November 6, 2015

CERTIFIED MAIL
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Reference Number: 15-0046

Mr. Jeff P. H. Cazeau, Esq.
Mr. Mark J. Stempler, Esq.
Becker & Poliakoff
121 Alhambra Plaza, 10th Floor
Coral Gables, FL 33185

Dear Messrs. Cazeau & Stempler:

Southstar Engineering & Consulting, Inc. (Southstar) appeals the California Department of Transportation's (Caltrans) denial of its application for certification as a Disadvantaged Business Enterprise (DBE) under criteria set forth at 49 C.F.R. Part 26 (the Regulation). After reviewing the full administrative record, we conclude that substantial evidence supports Caltrans's determination. We affirm under §26.89(f)(1).

In the denial letter dated October 20, 2014, Caltrans cites the firm's failure to meet the requirements of §§26.69 (c), (e), and (h) relating to ownership, and §§26.71 (c) and (d) relating to control. The Department affirms on the basis of §26.71(d)(2).[1]

*Applicable Regulation Provisions*

§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."

§26.69(c), at the time of the 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

[1] In light of this disposition, we do not reach Caltrans's other rationales.

share in the risks and profits commensurate with their ownership interests, as demonstrated by the substance, not merely the form, of arrangements."

§26.69(e) provides:

"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."

§26.69(h) provides:

(1) You must presume as not being held by a socially and economically disadvantaged individual, for purposes of determining ownership, all interests in a business or other assets obtained by the individual as the result of a gift, or transfer without adequate consideration, from any non-disadvantaged individual or non-DBE firm who is—

(i) Involved in the same firm for which the individual is seeking certification, or an affiliate of that firm;

(ii) Involved in the same or a similar line of business; or

(iii) Engaged in an ongoing business relationship with the firm, or an affiliate of the firm, for which the individual is seeking certification.

(2) To overcome this presumption and permit the interests or assets to be counted, the disadvantaged individual must demonstrate to you, by clear and convincing evidence, that—

(i) The gift or transfer to the disadvantaged individual was made for reasons other than obtaining certification as a DBE; and

(ii) The disadvantaged individual actually controls the management, policy, and operations of the firm, notwithstanding the continuing participation of a non-disadvantaged individual who provided the gift or transfer."

§26.71(d) provides:

"The socially and economically disadvantaged owners must possess the power to direct or cause the direction of the management and policies of the firm and to make day-to-day as well as long-term decisions on matters of management, policy and operations.

(1) A disadvantaged owner must hold the highest officer position in the company (e.g., chief executive officer or president).

(2) In a corporation, disadvantaged owners must control the board of directors.

(3) In a partnership, one or more disadvantaged owners must serve as general partners, with control over all partnership decisions."

§26.89(f)(1) provides:

"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."

§26.89(g) provides:

"All decisions under this section are administratively final, and are not subject to petitions for reconsideration."

*Operative Facts*

Southstar's primary activities include civil engineering, project management, construction management, roadway/highway design, and transportation engineering (Uniform Certification Application (UCA) dated April 29, 2014, at 2). The firm was established in September 2006. *Id.* Disadvantaged owner Yvette Kirrin is the President and owns 25% of the firm. *Id.* at 4. Daniel Ciacchella, also disadvantaged and the firm's Chief Operating Officer, owns 27.5%. *Id.* Amr Abuelhassan, a non-disadvantaged 21.25% owner, is Southstar's Chief Financial Officer. *Id.* Jason Bennecke, another non-disadvantaged 21.25% owner, is the Chief Administrative Officer. *Id.* Non-disadvantaged Frank Sherkow owns the remaining 5% of the firm (Appeal Letter dated January 7, 2015; Southstar Letter Regarding DBE Application dated August 19, 2014[2] at 3.) All owners are directors.

The UCA states that Yvette Kirrin contributed **REDACTED** and that Daniel Ciacchella contributed **REDACTED** in capital in exchange for their ownership interests.[3] The Close Corporation Agreement (CCA) states that, on January 1, 2009, each of the shareholders converted shareholder loans to capital contributions, for a total of **REDACTED**. Each shareholder was to be credited with a share of the overall **REDACTED** capital proportional to his/her stock ownership. Southstar explains on appeal: "Owners are required to have their

[2] This letter (Southstar Letter) is a response to Caltrans's ownership and control questions sent in an e-mail dated August 14, 2014.

[3] The disadvantaged owners appear to have modified their capital contribution claims when CUCP conducted the On-Site Review Report (OSRR) dated August 4, 2014. The OSRR states that Yvette Kirrin deposited **REDACTED** to become an owner and loaned the firm **REDACTED** for operations.

On appeal, Southstar claims that Mr. Ciachella contributed **REDACTED** and Ms. Kirrin **$REDACTED** Appeal Letter at 6.

percentage of **REDACTED** in original capitalization, plus a minimum of about **REDACTED** each of cash from deferred salaries, Company equity and loans. When owners leave, they are paid back this money."

The record contains a letter dated November 3, 2014, from Southstar's accounting firm (Accountant's Letter) stating that Yvette Kirrin contributed **REDACTED** and Daniel Ciacchella contributed **REDACTED** Absent from the record is original evidence (e.g., canceled check, pay stub showing withholding) of these contributions.

With regard to board control and voting, Southstar's Amended By-Laws and the CCA provide [4]:

> ***Amended By-Laws (2010) Section 3.9 Quorum.*** *A majority of the authorized number of directors shall constitute a quorum for the transaction of business*, except to adjourn as provided in Section 3.12. Every act or decision done or made *by a majority of the directors present* shall be regarded as the act of the board of directors… A meeting at which a quorum is initially present may continue to transact business notwithstanding the withdrawal of directors, if any action taken is approved by at least a majority of the required quorum for that meeting.[5] (Emphasis added.)
>
> ***Close Corporation Agreement (2010) Section 3.1 Directors and Voting by Directors.*** *All Shareholders will be directors of the Corporation and, as directors, will vote proportional to the shares of stock* in the Corporation owned by such director/Shareholder. Unless a greater vote is required by California law, the Bylaws, or this Agreement, all matters approved by directors will require the affirmative vote of directors holding at least fifty-one percent (51%) of the voting power. *Meetings of directors will be called and held in accord with the provisions of the Bylaws*. (Emphasis added).

Although the CCA provision also states that board meetings will be held as provided in the by-laws—and although Southstar evidently intended, in adopting the CCA, to change from one-director, one-vote—the Amended By-Laws, again, reflect no change from "majority of directors" to "majority of shares" for quorum and voting purposes. See Section 3.9 of the Amended By-Laws, which Southstar confirms (Southstar Letter at 6; Appeal Letter at 7) to be the latest version.

The disadvantaged shareholders, Southstar Letter at 6, cite Section 3.1 of the CCA and 2.08 of the Amended By-Laws as evidence that Southstar changed *director voting* from one-director, one-vote to proportional to stock ownership. However, section 2.08 of the Amended By-Laws

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[4] A letter from Southstar to CUCP dated August 19, 2014, states that the original by-laws were superseded in 2010, the same year the shareholders adopted the CCA.

[5] Based on this language, Caltrans reasons that without a non-disadvantaged owner present at a meeting, there can be no quorum. Denial Letter at 4. Caltrans concedes that Southstar claims "recently" to have changed this provision to reflect a "majority of shareholders" constituting a quorum, citing error on Southstar's part. It is possible that the "change" refers to the CCA language. Southstar similarly implies, Appeal Letter at 7, that its 2010 amendment resolved Caltrans' one-director, one-vote issue. Nevertheless, the record before us contains no corresponding change to the by-law provision (§3.9).

does not relate to *director* voting at all: it relates to votes of *shareholders*. The documents provided to Caltrans show that section 3.9 of the Amended By-Laws, the provision concerning *director* quorums and voting, remains unchanged since 2010.

*Discussion and Decision*

*i. Ownership*

The contributions of capital by socially and economically disadvantaged owners to acquire their ownership interests must be real and substantial. *See* §26.69(e). The record contains conflicting claims of capital contribution and amounts from Yvette Kirrin and Daniel Ciacchella. There is no original documentation in the record, though the Accountant's Letter indicates capital contributions in the amounts of $3,000 from Yvette Kirrin and $5,000 from Daniel Ciacchella.

We reach no conclusion as to whether those amounts are commensurate with stated ownership percentages because Caltrans did not raise the issue, and new section 26.69(c)(2) was not in effect at the time of the decision. *See* 79 Fed. Reg. at 59566 (October 2, 2014) (final rule effective November 3, 2014). *See generally* §26.89(f)(5).

*ii. Control*

Caltrans concludes that disadvantaged persons do not control the board of directors under §26.71(d)(2). The board comprises five directors, only two of whom are disadvantaged. The by-laws and the CCA are at odds (and the CCA provision arguably internally inconsistent) regarding whether each director has one vote (by-laws) or votes in proportion to the number of shares s/he owns (CCA).

On appeal, Southstar relies on the CCA (for the citation to by-law §2.08, as noted above, is inapposite) for the proposition that director voting is based on share ownership. Section 3.9 of the By-Laws, in contrast, shows the rule to be one vote per director.

Under the by-law provision, the disadvantaged owners require the assent and presence of at least one non-disadvantaged director to form a quorum to transact business. Accordingly, as a technical, mathematical matter, there is substantial evidence that:

1. The board may not act without at least one non-disadvantaged member's assent; and
2. Non-disadvantaged directors can, themselves, form a quorum and transact whatever business they choose without the presence or assent of the disadvantaged owner/directors.

We are not experts in California law. We do not purport to say which provision, by-law or CAA, governs. That was Southstar's case to make under §§26.61 and 26.71(d). We merely conclude that substantial evidence, namely the by-law provision, supports Caltrans's conclusion, which we affirm under §26.89(f)(1).

*Conclusion*

We affirm Caltrans's ineligibility determination on the basis of §26.71(d)(2) as supported by substantial evidence and not inconsistent with the Regulation's substantive and procedural provisions relating to certification.

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

Sincerely,

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

cc: Caltrans