Cite as: *Size Appeal of Carntribe-Clement 8AJV # 1, LLC* , SBA No. SIZ-5357 (2012)

United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Carntribe-Clement 8AJV # 1, LLC, Appellant, Appealed From Size Determination No. 3-2012-010	SBA No. SIZ-5357 Decided: June 13, 2012

APPEARANCES

J. David Pugh, Esq., and Frederic L. Smith, Jr., Esq., Bradley Arant Boult Cummings LLP, Birmingham, Alabama, for Appellant

William K. Walker, Esq., Walker Reausaw, Washington D.C., for Alutiiq Manufacturing Contractors, LLC

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DECISION

I. Introduction and Jurisdiction

On January 3, 2012, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area III (Area Office) issued Size Determination No. 3-2012-010 finding that Carntribe-Clement 8AJV # 1, LLC (Appellant) is not a small business under the size standard associated with Solicitation No. W912HN-11-D-0028. Appellant is an SBA-approved 8(a) Business Development (BD) mentor-protégé joint venture established on December 14, 2010, between Carntribe, LLC (Carntribe) and The Clement Group (Clement). Carntribe is a participant in the 8(a) BD program. The Area Office found that Carntribe's minority owner, Mr. Craig Clement, has the power to veto certain decisions of Carntribe in violation of 13 C.F.R. § 124.106(c), and that Mr. Clement therefore exerts negative control over Carntribe. The Area Office further determined that Mr. Clement also controls Clement, by virtue of his 70% ownership of that firm. Because Mr. Clement could exercise direct control over Clement and negative control over Carntribe, the Area Office determined that Carntribe is affiliated with Clement. Although Carntribe alone is a small business, the Area Office found that Carntribe is other than small when its receipts are combined with those of Clement. As a result, the Area Office determined that joint ventures to which Carntribe is a party, including Appellant, are not eligible small businesses.

Appellant maintains that the size determination is clearly erroneous, and that the Area Office lacked authority to examine Carntribe's compliance with substantive 8(a) BD provisions. For the reasons discussed *infra*, the appeal is granted and the size determination is reversed.

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

II. Issue

Whether the Area Office made a clear error of law or fact in assessing the size of Carntribe, the 8(a) BD protégé member of an SBA-approved mentor-protégé joint venture, for a competitive 8(a) BD procurement? 13 C.F.R. § 134.314.

III. Background

A. Solicitation and Protest

On January 26, 2011, the U.S. Department of the Army, Corps of Engineers Savannah District (Army) issued Solicitation No. W912HN-11-D-0028 (RFP) seeking proposals for a multiple-award construction contract. The Contracting Officer (CO) set aside the procurement exclusively for participants in the 8(a) BD program, and assigned North American Industry Classification System (NAICS) code 236220, Commercial and Institutional Building Construction, with a corresponding size standard of $33.5 million average annual receipts.

Appellant was selected as one of the successful offerors. On October 3, 2011, the Army received a post-award size protest from Alutiiq Manufacturing Contractors, LLC (Alutiiq), a disappointed offeror. Citing 13 C.F.R. § 121.103(h), Alutiiq alleged that Carntribe and Clement are generally affiliated, notwithstanding their mentor-protégé relationship, because the firms had formed at least five joint ventures together. Alutiiq asserted that "multiple joint ventures between the same two entities, even those in an approved mentor-protégé relationship, can form the basis for a finding of affiliation." (Protest at 2.) Additionally, Alutiiq alleged that Carntribe and Clement are affiliated under the totality of the circumstances, 13 C.F.R. § 121.103(a)(5).

B. Size Determination

On January 3, 2012, the Area Office issued its size determination. The Area Office explained how SBA determines affiliation under 13 C.F.R. § 121.103 and summarized the information submitted by Appellant in response to the protest. The Area Office indicated that Appellant is an SBA-approved 8(a) BD joint venture established on December 14, 2010, and that the instant procurement is Appellant's only contract award. (Size Determination at 4.) The Area Office noted that Carntribe acknowledged the existence of four other joint ventures with Clement and found that all but one are SBA-approved 8(a) BD joint ventures. The Area Office stated that one of the other SBA-approved joint ventures has been awarded one contract. (*Id.* at 4-5.)

The Area Office determined that Mr. Brian Carnahan, who is 60% owner and president of Carntribe, has the power to control Carntribe. (*Id.* at 6.) The remaining 40% of Carntribe is owned by Mr. Clement. The Area Office found that Mr. Clement is president and owns 70% of Clement, with each of his four children holding a 7.5% interest in Clement. The Area Office determined that, under the concept of identity of interest, the members of the Clement family are treated as one party, so each family member has the power to control Clement.

The Area Office next addressed Alutiiq's contention that multiple joint ventures, even in the context of an SBA-approved 8(a) BD mentor-protégé relationship, can be a basis for finding affiliation. The Area Office found that Alutiiq's only support for this argument was that Carntribe and Clement had formed five joint ventures, and those five joint ventures collectively had been awarded a total of two contracts. The Area Office stated that the formation of more than one joint venture between a mentor and protégé is not sufficient grounds to establish affiliation, and that neither Appellant, nor any of the four other joint ventures established between Carntribe and Clement, ran afoul of 13 C.F.R. § 121.103(h), which limits a joint venture's contract awards. The Area Office also disagreed with Alutiiq's suggestion that Carntribe and Clement have a continuous business relationship. The Area Office found that, notwithstanding the five joint ventures, Carntribe had successfully demonstrated that it is not economically dependent on Clement. The Area Office determined the joint venture revenues are a limited percentage of Carntribe's revenues. The Area Office concluded that "Carntribe and Clement are not affiliated based upon any of the joint ventures they have formed." (Size Determination at 8.)

Having rejected Alutiiq's protest allegations, the Area Office acknowledged that it "may not review mentor-protégé eligibility issues, regarding the mentor-protégé agreement." (*Id.* at 9 (citing *Size Appeal of White Hawk/Todd, A Joint Venture*, SBA No. SIZ-4950 (2008)).) The Area Office reasoned, however, that "because [Appellant] seeks to use the 8(a) mentor-protégé status as a basis for an exception to affiliation, [Appellant] must comply with 8(a) requirements." (*Id.* at 9.) The Area Office reviewed Appellant's "operating agreement, also serving as the joint venture agreement," and found that it complied with 13 C.F.R. § 124.513(c) and (d). (*Id.*) As a result, the Area Office determined that "[t]he exception to affiliation for joint ventures between approved mentors and protégés is applicable here and the venturers are not found to be affiliated base[d] on the joint venture formed for the instant procurement." (*Id.* at 10.)

Finally, the Area Office considered whether Mr. Clement could exercise negative control over Carntribe, the protégé member of the joint venture. The Area Office stated that a September 23, 2008 amendment to Carntribe's operating agreement transferred a 40% ownership stake to Mr. Clement. The ownership change was approved by Mr. Joseph P. Loddo, Associate Administrator, Office of Business Development, on January 22, 2009, but the Area Office found that this approval was "not in compliance with SBA rules," specifically 13 C.F.R. §§ 124.520(d)(2) and 124.105(h)(2), which according to the Area Office ought to have limited Mr. Clement to no more than 30% ownership. (Size Determination at 10, n.1.)

The Area Office further found that, as minority owner of Carntribe, Mr. Clement gained the power to prevent new members from joining the company under Article VII of Carntribe's articles of organization. The Area Office asserted that "this does not directly affect the daily

operation of the business," but instead was "significant because [Carntribe] is an 8(a) participant and individuals who have been determined to be socially and economically disadvantaged must have control over [Carntribe] to remain eligible for the 8(a) program." (*Id.* at 11.) The Area Office also determined that Mr. Clement could prevent dissolution of Carntribe under paragraph 8.2 of Carntribe's operating agreement, by withholding his written consent. The Area Office stated this provision is contrary to 8(a) BD regulations at 13 C.F.R. § 124.106(c), which require that one or more disadvantaged individuals have control over "all decisions" of an 8(a) BD company. (*Id.*) The Area Office concluded that, "based on 13 C.F.R. § 124.106(c), [Mr.] Carnahan being the disadvantaged individual no longer has the power to control all decisions of [Carntribe]." (*Id.* at 12.)

Because the Area Office determined that Mr. Clement has the power of negative control over Carntribe, and because Mr. Clement also controls Clement, the Area Office found Carntribe affiliated with Clement. The Area Office noted that although Carntribe alone is a small business under the $33.5 million size standard, Carntribe is no longer small once its receipts are aggregated with those of Clement. (*Id.*)

C. Appeal Petition

On January 18, 2012, Appellant filed its appeal of the size determination with OHA. Appellant maintains that the size determination is clearly erroneous and should be reversed.

Appellant argues the Area Office had no jurisdiction to consider protests calling for a re-review of approved mentor-protégé agreements. *Size Appeal of White Hawk/Todd, A Joint Venture*, SBA No. SIZ-4950, at 3 (2008) ("an area office and OHA may not review mentor-protégé eligibility issues"), *recons. denied*, SBA No. SIZ-4968 (2008) (PFR). Appellant argues that by focusing on Carntribe's compliance with 13 C.F.R. § 124.106(c), the Area Office made an "end run around the SBA's Director, Office of Business Development's approval of the Carntribe-Clement Mentor-Protégé Agreement." (Appeal at 3.)

Appellant contends that SBA's Office of Business Development would not have approved the mentor-protégé agreement if it had raised issues of negative control, because it is agency policy to reject a mentor-protégé agreement where "the agreement poses issues of negative control." 8(a) BD Program Standard Operating Procedures, at 171 (2004).[1] Yet the Office of Business Development did approve the agreement, as the Area Office itself acknowledges. (Size Determination at 5.) Therefore, reasons Appellant, the Office of Business Development had already previously determined that there were no issues of negative control. (Appeal at 4.)

Appellant further argues that it is irrelevant whether the Office of Business Development was correct in concluding that there are no issues of negative control because that determination implicates mentor-protégé eligibility issues. As a result, the question of whether there was negative control is within the exclusive jurisdiction of SBA's Office of Business Development.

[1] The SOP is available at: http:// archive.sba.gov/idc/groups/public/documents/tx_san_antonio/tx_st_ct_ sop8053.pdf.

See White Hawk/Todd; 13 C.F.R. § 124.520(e).

Next, Appellant contends that, even supposing the Area Office did have jurisdiction to examine the issue of negative control, the conclusion that Mr. Clement, the minority owner of Carntribe, could exercise negative control over Carntribe is manifestly erroneous. Appellant emphasizes that Mr. Carnahan, an economically disadvantaged individual, holds a 60% interest in Carntribe, and that Carntribe's articles of organization name Mr. Carnahan as the sole manager of Carntribe. Appellant contends further that, under applicable state law, if the articles of organization vest management of a limited liability company in a manager, that manager has the power to manage the business and the affairs of the limited liability company as provided in the operating agreement. Ala. Code. § 10A-5-4.01(b). Appellant asserts that the manager of a limited liability company is an agent of the limited liability company for the purposes of its business or affairs, and that an act of the manager binds the limited liability company, unless the manager has no authority to act for the company in the particular matter and the person with whom the manager is dealing has knowledge of such fact. *Id.* § 10A-5-3.03(b)(1). In this case, Appellant argues that Mr. Clement, the minority owner, has no authority to act on behalf of Carntribe or to bind Carntribe. Rather, Mr. Carnahan has sole and exclusive control over Carntribe's day-to-day business operations.

Appellant asserts that Carntribe's operating agreement underscores Mr. Carnahan's sole and exclusive control. Section 4.1 provides that "[t]he Manager shall have the right to conduct the day-to-day business of the Company," and that the Manager "may execute any contract or contracts, borrow money, convey property and mortgage property, and may sign checks for the Company." Section 7.2 gives the Manager the authority to open and close bank accounts and to make withdrawals in the ordinary course of business on such signature or signatures as the Manager deems appropriate. As the majority owner of Carntribe, Mr. Carnahan has unilateral authority to require Carntribe's members to make additional capital contributions, fix his own compensation as manager, determine the manner and frequency with which company financial statements are prepared, and make all tax elections required or permitted by the Internal Revenue Code.[2] Mr. Clement cannot prevent Carntribe from paying distributions to its members.[3] Furthermore, because the operating agreement does not permit Mr. Carnahan to be replaced as manager by less than a majority vote, Mr. Clement has no power to remove or replace Mr. Carnahan. *See id.* § 10A-5-4.01(b).

Appellant contends that the actions that require Mr. Clement's consent are limited solely to certain fundamental and extraordinary matters that do not restrict day-to-day business. The actions that require Mr. Clement's consent are admitting new members, amending the operating agreement, transfer of Mr. Carnahan's interest in Carntribe, and mergers and other

[2] Sections 2.3, 4.3, 7.1.B, and 7.3 of Carntribe's operating agreement vest this authority in the majority owner.

[3] Section 5.1.A of Carntribe's operating agreement provides that net profits and net losses will be allocated to the members in accordance with their membership interests in Carntribe. Neither the articles of organization nor the operating agreement give Mr. Clement the right to prohibit or restrict Carntribe from paying distributions to its members.

restructurings.[4] Appellant argues that such supermajority voting requirements are permissible so long as they do not restrict day-to-day operation of the business. According to Appellant, the situations requiring Mr. Clement's consent are designed to protect Mr. Clement's investment. Appellant explains that investors may be reluctant to invest in small businesses like Carntribe if the manager or majority owner had the unfettered power to admit new members or issue additional membership interests and thereby dilute the minority owner's investment.

Finally, Appellant urges OHA to interpret 13 C.F.R. § 124.106(c), the regulation repeatedly cited by the Area Office regarding control over an 8(a) BD limited liability company, in manner consistent with OHA's interpretation of negative control in the context of size regulations. Specifically, Appellant maintains that a minority owner's ability to block certain fundamental actions in order to protect his or her investment should not constitute negative control. Appellant contends that to hold otherwise is contrary to public policy because it "would dramatically dampen investors' willingness to invest in the small businesses the SBA intends to cultivate and grow." (Appeal at 10.)

D. Alutiiq Response

On February 3, 2012, Alutiiq submitted its response to the appeal. Alutiiq maintains the Area Office did not clearly err, and requests that OHA affirm the size determination.

Alutiiq first argues that the Area Office's jurisdiction to determine eligibility is not at issue. According to Alutiiq, the Area Office did not base the size determination on the propriety of the mentor-protégé agreement. Therefore, in Alutiiq's view, Appellant's argument that the Area Office lacks jurisdiction to "consider protests calling for a re-review of the approved mentor-protégé agreements" is misplaced.

Alutiiq next argues that the Area Office's finding of negative control was proper, as Mr. Clement's consent is required for critical decisions affecting the business, *i.e.*, admitting new members, amending the operating agreement or articles or organization, transfers of membership interests, and approvals of mergers and conversions. Alutiiq argues that the instant appeal may be distinguished from *Size Appeal of EA Engineering Science and Technology, Inc.*, SBA No. SIZ-4973 (2008). That case did not involve a competitive 8(a) BD set aside, so there was no reason to consider the specific rules for control found in the 8(a) BD regulations, namely 13 C.F.R § 124.106(c) and (e)(1). 13 C.F.R § 124.106(c) provides that "[i]n the case of a limited liability company, one or more disadvantaged individuals must serve as management members with control over all decisions of the limited liability company." 13 C.F.R § 124.106(e)(1) provides, "no non-disadvantaged individual or immediate family member may ... [e]xercise actual control or have the power to control the applicant or Participant." Alutiiq argues these provisions applicable to the 8(a) BD program do not distinguish between decisions affecting a company's day-to-day operations and fundamental company actions. Rather, the language of the regulations requires the disadvantaged individuals to control all decisions, without mentioning exceptions for super-majority provisions as allowed in *EA Engineering*.

[4] Article VII of Carntribe's articles of organization requires unanimous consent for admission of new members.

Alutiiq goes on to argue that OHA should interpret the general standards for negative control, 13 C.F.R § 121.103(a)(3), in a manner that is harmonious with the relevant 8(a) BD programmatic rules. Applying those principles to this case, Alutiiq argues that the 8(a) BD requirement that disadvantaged individuals control "all" decisions should determine whether negative control exists.

E. Agency Comments

On March 28, 2012, OHA requested comments from SBA on the jurisdictional issues presented in the appeal. Specifically, OHA requested that SBA address three questions. First, OHA asked whether the instant appeal is distinguishable from OHA's recent decisions in *Size Appeal of Trident*^{3}*, LLC*, SBA No. SIZ-5315 (2012) and *Size Appeal of Alutiiq Diversified Servs., LLC*, SBA No. SIZ-5318 (2012), both of which were issued after the filing of the instant appeal. Second, OHA inquired whether, in a competitive 8(a) BD procurement, size is necessarily part of the "eligibility" review conducted by the Office of Business Development (or a district office acting on its behalf) and if so, what role, if any, an area office plays in determining size in that situation. According to 13 C.F.R. § 124.517(a), "[t]he eligibility of a[n 8(a) BD] Participant for a sole source or competitive 8(a) requirement may not be challenged by another Participant or any other party, either to SBA or any administrative forum as part of a bid or other contract protest." Finally, OHA asked whether an area office may undertake a size review of the protégé member of an SBA-approved 8(a) BD mentor-protégé joint venture at the time of contract award.

On April 3, 2012, SBA submitted comments to OHA. Regarding the first question, SBA begins its discussion by summarizing both cases. In *Trident*^{3}, the specific jurisdictional issue was whether an area office has authority to review an 8(a) BD mentor-protégé joint venture agreement where the review was previously performed by SBA's Office of Business Development or a district office. In that case, the area office followed OHA's decision in *Size Appeal of Lance Bailey & Assocs., Inc.*, SBA No. SIZ-4788 (2006), which instructed that area offices must examine the joint venture agreement of the protested concern for compliance with 8(a) BD joint venture rules, even where the district office had already approved the joint venture agreement. *Trident*^{3} overturned *Lance Bailey* in this respect, holding that once the cognizant SBA district office has approved a joint venture agreement, area offices have no authority to perform the same review.

In *Alutiiq Diversified*, which likewise involved a protest of an 8(a) BD mentor-protégé joint venture, the area office did not examine the relationship for compliance with 8(a) BD program requirements. OHA determined that the area office correctly refrained from doing so, and reiterated that area offices lack subject matter jurisdiction over protest allegations regarding compliance with SBA's mentor-protégé regulations.

As noted *supra*, OHA issued its decisions in *Trident*^{3} and *Alutiiq Diversified* after the instant size determination. As a result, SBA contends that the holding from *Lance Bailey* was still in effect when the Area Office made the instant size determination. In SBA's view, the Area Office cannot be held to follow OHA rulings that had not yet been issued. SBA acknowledges,

however, that, if OHA had issued *Trident*[3] prior to the size determination at issue in this appeal, the facts would have dictated that the Area Office refrain from reviewing the joint venture agreement in this case. (Agency Comments at 2-3.)

SBA next turns to OHA's second question. SBA asserts that the size determination program applies to all Federal procurement programs for which status as a small business is required or advantageous, including the 8(a) BD program. In a competitive 8(a) BD acquisition, the procuring activity requests that the appropriate SBA district office servicing the apparent awardee determine the firm's eligibility for award. "Eligibility" is based on 8(a) BD program criteria, including whether the 8(a) BD concern is a small business under the NAICS code assigned to the requirement. 13 C.F.R. § 124.507(b). Therefore, in SBA's view, "size is one of the elements the District Office must consider in determining whether the apparent successful offeror is eligible for award of an 8(a) BD contract." (Agency Comments at 3.)

SBA goes on to argue that although SBA program offices are responsible for determining size as part of the eligibility of the business for SBA's various programs and benefits, "any such determination of size is informal, non-binding, unappealable and only advisory. Such a determination is considered to be an 'opinion."' (*Id.* (citing 13 C.F.R. § 121.403).) SBA maintains that such advisory opinions differ significantly from the determination of a concern's size by an area office, because only the area offices are authorized to make formal size determinations for all SBA program areas, except for purposes of the disaster loan program. 13 C.F.R. § 121.1002.

SBA observes that an applicant cannot appeal a district or program office's opinion on size issues to OHA because its recourse is to request a formal size determination from an area office. 13 C.F.R. §§ 121.1001(b)(2)(i)(A), 124.102(c). Similarly, the program office may request a formal size determination rather than determining size on its own. 13 C.F.R. §§ 121.1001(b)(2)(i)(B), 124.102(b). According to SBA, these regulations confirm that program and district offices do not have the authority to render formal size determinations.

Regarding OHA's final question as to whether an area office may, at the time of contract award, undertake a size review of the protégé member of an SBA-approved 8(a) BD mentor-protégé joint venture, SBA responds that the size status of an apparent successful offeror may be protested in an 8(a) BD competitive procurement. 13 C.F.R. §§ 124.517(b), 121.1001(a)(2). Although area offices lack the authority to initiate their own size protests on competitive 8(a) BD procurements, 13 C.F.R. § 121.1001(a)(2), SBA reasons that other entities are authorized to protest the size of an apparent successful awardee in competitive 8(a) BD procurements, and there is no exception for when the awardee is an approved 8(a) BD mentor-protégé joint venture.

SBA goes on to argue that an area office may consider the size of the protégé firm when a joint venture is the offeror. SBA finds support for this conclusion in 13 C.F.R. § 121.103(h)(3)(iii), which provides that a mentor-protégé joint venture will qualify as a small business, so long as the protégé is small under the NAICS code assigned to the procurement. SBA reasons that, as a result of this exception, where a protégé and its mentor submit an offer as a joint venture, SBA will not aggregate the size of both parties in determining the size of the joint venture. Therefore, the key issue is whether the protégé independently qualifies as small.

(Agency Comments at 5.) SBA maintains that, by scrutinizing the size of the protégé firm, an area office is merely acting in accordance with the regulations.

F. Appellant's Response

On April 11, 2012, Appellant submitted its response to SBA's comments. With regard to OHA's first question of whether the instant case was distinguishable from *Trident*[3] and *Alutiiq Diversified*, Appellant responded that it is not distinguishable, as negative control is an 8(a) BD eligibility issue, and such matters are beyond the jurisdiction of an area office. According to Appellant, *Trident*[3] and *Alutiiq Diversified* confirm this OHA precedent from *Size Appeal of White Hawk/Todd, A Joint Venture*, SBA No. SIZ-4950, at 3 (2008) that an area office "may not review mentor-protégé eligibility issues." To support its argument, Appellant references an SBA slideshow presentation at the National 8(a) Association 2012 Winter Conference. According to the presentation, when considering whether to approve a mentor-protégé agreement:

> SBA is looking to see if the assistance to be provided will promote developmental gains to the 8(a) firm, if the developmental gains are tied to the approved business development plan, *whether there are issues of negative control*, and if the agreement is merely a mechanism to enable non-8(a) firms to receive 8(a) contracts.

Slide 7 (emphasis added);[5] *Cf.*, 13 C.F.R. § 124.520(e) ("The [[mentor-protégé] agreement will not be approved if SBA determines that the assistance to be provided is not sufficient to promote any real developmental gains to the protégé, or if SBA determines that the agreement is merely a vehicle to enable the mentor to receive 8(a) contracts."). Appellant reiterates that, according to the 8(a) BD SOP, SBA "will not approve a Mentor-Protégé Agreement when ... [t]he Agreement poses issues of negative control." Appellant argues these legal authorities, taken together with SBA's policy statements and slideshow presentation, make plain that issues of negative control are eligibility issues, and may not be reviewed by an area office. *See also Trident*[3], SBA No. SIZ-5315, at 11 (determining that 13 C.F.R. § 121.103(h)(3)(iii) precludes an area office from reviewing the substance of a mentor-protégé joint venture); *Alutiiq Diversified*, SBA No. SIZ-5318 (holding that compliance with 8(a) BD mentor-protégé requirements is a matter solely within the authority of the Director of the Office of Business Development); *Size Appeal of CJW Constr.*, SBA No. SIZ-5254, at 7 (2011) ("SBA had already examined the relationship between [the protégé] and [the mentor] when it approved [the protégé's] 8(a) application and mentor-protégé agreement. The Area Office should not have reached behind these approvals to examine a relationship which had already been examined and approved by SBA."); *Size Appeal of Innovative Resources*, SBA No. SIZ-5259, at 5 (2011) ("The Area Office was not responsible for reviewing the terms of the [8(a)] joint venture agreement, and the Area Office properly did not second guess SBA's approval of the joint venture.").

[5] The presentation is available at: http:// www.national8aassociation.org/index.php/conferences/2012-winter-conference/2012-winter-conference-power-points.

Appellant argues that the Area Office improperly found negative control based on the September 23, 2008 amendment to Carntribe's operating agreement. (Response at 4.) Yet the Area Office itself noted that the Office of Business Development examined and approved that amendment in January 2009. (*Id.*) Furthermore, in reviewing the joint venture, SBA's Alabama District Office would have considered whether there was negative control as well. (*Id.*) Therefore, Appellant contends that the Office of Business Development and the District Office considered negative control, an eligibility issue, at least twice before the Area Office reevaluated the issue. Not only did the Area Office lack subject matter jurisdiction to make such a determination, asserts Appellant, but this review also was unwarranted because it does not "serve any useful purpose for different offices within SBA to conduct duplicative, and potentially contradictory, reviews." (*Id.* at 5 (quoting *Trident*[3], SBA No. SIZ-5315, at 13).) Appellant argues that to hold otherwise would create a climate of uncertainty, thereby discouraging investment in small businesses and participation in the 8(a) BD program.

Appellant argues that the agency response does not successfully distinguish the instant appeal from *Trident*[3] and *Alutiiq Diversified*. Appellant asserts that the applicable regulations are the same now as they were in *Trident*[3] and *Alutiiq Diversified*. Moreover, *Trident*[3] did not alter the jurisdictional analysis from *White Hawk/Todd*, which the recent amendments to 13 C.F.R. § 121.103(h)(3)(iii) confirm. Appellant contends that if it were true, as SBA suggests, that "[t]he Area Office cannot be held to follow OHA rulings that have not yet been issued," then OHA would not have been empowered to reverse the size determination in *Trident*[3]. (Response at 5.)

As for OHA's questions regarding an area office's role in determining size in competitive 8(a) BD procurements, Appellant responds that an area office may not review the size of an approved mentor-protégé joint venture, or the protégé member of that joint venture. In Appellant's view, SBA's argument that an area office must be able to consider whether the protégé is small is inconsistent with the current language of 13 C.F.R. § 121.103(h)(3)(iii), which contemplate that a joint venture will be approved under provisions of Part 124. Appellant urges that divesting area offices of the authority to conduct "duplicative reviews" necessarily restricts area offices' authority to examine size of an SBA-approved mentor-protégé joint venture, because the agency would have already determined that the protégé is small for purposes of the procurement. Appellant argues *Trident*[3] removed any authority of area offices to make size determinations with respect to SBA-approved mentor-protégé joint ventures. *Trident*[3], SBA No. SIZ-5315, at 14 (holding that the Area Office may not review the substance of an 8(a) BD mentor-protégé joint-venture agreement in connection with a size protest, including whether the joint venture complies with 13 C.F.R. § 124.513).

IV. 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. Analysis

The size determination in this case is flawed in two significant respects. First, the Area Office improperly conducted an analysis of Carntribe's compliance with substantive 8(a) BD requirements, which are set forth in 13 C.F.R. Part 124. OHA has long recognized that such issues are beyond the scope of an area office's subject matter jurisdiction. Rather, insofar as the Area Office had concerns about such issues, the appropriate resolution would have been to refer the question to the Office of Business Development for further review and investigation. Second, although the Area Office couched its analysis in terms of "negative control," the Area Office did not apply the proper legal standard for such a review as articulated in prior OHA case decisions.[6]

The Area Office determined that Carntribe alone is a small business; that Carntribe and Clement are parties to an SBA-approved 8(a) BD mentor-protégé arrangement; that "[t]he exception to affiliation for joint ventures between approved mentors and protégés is applicable here"; and that Alutiiq's protest allegations were devoid of merit. Accordingly, the sole grounds for finding Carntribe and Clement affiliated was that Mr. Clement could exercise negative control over Carntribe. Because the Area Office's analysis of negative control was faulty, Carntribe and Clement are not affiliated, and the size determination must be reversed.

1. Compliance with Substantive 8(a) BD Requirements

The first problem with the size determination is that the Area Office conducted a review of Carntribe's compliance with substantive 8(a) BD requirements. Specifically, the size determination repeatedly indicates that Carntribe did not comply with 13 C.F.R. § 124.106(c), which provides that, for a limited liability company (LLC) to be eligible for the 8(a) BD program, one or more disadvantaged individuals must control "all decisions" of the LLC. The Area Office found that Mr. Clement, the minority owner of Carntribe and who is not himself a disadvantaged individual, has authority to "block certain actions, namely adding members and dissolving Carntribe." (Size Determination at 11.) As a result, the Area Office concluded that

[6] Given that the Area Office could not have initiated its own size protest against Appellant on this competitive 8(a) BD procurement, 13 C.F.R. § 121.1001(a)(2), there may also be a question as to whether the Area Office properly introduced new issues that were not included in the underlying protest. Alutiiq's protest here did not allege any issue of negative control. *See* Section III.A, *supra*. Furthermore, assuming that the Area Office properly raised this new issue, due process would require that the challenged firm be afforded reasonable notice and an opportunity to respond. *Size Appeal of Alutiiq Int'l Solutions, LLC*, SBA No. SIZ-5069, at 4 (2009) ("it is axiomatic that before finding a concern other than small on grounds not found in a protest, an area office must provide notice to the protested concern of any change in focus and request a response."). Here, it is unclear whether Appellant had notice of the negative control issue. Nevertheless, I find it unnecessary to explore these matters further, because the record clearly demonstrates that Mr. Clement does not have the ability to exercise negative control over Carntribe.

"[t]he facts detailed above are contrary to the 8(a) requirements of 13 C.F.R. § 124.106(c)." (*Id.*) The Area Office recognized that, almost three years earlier, the Office of Business Development had reviewed and approved an amendment to Carntribe's operating agreement, which had transferred partial ownership to Mr. Clement. The Area Office found, however, that the approval was "not in compliance with SBA rules." (*Id.* at 10 n.1.)

OHA has held on several occasions that area offices lack jurisdiction to review the substantive requirements of 13 C.F.R. Part 124. Rather, "compliance with substantive 8(a) BD program requirements falls exclusively within the purview of the Office of Business Development." *Trident*[3], SBA No. SIZ-5315, at 13. *See also Size Appeal of DCS Night Vision JV, LLC*, SBA No. SIZ-4997, at 9 (2008) ("The power to approve mentor-protégé agreements, and their renewals, is vested solely with SBA's Director, Office of Business Development."); *Size Appeal of White Hawk/Todd, A Joint Venture*, SBA No. SIZ-4950, at 3 (2008) (holding that "an area office and OHA may not review mentor-protégé eligibility issues), *recons. denied*, SBA No. SIZ-4968 (2008) (PFR). By regulation, an 8(a) BD Participant's eligibility "may not be challenged by another [8(a) BD] Participant or any other party, either to SBA or any administrative forum as part of a bid or other contract protest." 13 C.F.R. § 124.517(a). Furthermore, SBA regulations instruct that "[a]nyone with information questioning the eligibility of a Participant to continue participation in the 8(a) BD program or for purposes of a specific 8(a) contract may submit such information to [the Office of Business Development] under [the process for eligibility reviews at] § 124.112(c)." 13 C.F.R. § 124.517(e).

Accordingly, the Area Office in this case clearly erred in reviewing Carntribe's compliance with 13 C.F.R. § 124.106(c), or other provisions of Part 124. An area office has no jurisdiction to examine whether or not an 8(a) BD participant has complied with substantive 8(a) BD provisions in 13 C.F.R. Part 124. Nor is an area office authorized to overrule approval on such matters by the Office of Business Development. In the event, as evidently occurred here, that the Area Office harbored doubts about an 8(a) BD participant's compliance with Part 124, the Area Office should have directed the matter to the Office of Business Development pursuant to 13 C.F.R. § 124.517(e).

In its comments, SBA appears to acknowledge that, under existing OHA precedent, an area office must "refrain" from examining an 8(a) BD participant's compliance with Part 124. (Agency Comments at 2-3.) SBA urges, however, that the Area Office here should be excused because OHA's most recent rulings were published only after the instant size determination was issued. This argument is meritless. OHA's recent decisions in *Trident*[3] and *Alutiiq Diversified* followed long-standing OHA precedent, such as *White Hawk/Todd*, which preceded the instant size determination.

SBA also maintains that area offices alone have authority to render formal size determinations, and that the views of other SBA personnel are not controlling on questions of size. (Agency Comments at 3, citing 13 C.F.R. §§ 121.403, 121.1002.) While SBA is correct on these points, the argument is nevertheless unpersuasive because the Area Office here did not limit itself to examining Appellant's compliance with the size regulations in 13 C.F.R. Part 121. By expanding the scope of the review, and assessing Carntribe's compliance with substantive 8(a) BD provisions in 13 C.F.R. Part 124, the Area Office exceeded its authority.

2. Negative Control

The Area Office also erred in its examination of negative control. As discussed above, in reaching its decision, the Area Office applied 13 C.F.R. § 124.106(c), which provides that to be eligible for the 8(a) BD program, one or more disadvantaged individuals must control "all decisions" of an LLC. Under this standard, if a minority investor (who is not a disadvantaged individual) can veto any decision of the 8(a) BD participant there may be issues of negative control.

Within the context of size regulations, however, OHA applies a very different legal standard in analyzing negative control. Negative control exists if a minority owner can block ordinary actions essential to operating the company. On the other hand, the power to veto unusual or "extraordinary" actions may be designed to protect the interests of the minority investor and therefore do not pose issues of negative control. OHA has explained:

> [A] minority shareholder's power to veto extraordinary actions outside the ordinary course of business — such as the issuance of additional stock, amendment of the concern's charter or bylaws, or entry into a substantially different line of business — does not necessarily constitute 'negative control.' *Size Appeal of EA Engineering Science, and Technology, Inc.*, SBA No. SIZ-4973, at 9-10 (2008). Rather, a requirement that minority shareholders consent to extraordinary actions may simply protect the minority shareholder's investment. *Id.* Conversely, negative control exists when a minority shareholder can block 'ordinary actions essential to operating the company.' *Size Appeal of Eagle Pharmaceuticals, Inc.*, SBA No. SIZ-5023, at 10 (2009); *Size Appeal of Novalar Pharmaceuticals, Inc.*, SBA No. SIZ-4977, at 14 (2008). OHA has determined that the creation of debt and the payment of dividends are among such 'ordinary actions,' as these matters are fundamental to the daily operation of a business. *Eagle Pharmaceuticals*, at 11.

Size Appeal of BR Constr., LLC, SBA No. SIZ-5303, at 8 (2011).

Here, the Area Office found that Mr. Clement had veto power over two issues: adding new members to Carntribe and dissolving Carntribe. (Size Determination at 11.) These are highly unusual or extraordinary events, and Mr. Clement's power to object to such decisions is thus designed to preserve his investment. Stated differently, should such events occur, they would represent a serious threat to Mr. Clement's interest in Carntribe. Adding new members could dilute Mr. Clement's interest in Carntribe, whereas Mr. Clement's interest could vanish altogether in the case of dissolution. Therefore, requiring Mr. Clement's consent to such eventualities is designed to protect Mr. Clement's investment, and does not establish that he has negative control over Carntribe. *EA Eng'g, Sci, and Tech.*, SBA No. SIZ-4973, at 10 (reversing an area office's finding of negative control and holding that requiring supermajority vote to amend the charter or bylaws, issue additional shares of capital stock, and enter into substantially different business served to protect the minority shareholder's investment, and did not interfere with the majority owner's operation of the business).

Furthermore, Appellant has persuasively shown that, under applicable state law and Carntribe's operating agreement, the power to control daily operations rests with Mr. Carnahan, not Mr. Clement. OHA has recognized that ordinary daily operations 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 independent auditors. *Id.* at 9-10; *Eagle Pharm.*, SBA No. SIZ-5023, at 10; *Size Appeal of DHS Sys., LLC*, SBA No. SIZ-5211, at 7 (2011). Here, these matters rest solely within the control of Mr. Carnahan. The articles of organization designate Mr. Carnahan the sole manager of Carntribe. The operating agreement expressly confers upon the manager "the right to conduct the day-to-day business of the Company." (Carntribe Operating Agreement § 4.1.) The manager "may execute any contract or contracts, borrow money, convey property and mortgage property, and may sign checks for the Company." (*Id.*) Mr. Clement has no power to block Mr. Carnahan from discharging these duties, or to remove Mr. Carnahan as manager. These facts show that Mr. Clement's agreement is required only for extraordinary actions that threaten his investment, and not for ordinary actions essential to operating the company. Indeed, the Area Office itself remarked that the decisions requiring Mr. Clement's consent do "not directly affect the daily operations of the business." (Size Determination at 11.)

In sum, negative control exists when a minority owner can block ordinary actions essential to operating the company. *BR Constr.*, SBA No. SIZ-5303, at 8; *Eagle Pharm.*, SBA No. SIZ-5023, at 10. Because Mr. Clement has no ability to interfere with the daily operations of Carntribe, the Area Office erred in finding negative control.

V. Conclusion

Appellant has demonstrated that the size determination is clearly erroneous. The Area Office had no authority to examine Carntribe's compliance with substantive 8(a) BD provisions, as such matters are exclusively within the jurisdiction of the Office of Business Development. The Area Office further erred in determining that Mr. Clement could exert negative control over Carntribe. For these reasons, the appeal is GRANTED, and the size determination is REVERSED. This is the final decision of the Small Business Administration. *See* 13 C.F.R. § 134.316(d).

KENNETH M. HYDE
Administrative Judge