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CERTIFIED MAIL
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Reference Number: 14-0042

Heather Kennedy, Esq.
Acting Director
Economic Opportunity Division
Indiana Department of Transportation
100 N. Senate, Room N750
Indianapolis, IN 46204

Dear Ms. Kennedy:

Blue Sky Contractor Supply, LLC, appeals the Indiana Unified Certification Program's (IUCP) determination that it is ineligible for certification as an Disadvantaged Business Enterprise (DBE) under criteria set forth at 49 CFR Part 26 (the DBE Regulation). Having carefully reviewed the full administrative record, we find no substantial evidence in support of IUCP's determination of September 10, 2013, which is partly inconsistent with the substantive and procedural certification provisions noted below. However, we further find the record unclear or incomplete concerning ownership matters likely to have a significant impact on the outcome of the case. Hence we remand under §26.89(f)(4) for further proceedings consistent with the instructions below.

In the September 2013 denial letter, IUCP states two grounds for concluding that Blue Sky is ineligible:

First, IUCP reports that it has "concerns that [disadvantaged owner] Mrs. Flamini *may not have met* the requirements for economic disadvantaged status" and is "not convinced [she represented] her economic status honestly." Denial Letter at 2 (emphasis added). Second, IUCP has "concerns that the disadvantaged owner [sic] *may not have met* the ownership requirements" because her capital contributions generally followed those of other investors in the firm, including other disadvantaged owners. Id. at 3 (emphasis added). The issues ostensibly

presented on appeal, accordingly, concern the presumption of economic disadvantage under §26.67(a) and substantiality of capital and/or ownership under §26.69.¹

Applicable Authority

Section 26.61(b) provides:

“The firm seeking certification has the burden of demonstrating to you, by a preponderance of the evidence, that it meets the requirements of this subpart concerning group membership or individual disadvantage, business size, ownership, and control.”

The applicant firm bears the burden of proof with respect to each element of eligibility. The firm’s failure to show that it satisfies a certification requirement renders the firm ineligible.”

Section 26.67(a) states:

“*Presumption of disadvantage.* (1) You must rebuttably presume that citizens of the United States (or lawfully admitted permanent residents) who are women, Black Americans, Hispanic Americans, Native Americans, Asian-Pacific Americans, Subcontinent Asian Americans, or other minorities found to be disadvantaged by the SBA, are socially and economically disadvantaged individuals. You must require applicants to submit a signed, notarized certification that each presumptively disadvantaged owner is, in fact, socially and economically disadvantaged.

(2)(i) You must require each individual owner of a firm applying to participate as a DBE, whose ownership and control are relied upon for DBE certification, to certify that he or she has a personal net worth that does not exceed \$1.32 million.

(ii) You must require each individual who makes this certification to support it with a signed, notarized statement of personal net worth, with appropriate supporting documentation. To meet this requirement, you must use the DOT personal net worth form provided in appendix G to this part without change or revision. Where necessary to accurately determine an individual's personal net worth, you may, on a case-by-case basis, require additional financial information from the owner of an applicant firm (e.g., information concerning the assets of the owner's spouse, where needed to clarify whether assets have been transferred to the spouse or when the owner's spouse is involved in the operation of the company). Requests for additional information shall not be unduly burdensome or intrusive.

(iii) In determining an individual's net worth, you must observe the following requirements:

¹ IUCP cites section 26.69(c) but not (e), which is the capital contribution requirement. Further, we do not find that IUCP’s rationale, see section 26.86(a), adequately supports a conclusion that Mrs. Flamini’s ownership is merely pro forma. Finally, it appears that IUCP imposed a higher than warranted standard of proof on Blue Sky.

“Although Blue Sky may provide quality service, we do not believe that Blue Sky has met its burden of proof to provide [sic] and convincing evidence that Mrs. Flamini is economically disadvantaged and owns the business in accordance with the DBE regulations.” Rebuttal Letter from IUCP to Department Dated January 27, 2014.

(A) Exclude an individual's ownership interest in the applicant firm;

(B) Exclude the individual's equity in his or her primary residence (except any portion of such equity that is attributable to excessive withdrawals from the applicant firm). The equity is the market value of the residence less any mortgages and home equity loan balances. Recipients must ensure that home equity loan balances are included in the equity calculation and not as a separate liability on the individual's personal net worth form. Exclusions for net worth purposes are not exclusions for asset valuation or access to capital and credit purposes.

(C) Do not use a contingent liability to reduce an individual's net worth.

(D) With respect to assets held in vested pension plans, Individual Retirement Accounts, 401(k) accounts, or other retirement savings or investment programs in which the assets cannot be distributed to the individual at the present time without significant adverse tax or interest consequences, include only the present value of such assets, less the tax and interest penalties that would accrue if the asset were distributed at the present time.

(iv) Notwithstanding any provision of Federal or State law, you must not release an individual's personal net worth statement nor any documents pertaining to it to any third party without the written consent of the submitter. Provided, that you must transmit this information to DOT in any certification appeal proceeding under §26.89 of this part or to any other State to which the individual's firm has applied for certification under §26.85 of this part.”

Section 26.67(b) states:

Rebuttal of presumption of disadvantage. (1) An individual's presumption of economic disadvantage may be rebutted in two ways.

(i) If the statement of personal net worth and supporting documentation that an individual submits under paragraph (a)(2) of this section shows that the individual's personal net worth exceeds \$1.32 million, the individual's presumption of economic disadvantage is rebutted. You are not required to have a proceeding under paragraph (b)(2) of this section in order to rebut the presumption of economic disadvantage in this case.

Example to paragraph (b)(1)(i): An individual with very high assets and significant liabilities may, in accounting terms, have a PNW of less than \$1.32 million. However, the person's assets collectively (e.g., high income level, a very expensive house, a yacht, extensive real or personal property holdings) may lead a reasonable person to conclude that he or she is not economically disadvantaged. The recipient may rebut the individual's presumption of economic disadvantage under these circumstances, as provided in this section, even though the individual's PNW is less than \$1.32 million.

(ii)(A) If the statement of personal net worth and supporting documentation that an individual submits under paragraph (a)(2) of this section demonstrates that the individual is able to accumulate substantial wealth, the individual's presumption of economic disadvantage is

rebutted. In making this determination, as a certifying agency, you may consider factors that include, but are not limited to, the following:

- (1) Whether the average adjusted gross income of the owner over the most recent three year period exceeds \$350,000;
- (2) Whether the income was unusual and not likely to occur in the future;
- (3) Whether the earnings were offset by losses;
- (4) Whether the income was reinvested in the firm or used to pay taxes arising in the normal course of operations by the firm;
- (5) Other evidence that income is not indicative of lack of economic disadvantage; and
- (6) Whether the total fair market value of the owner's assets exceed \$6 million.

(B) *You must have a proceeding under paragraph (b)(2) of this section in order to rebut the presumption of economic disadvantage in this case.*

(2) If you have a reasonable basis to believe that an individual who is a member of one of the designated groups is not, in fact, socially and/or economically disadvantaged you may, at any time, start a proceeding to determine whether the presumption should be regarded as rebutted with respect to that individual. Your proceeding must follow the procedures of §26.87.

(3) In such a proceeding, you have the burden of demonstrating, by a preponderance of the evidence, that the individual is not socially and economically disadvantaged. You may require the individual to produce information relevant to the determination of his or her disadvantage.

(4) When an individual's presumption of social and/or economic disadvantage has been rebutted, his or her ownership and control of the firm in question cannot be used for purposes of DBE eligibility under this subpart unless and until he or she makes an individual showing of social and/or economic disadvantage. If the basis for rebutting the presumption is a determination that the individual's personal net worth exceeds \$1.32 million, the individual is no longer eligible for participation in the program and cannot regain eligibility by making an individual showing of disadvantage, so long as his or her PNW remains above that amount.” (Emphasis added.)

Section 26.69(c), at the time of decision, read:

“The firm’s ownership by socially and economically disadvantaged individuals must be real, substantial, and continuing, going beyond mere pro forma ownership of the firm as reflected in the ownership documents. The owners must enjoy the customary incidents of ownership, and share in the risks and profits commensurate with their ownership interests, as demonstrated by the substance, not merely the form, of arrangements.”

Section 26.69(e) states:

“The contributions of capital or expertise by the socially and economically disadvantaged owners to acquire their ownership interests must be real and substantial. Examples of insufficient contributions include a promise to contribute capital, an unsecured note payable to the firm or an owner who is not a disadvantaged individual, or mere participation in a firm's activities as an employee. Debt instruments from financial institutions or other organizations that lend funds in

the normal course of their business do not render a firm ineligible, even if the debtor's ownership interest is security for the loan.”

Section 26.69(i) states:

“You must apply the following rules in situations in which marital assets form a basis for ownership of a firm:

(1) When marital assets (other than the assets of the business in question), held jointly or as community property by both spouses, are used to acquire the ownership interest asserted by one spouse, you must deem the ownership interest in the firm to have been acquired by that spouse with his or her own individual resources, provided that the other spouse irrevocably renounces and transfers all rights in the ownership interest in the manner sanctioned by the laws of the state in which either spouse or the firm is domiciled. *You do not count a greater portion of joint or community property assets toward ownership than state law would recognize as belonging to the socially and economically disadvantaged owner of the applicant firm.*

(2) A copy of the document legally transferring and renouncing the other spouse's rights in the jointly owned or community assets used to acquire an ownership interest in the firm must be included as part of the firm's application for DBE certification.” (Emphasis added.)

Section 26.89(f) provides, in pertinent part:

“(1) The Department affirms [the certifier’s] decision unless it determines, based on the entire administrative record, that [the] decision is unsupported by substantial evidence or inconsistent with the substantive or procedural provisions of this part concerning certification.

(2) If the Department determines, after reviewing the entire administrative record, that your decision was unsupported by substantial evidence or inconsistent with the substantive or procedural provisions of this part concerning certification, the Department reverses your decision and directs you to certify the firm or remove its eligibility, as appropriate. You must take the action directed by the Department's decision immediately upon receiving written notice of it.”

Pertinent Facts

Blue Sky is a contractor supply company formed in December 2010. Theresa Flamini and ten other owners own all of the shares of Blue Sky’s two classes of member interest. Three of the eleven owners—Ms. Flamini, Antonietta Camaioni, and Jose Avila—are presumed to be socially and economically disadvantaged by virtue of being Hispanic or female or, in the case of Ms. Flamini, both.

According to the Uniform Certification Application (UCA) of May 30, 2013 and the On-Site Review Report (OSRR) of June 27, 2013, Ms. Flamini owns 70% of Blue Sky. Ms. Flamini claims that there are two classes of member interest, that she owns all 70 Class A voting

interests, and that ten other individuals own nonvoting Class B interests, in percentages ranging from 1.5% to 5.0%.² See, e.g., Appeal Letter of December 9, 2013 at 1-2; OSSR at 3; UCA at 4.

IUCP concludes, Denial Letter at 3, that Ms. Flamini contributed capital of \$479,835 and the other members contributed capital of \$600,000. IUCP further concludes that the combined disadvantaged ownership of Ms. Flamini, Mr. Avila, and Ms. Camaioni, is 53.7%, “which meets the ownership requirements for DBE certification.” Denial Letter at 3.

IUCP takes issue with the firm having opened a line of credit, evidently obtained by Ms. Flamini, four months after it was formed and with Ms. Flamini and her husband having guaranteed a line of credit of \$450,000 to the firm some eight-plus months after it was formed.³ The concern appears to be that Ms. Flamini’s capital infusion/s (which the firm argues total \$1.1 million—resulting in total disadvantaged owner capital of \$1.2 million versus non-disadvantaged owner capital of \$500,000) was/were not contemporaneous with the investments of other owners, including the other two disadvantaged owners.

Blue Sky on appeal explains that Ms. Flamini sought outside investments first and contributed further capital when the business required it. The issue posed under IUCP’s reasoning is whether the Regulation requires all of the disadvantaged owners’ capital contributions to be contemporaneous with those of non-disadvantaged investors in the business.

The second issue concerns economic disadvantage. Blue Sky asserts that Ms. Flamini filed a personal financial statement (PFS) with IUCP that shows her personal net worth to be in the neighborhood of \$250,000, or over \$1 million below the § 26.67(a) ceiling of \$1.32 million.⁴ That PFS, absent from the record but acknowledged in the Denial Letter, failed to provide a value for Ms. Flamini’s business interests in two other, non-applicant firms. The PFS, further, provided values of \$0 for cash on hand, savings, and personal property.

² The record is not completely clear concerning the extent to which Ms. Flamini owns Class B interests. Blue Sky appears to state that “investors” own all of the Class B interests while Ms. Flamini owns all of the Class A interests and no Class B interests.

³ Denial Letter at 3. Mr. Avila and Ms. Camaioni contributed a combined \$100,000. See, e.g., OSSR at 3 (Q&A 12); Appeal Letter at 3. Ms. Camaioni’s check is drawn on an account she holds jointly with her presumed non-disadvantaged spouse. Similarly, Mr. and Ms. Flamini have jointly guaranteed the firm’s line of credit dated April 26, 2011 per the guaranty dated September 5, 2011. IUCP appears to have made no adjustment for marital property, and we find no §26.69(i) renunciation(s) in the record. There is, finally, no indication that Mr. Camaioni or Mr. Flamini is disadvantaged.

Despite references to an additional \$650,000 line of credit, the record suggests that the April 2011 line of credit and the September 2011 guaranty relate to the same \$450,000 credit line. See, e.g., Letter from Tuan Nguyen, Vice President, Standard Bank, to Blue Sky Dated September 10, 2012. IUCP’s denial letter is generally consistent with this reading.

⁴ The administrative record contains more than a ream of documents, many of them financial and going into substantial detail. We see any number of back up documents but no actual personal financial statement in the record IUCP provided. Accordingly, we rely on the parties’ appeal assertions as the best and only evidence regarding the initial and revised numbers.

On appeal, Blue Sky states that the omissions were an oversight and that the two other firms have run net operating losses in the two most recent years for which data were available. Blue Sky provides values for the line-items IUCP would (but did not formally, see §26.67(b)) challenge. The resulting personal net worth, according to the firm, rises by at most \$322,000, attributable mostly to personal property worth \$300,000. Appeal Letter at 2-3. Blue Sky argues that the adjustments to the PFS are not outcome-determinative. Appeal Letter at 3. Blue Sky states that it demonstrated, by a preponderance of the evidence, that Theresa Flamini's personal net worth is well below the regulatory cap.

Discussion and Decision

Disadvantage

The evidence appears to be uncontroverted that Ms. Flamini and two other owners are presumed to be disadvantaged and that IUCP conducted no §26.67(b)/26.87 proceeding to rebut the presumption. (It is unclear whether IUCP requested or obtained PFSs from Ms. Camaioni and Mr. Avila.) Our analysis of available evidence prompts us to concur with Blue Sky, that its owners are entitled to the presumption because IUCP failed to rebut as the Regulation requires.

Because of evident analytical (including concerning excludable assets, see Denial Letter at 2 regarding the value of Ms. Flamini's primary residence) and procedural (no hearing, wrong burden of proof) lapses, we do not consider social and economic disadvantage to be an issue properly before us in this appeal. The burden is on the certifier to require applicable certifications of personal net worth and to rebut the presumption of disadvantage.

Were the issue properly framed, we would likely reverse IUCP's decision as unsupported by substantial evidence and substantively and procedurally inconsistent with the requirements of §26.67. See §26.89(f)(2). We direct IUCP, for present purposes, to consider the applicant to have made its case under §26.67 and consider only the ownership issues (essentially sufficiency of capital) described below.⁵ These are the only issues that the Department considers to be outcome-determinative under §26.89(f)(4).

Ownership

IUCP concludes that the disadvantaged owners meet the requirements of §26.69(b) and (c), as noted above. This conclusion implies that the firm met its burden under §§26.61(b) and 26.69(e). That being the case, the resulting ineligibility conclusion seems surprising.

If the issue is, as IUCP states it, simply whether Ms. Flamini's capital contributions must be concurrent with those of other members, we note that the Department does not read the

⁵ Should IUCP certify Blue Sky, it may of course revisit issues of economic disadvantage at any time it has reasonable cause to believe the disadvantaged owners upon whose ownership eligibility depends (we cannot reasonably conclude, based on the facts before us, whether that is one person or three) are no longer socially and economically disadvantaged. See generally §26.87(b).

Regulation to require exact concurrence. Indeed, section 26.69 generally assumes that the disadvantaged owners may continue to contribute capital to the firm over time, as business needs dictate. (Note the concept of “continuing” ownership in section 26.69(c).)

We acknowledge the “to acquire” language in §26.69(e), but we disagree that the timing is the main issue in this appeal. The Department’s past appeal decisions allow reasonable temporal leeway concerning disadvantaged owners’ capital contributions.

We believe the main issues in this case are:

1. Is the guaranteed line of credit properly construed to be Ms. Flamini’s capital contribution in whole or part?⁶
2. Have the disadvantaged owners contributed at least 51% of total capital?⁷

Conclusion

We remand and direct IUCP either to certify the firm or clarify why it considers the firm ineligible, in the latter case with a rationale limited to analyzing the substantiality of the disadvantaged owners’ capital contributions within the meaning of §§26.69(e) and (i).

We direct IUCP not later than July 31, 2015, either to certify Blue Sky or to produce a new denial letter that speaks specifically to the capital contribution/marital property issues identified and which otherwise comports with the Regulation’s substantive and procedural requirements, including those of §26.86(a).

Should IUCP certify the firm, it may review eligibility under §26.83 and, if applicable, initiate a §26.87 proceeding at any time.

Should IUCP again determine that Blue Sky is ineligible (on the narrowed grounds set forth here), then the firm will have the usual 90 days within which to appeal to the Department.

⁶ It suffices for present purposes to ask IUCP to elaborate on its analysis of the guaranty transaction: why does a joint guaranty between husband and wife qualify 100% as a contribution of capital from the wife? If it does so qualify, then why is the firm ineligible?

⁷ Even if the \$450,000 loan is properly characterized as entirely Ms. Flamini’s capital contribution, then the disadvantaged owners, on the mostly undisputed facts before us, collectively contributed \$525,000 versus the non-disadvantaged owners’ \$525,000—unless there are spousal renunciations of which we are not aware. We note that there are several other checks in the record that might boost the disadvantaged owners’ capital contributions above parity with the non-disadvantaged owners, but IUCP in the original denial letter does not explain, contrary to §26.86(a), how it derives a figure of \$479,853 for Ms. Flamini alone.

This decision is administratively final and not subject to petitions for reconsideration.

Sincerely,

Samuel F. Brooks
DBE Appeal Team Lead
External Civil Rights Programs Division

cc: Joseph R. Ziccardi, Esq., for Blue Sky