Honeycomb did not respond to the appeals.

III. Discussion

A. Standard of Review

*6 Appellant has the burden of proving, by a preponderance of the evidence, all elements of the appeals. Specifically, Appellant must prove the size determinations are 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 finding of fact or law. *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 11 (2006).

B. Analysis

*6 I find no merit to these appeals. Appellant's protests alleged that Honeycomb is not a small business due to affiliation with Plexus, a venture capital firm. Section II.B, *supra*. The Area Office determined, however, and Appellant does not dispute, that Plexus is a licensed SBIC. Section II.D, *supra*. SBA affiliation regulations provide that:

*6 Business concerns owned in whole or substantial part by investment companies licensed, or development companies qualifying, under the Small Business Investment Act of 1958, as amended, are not considered affiliates of such investment companies or development companies.

*6 13 C.F.R. § 121.103(b)(1). Applying this exception, then, the Area Office appropriately concluded that any ownership interest Plexus may hold in Honeycomb does not give rise to affiliation. Section II.D, *supra*.

*6 In seeking to overturn the size determinations, Appellant maintains that the exception to affiliation at § 121.103(b)(1) should be limited to a period of seven years after the SBIC first established control over the small business. Section II.E, *supra*. Appellant asserts that Plexus initially acquired control over Honeycomb on March 27, 2013, so the Area Office should have found that the exception to affiliation expired after March 27, 2020. *Id.*

*6 Appellant's arguments are unpersuasive for two reasons. First, Appellant has not established that the exception to affiliation at § 121.103(b)(1) remains valid only for a seven-year period. As noted above, the underlying regulation, § 121.103(b)(1), merely requires that an SBIC must be licensed by SBA in order for the exception to apply, and there is no indication within the text of § 121.103(b)(1) that the exception expires after a seven-year interval. Further, although SBA regulations governing SBICs at 13 C.F.R. § 107.865 do refer to a seven-year period, this latter rule does not state that the consequence of any violation is that the SBIC will then become affiliated with the small business in which the SBIC holds the investment. Accordingly, while it may well be true that an SBIC which contravenes § 107.865 would face penalties from SBA — such as, for example, being required to divest that particular investment or potentially losing access to SBA funding — Appellant has not demonstrated that violation of § 107.865 also somehow negates the exception to affiliation at § 121.103(b)(1).

*7 Second, even assuming Appellant were correct that the exception to affiliation at § 121.103(b)(1) is limited to a time period of seven years after the SBIC first established control over the small business, Appellant has not shown that Plexus actually did gain such control over Honeycomb in 2013. Although Plexus provided a short-term loan to Honeycomb's parent company during 2013, the loan itself did not grant Plexus any interest in Honeycomb, and Honeycomb produced evidence that the loan was fully

repaid as of December 5, 2013. Section II.C, *supra*. Plexus also acquired a warrant during 2013 permitting Plexus to purchase up to 14,000 shares of Honeycomb stock. *Id.* The warrant, though, was not (and still has not been) exercised, and even at the time the warrant was issued, the 14,000 shares represented only a 10% minority interest in Honeycomb. *Id.* Accordingly, Appellant has not shown any possible basis to conclude that Plexus actually established control over Honeycomb during 2013, such that the seven-year time period referenced at § 107.865 would have lapsed.

*7 Appellant also argues that the Area Office incorrectly analyzed the “present effect rule”, 13 C.F.R. § 121.103(d)(1), in concluding that Plexus's option to purchase 14,000 shares of Honeycomb stock would not, if exercised, be sufficiently large to give Plexus any power to control Honeycomb. This argument fails because, as discussed *supra*, Plexus is a licensed SBIC, and the Area Office correctly concluded that a Plexus ownership interest in Honeycomb cannot give rise to affiliation under § 121.103(b)(1). Any error in the Area Office's analysis of the “present effect rule”, then, is harmless, as it would not affect the outcome of the case. *E.g.*, *Size Appeal of Melton Sales & Serv., Inc.*, SBA No. SIZ-5893, at 14 (2018); *Size Appeal of Automation Precision Tech., LLC*, SBA No. SIZ-5850, at 17 (2017). Nevertheless, Appellant has not, in any event, shown any significant error in the Area Office's consideration of the “present effect rule”. The record reflects that, apart from the unexercised warrants, Plexus holds no ownership interest in Honeycomb. Section II.C, *supra*. According to the information Honeycomb provided to the Area Office, the overwhelming majority of Honeycomb's stock is owned by its parent company, Overall-Honeycomb, LLC, which in turn is predominantly owned and controlled by an individual, Mr. Davis. *Id.* Further, as stated in the warrant itself, even at the time the warrant was issued in 2013, the 14,000 shares would have constituted only a 10% minority interest in Honeycomb. *Id.* Given this record, then, there is simply no basis to conclude that Plexus's warrant, if exercised, would give Plexus enough of an ownership interest to control Honeycomb.

*8 Lastly, Appellant complains that Honeycomb and Plexus could potentially be affiliated on alternate grounds unrelated to stock ownership. Appellant, though, did not clearly allege any such alternate grounds in its protests, and it is well-settled that “[a]n area office has no obligation to investigate issues beyond those raised in the protest.” *Size Appeal of Fuel Cell Energy, Inc.*, SBA No. SIZ-5330, at 5 (2012). Nor has Appellant, even on appeal, identified any specific alternate grounds that should have compelled additional investigation or review.

IV. Conclusion

*8 Appellant has not shown clear error in the size determinations. Accordingly, the appeals are DENIED and the size determinations are AFFIRMED. This is the final decision of the Small Business Administration. See 13 C.F.R. § 134.316(d).

*8 Kenneth M. Hyde

*8 Administrative Judge

Footnotes

The Area Office issued two formal size determinations, which are substantively identical. Size Determination No. 3-2021-056 addressed Appellant's protest filed under RFP No. SPRHA4-21-R-0160, and Size Determination No. 3-2021-057 addressed Appellant's protest filed under RFP No. SPRHA4-21-R-0157. For convenience, citations are to Size Determination No. 3-2021-056.

2

Appellant filed separate appeals pertaining to each size determination, but like the underlying size determinations, the two appeals are substantively identical. For convenience, citations are to the appeal of Size Determination No. 3-2021-056. Because the two appeals raise identical issues and involve the same parties, OHA consolidated the appeals for adjudication.

SBA No. SIZ-6133, 2021 (S.B.A.), 2021 WL 6108451