United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Magnum Opus Technologies, Inc., Appellant, Appealed From Size Determination No. 05-2012-035	SBA No. SIZ-5372 Decided: July 2, 2012

APPEARANCES

Theodore P. Watson, Esq., and Idris S. Keith, Esq., Watson & Associates, Denver, Colorado, for Appellant

Barbara A. Duncombe, Esq., Taft, Stettinius & Hollister LLP, Dayton, Ohio, for Sterling Medical Associates, Inc.

DECISION

I. Introduction and Jurisdiction

On April 5, 2012, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area V (Area Office) issued a size determination in case number 5-2012-035, finding that Magnum Opus Technologies, Inc. (Appellant) is not a small business under the size standard associated with solicitation W91YTZ-11-R-0021. Appellant contends the size determination is clearly erroneous, and requests that SBA's Office of Hearings and Appeals (OHA) reverse the size determination and determine that Appellant is a small business. For the reasons discussed *infra*, the size determination is vacated and the matter is remanded to the Area Office for further review and investigation.

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 it is timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Mentor-Protégé

Appellant is now a graduate of SBA's 8(a) Business Development (BD) program. While a participant in the 8(a) BD program, Appellant entered into a mentor-protégé relationship with

Sterling Medical Associates, Inc. (Sterling), in which Appellant was the protégé and Sterling was the mentor. SBA approved their mentor-protégé agreement on February 5, 2004. After several approved extensions, the agreement expired on February 5, 2008.

Under their mentor-protégé arrangement, Appellant and Sterling formed two joint ventures: Magnum Medical Overseas JV, LLC (Magnum Medical Overseas) and Magnum Medical, JV (Magnum Medical). Magnum Medical Overseas is 90% owned by Sterling and 10% owned by Appellant. Magnum Medical Overseas was awarded one contract. Magnum Medical is 55% owned by Sterling and 45% owned by Appellant. Magnum Medical was awarded ten contracts between October 1, 2004 and July 27, 2007. All of the contracts awarded to the joint ventures were small business set-asides; none was an 8(a) BD set-aside.

Neither joint venture has bid on a federal contract since 2007. However, Appellant has continued to compete for contracts independently from Sterling. In addition, even after Appellant's graduation from the 8(a) BD program, Appellant and Sterling have continued to work together to complete the contracts previously awarded to the joint ventures.

B. Solicitation and Protest

On March 21, 2011, the U.S. Department of the Army (Army) issued solicitation W91YTZ-11-R-0021 seeking direct health care provider medical services in the Washington, D.C. area. The Contracting Officer (CO) set aside the procurement exclusively for small businesses, and assigned North American Industry Classification System (NAICS) code 622110, General Medical and Surgical Hospitals, with a corresponding size standard of $34.5 million in average annual receipts. On June 14, 2011, the CO notified offerors that Appellant was an apparent awardee. Nurses Etc. Staffing (NES) challenged Appellant's size, but the Army elected to reevaluate proposals, and the Area Office therefore dismissed NES's protest as premature.

On March 13, 2012, the CO announced nine successful offerors, including Appellant and NES. On March 16, 2012, NES protested Appellant's award, alleging that Appellant was not a small business because Appellant is affiliated with Sterling based on common management, 13 C.F.R. § 121.103(c), and the newly organized concern rule, 13 C.F.R. § 121.103(g). With regard to the common management allegation, NES observed that the President/CEO of Appellant is also the managing partner of Magnum Medical. With regard to the newly organized concern allegation, NES quoted the applicable regulation but offered no rationale for why Appellant and Sterling might be affiliated under that theory.

On March 23, 2012, Appellant responded to the protest. Appellant maintained that it was awarded the instant contract on its own merits, without assistance from Sterling. Appellant contended that NES's protest should be dismissed as insufficiently specific, as it "lacks corroboration and clarity." (Response at 3.) Appellant further asserted that neither of the protest grounds advanced by NES had merit, and that the Area Office's analysis "should be confined to those contentions." (Response at 2.) The remainder of Appellant's response focused on refuting the theories of affiliation raised in the protest: common management and the newly organized concern rule. Appellant maintained that NES's allegation of common management should fail because any common management between Appellant and Magnum Medical arose in the context

of an SBA-approved 8(a) BD mentor-protégé arrangement. Appellant also argued that it is not a new organized concern, as it has been in business for more than a decade. (Response at 9.)

C. Size Determination

On April 5, 2012, the Area Office issued its size determination finding that Appellant is not a small business. The Area Office found no merit to NES's protest allegations and summarily rejected them. (Size Determination at 5.) The Area Office nevertheless determined, however, that Appellant is generally affiliated with Sterling, its former 8(a) BD mentor.

In reaching this result, the Area Office found that Magnum Medical, one of the joint ventures between Appellant and Sterling, did not comply with the ""3-in-2" rule, which indicates that a joint venture may be awarded no more than three contracts over a two-year period. Specifically, the Area Office noted that Magnum Medical had been awarded three contracts in 2005 and five contracts in 2006. (*Id.* at 6.) The Area Office reasoned that "[w]hen [the 3-in-2 rule] is exceeded, the joint venture is no longer considered to be a limited purpose business venture but a long term business relationship between the companies, causing a general affiliation between the companies." (*Id.*)

The Area Office recognized that Appellant and Sterling had been parties to an SBA-approved 8(a) BD mentor-protégé agreement, and that SBA regulation permits an exception to affiliation for joint ventures between a mentor and protégé. The Area Office determined, however, that under 13 C.F.R. § 121.103(h)(3), Appellant could avail itself of this exception only if the joint venture complied with 13 C.F.R § 124.513(c) and (d). Here, the Area Office found that the joint ventures did not comply with 13 C.F.R § 124.513(c) and (d) because Appellant did not own a majority interest in either joint venture. As a result, the Area Office found the exception to affiliation was not applicable.

The Area Office concluded that "the fact that Magnum Medical broke the 3 in 2 Rule creates a general affiliation between [Appellant] and Sterling." (Size Determination at 7.) Furthermore, given its affiliation with Sterling, Appellant exceeded the applicable size standard. Specifically, the Area Office determined that, "A size calculation of the two companies is not necessary. As affiliates, the entire revenue earned by the joint ventures would be included. The Federal Tax Returns for 2008, 2009, and 2010 show evidence that one of the joint ventures alone exceeds the $34.5 million size standard." (*Id.*)

D. Appeal Petition

On March 28, 2012, Appellant filed the instant appeal of the size determination with OHA. Appellant maintains that the size determination is clearly erroneous and should be overturned.

Appellant argues that the Area Office erred as a matter of law by introducing entirely new issues not included in the underlying protest, particularly whether Appellant was affiliated with Sterling under the 3-in-2 rule. Appellant complains that "the Area Office took the Protester's vague allegations and created further confusion with its concocted assertions that

were never included in the initial NES size protest." (Appeal at 4.) Appellant further insists that it was denied due process of law because the Area Office did not afford Appellant an opportunity to refute the new concerns. (*Id.*)

Appellant goes on to argue that the Area Office incorrectly focused on events that occurred during the years 2005-2006, long preceding the time period under review (2008-2010). (*Id.* at 5.) Appellant maintains that this past activity cannot establish that Appellant and Sterling are currently affiliated, particularly because Appellant and Sterling were at that time operating under an SBA-approved 8(a) BD mentor-protégé agreement. Appellant emphasizes that SBA's regulations specifically provide that affiliation cannot be found between a protégé firm and its mentor based on an approved mentor-protégé agreement or any assistance under that agreement. (*Id.* (citing 13 C.F.R. §§ 121.103(b)(6), 124.520(d)(4)).) Appellant also maintains that the Area Office erroneously viewed Appellant and Magnum Medical as a single entity. In reality, asserts Appellant, Magnum Medical "is, in no way, related to the [[instant] solicitation that [Appellant] bid on in its individual capacity." (*Id.* at 10.)

E. Sterling's Motion to Intervene

On May 2, 2012, Sterling moved to intervene in these proceedings under 13 C.F.R. § 134.210. Sterling argues it is an interested party because the size determination included an analysis of the SBA-approved 8(a) BD mentor-protégé relationship between Sterling and Appellant, and the two joint ventures formed pursuant to that relationship. Sterling argues further that it is has standing to intervene because the Area Office found Sterling to be affiliated with Appellant notwithstanding the mentor-protégé relationship.[1]

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. Standing

OHA's regulation governing standing to intervene provides that:

[1] Sterling also filed a response in support of the appeal petition, alleging numerous errors in the size determination. As discussed *infra*, however, I find that Sterling does not have standing to intervene. As a result, this decision will not address Sterling's arguments beyond the question of standing.

> Any interested person may move to intervene at any time until the close of record by filing and serving a motion to intervene containing a statement of the moving party's interest in the case and the necessity for intervention to protect such interest. An interested person is any individual, business entity, or governmental agency that has a direct stake in the outcome of the appeal.

13 C.F.R. § 134.210(b). In interpreting this provision, OHA has held that an alleged affiliate, whose size was not at issue in the size determination, has no "direct stake" in the outcome of the appeal. As a result, an alleged affiliate lacks standing to initiate its own appeal of a size determination, or to intervene in an appeal brought by another party. *Size Appeal of Ma-Chis Lower Creek Indian Tribe Enters, Inc.*, SBA No. SIZ-5333, at 2 (2012) (dismissing appeal filed by an alleged affiliate, because the alleged affiliate has no direct stake in the outcome of the case); *Size Appeal of Control Sys. Research, Inc.*, SBA No. SIZ-5012, at 2 (2008) (an alleged affiliate, whose "sole stake is to ensure [the challenged firm] is an eligible offeror so that [the alleged affiliate] can be its subcontractor," lacks standing to appeal). Similarly, Sterling has no direct stake in the outcome of the instant litigation. Even if the size determination were affirmed, that determination would not be binding on Sterling in any subsequent review. *E.g.*, *Size Appeal of Coastal Mgm't Solutions, Inc.*, SBA No. SIZ-5281, at 5 (2011) (citing *Size Appeal of Miltope Corp.*, SBA No. SIZ-5066, at 7 (2009)). Accordingly, Sterling's motion to intervene is DENIED.

C. Analysis

I find it appropriate to remand this matter for two reasons. First, Appellant has persuasively shown that the Area Office failed to provide proper notice that it was considering new issues beyond those raised in the protest, thereby denying Appellant a meaningful opportunity to be heard on these points. Second, it is apparent from the record that the Area Office erred in its application of the 3-in-2 rule. In particular, Magnum Medical's non-compliance with the 3-in-2 rule in 2005 and 2006 was not, by itself, sufficient grounds to find general affiliation between Appellant and Sterling.

1. Due Process

SBA regulation permits area offices to investigate issues beyond those specifically raised by a protester. 13 C.F.R. § 121.1009(b); *see also Size Appeals of Excalibur Laundries, Inc.*, SBA No. SIZ-5317 (2012). Nevertheless, "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." *Size Appeal of Alutiiq Int'l Solutions, LLC*, SBA No. SIZ-5069, at 4 (2009). Such precautions are essential to ensure that protested concerns "may craft a response [to new issues] that protects their interests and, thus, to afford protested concerns due process." *Id.* In *Alutiiq Int'l*, OHA remanded a size determination because the area office found that the protested concern had violated the ostensible subcontractor rule, an issue not raised in the protest, without affording notice to the protested concern. OHA concluded that "the Area Office committed clear error in denying [the protested concern] due process." *Id.*

Here, NES's protest alleged affiliation between Appellant and Sterling on the grounds of common management and the newly organized concern rule. Appellant's response to the protest

addressed those theories, and urged the Area Office to dismiss the protest for lack of specificity, or to limit the scope of the review to those particular issues. In the size determination, the Area Office found NES's protest allegations to be meritless, summarily rejecting them in a single paragraph. (Size Determination at 5.) The Area Office went on, however, to address Magnum Medical's compliance with the 3-in-2 rule more than five years ago. The record contains no indication that the Area Office notified Appellant it was examining this issue, or that Appellant was given any opportunity to respond to it. Although Appellant would have understood from the protest that certain aspects of its relationship with Sterling were under review, Appellant cannot reasonably be expected to have anticipated that Magnum Medical's compliance with the 3-in-2 rule would be significant, particularly given that Magnum Medical has no involvement with the instant procurement. Accordingly, the Area Office committed clear error in altering the focus of the review, without permitting Appellant an opportunity to respond to the new issues.

2. Mentor-Protégé

The size determination is also flawed in its application of the 3-in-2 rule. Specifically, the size determination incorrectly states that "the fact that Magnum Medical broke the 3 in 2 Rule creates a general affiliation between [[Appellant] and Sterling." (Size Determination at 7.) This conclusion is at odds with established OHA case precedent.

In *Size Appeals of Safety and Ecology Corp.*, SBA No. SIZ-5177 (2010), OHA held that 13 C.F.R. § 124.520(d)(4) shielded an 8(a) BD mentor and protégé, which had created multiple joint ventures, from affiliation, and stated that "forming a joint venture to compete for contracts is assistance provided pursuant to the mentor-protégé agreement. The regulation is clear that no such assistance can serve as the basis for an affiliation finding." *Safety and Ecology*, SBA No. SIZ-5177, at 24. OHA went on to examine the 3-in-2 rule. OHA explained that joint venture partners normally are affiliated only with respect to a specific contract, "as long as the [joint venture] follows the rules (including the 3-in-2 rule) set forth in the regulation." *Id.* at 26. If joint venturers do not comply with the 3-in-2 rule, though, their relationship may become subject to a broader affiliation analysis. OHA emphasized that:

> [A] violation of the 3-in-2 rule does not compel the conclusion that the joint venture parties are automatically generally affiliated. Rather, it means the Area Office may investigate the relationship underlying the joint entity for general, all-purpose affiliation.

Id. OHA reiterated that "violations of the 3-in-2 rule . . . cannot strip the relationship between [a mentor and protégé] of the protection offered them by § 124.520(d)(4)." *Id.* at 27. OHA also explained that non-compliance with the 3-in-2 rule is a particularly feeble basis to find affiliation between an 8(a) BD mentor and protégé when the joint venture in question is not even involved in the instant procurement. OHA found "no basis in the regulations for penalizing [participants in the 8(a) BD mentor-protégé program] with a finding of general affiliation ... based upon [non-compliance with the 3-in-2 rule by joint ventures] that are unconnected to the contract at issue." *Id.*, at 27, n.11.

Accordingly, in the instant case, the Area Office clearly erred in finding that Appellant

and Sterling are affiliated based solely on the fact that Magnum Medical did not adhere to the 3-in-2 rule during 2005 and 2006. Under *Safety and Ecology*, such non-compliance with the 3-in-2 rule—particularly by a joint venture that is not a participant in the instant procurement—does not by itself establish that Appellant and Sterling are automatically affiliated. Rather, Magnum Medical's non-compliance with the 3-in-2 rule could precipitate a broader review of the facts and circumstances underlying the relationship between Appellant and Sterling. Based on the available record, it appears that such a review has not yet occurred, and the Area Office offered no rationale for finding Appellant and Sterling affiliated other than the 3-in-2 rule.

3. Remand

On remand, the Area Office must solicit a narrative response from Appellant as to whether Magnum Medical's failure to comply with the 3-in-2 rule in 2005 and 2006 gives rise to general affiliation between Appellant and Sterling. The Area Office must then render a new size determination considering Appellant's response and OHA's decision in *Safety and Ecology*. In the event that the Area Office determines that Appellant is not generally affiliated with Sterling, the Area Office should examine whether Appellant qualifies as a small business under the applicable size standard.

IV. Conclusion

Appellant has demonstrated that the size determination is clearly erroneous. Accordingly, the appeal is GRANTED, the size determination is VACATED, and the matter is REMANDED to the Area Office for further determination.

KENNETH M. HYDE
Administrative Judge