August 2, 2016

Reference No. 16–0057

Vickie L. Henkel, CEO
Terra Associates, Inc.
REDACTED
Houston, TX 77008

RE: DBE Certification Denial of Terra Associates, Inc.

Dear Ms. Henkel.

Terra Associates, Inc. (TAI) appeals to the U.S. Department of Transportation, Departmental Office of Civil Rights (the Department), the City of Houston's (COH) denial of its application for certification as a Disadvantaged Business Enterprise (DBE), under criteria set forth under the DBE Program Regulation, 49 C.F.R. Part 26 (the Regulation). COH is a member of the Texas Unified Certification Program. It issued this DBE certification denial decision on October 2, 2015, citing TAI's failure to meet the requirements of §§26.69(c), (f), (h) and (j) relating to ownership and those under §§26.71(c), (d), (e), and (l) relating to control.

The Department requested the administrative record and COH's response to the issues raised in your appeal. We received the administrative record on January 27, 2016, which we reviewed along with your December 30, 2015 appeal. We conclude that substantial evidence supports COH's decision. It suffices for purposes of this appeal to affirm on the grounds relating to control specified by COH, for the reasons set forth below.

Standard of Review

Under 49 C.F.R. §26.86(d), a firm may appeal a denial of DBE certification to the Department. The Department does not make a de novo review or conduct a hearing; its decision is based solely on a review of the administrative record as supplemented by the appeal. 49 C.F.R. §26.89(e). The Department must affirm the initial decision unless it determines, based upon its review of the entire administrative record, that the decision was "unsupported by substantial evidence or inconsistent with the substantive or procedural provisions of this part concerning certification." 49 C.F.R. §26.89(f)(1). When reviewing the administrative record provided by the recipient, the Department's decision is based on the status and circumstances of the firm as of the date of the decision being appealed. 49 C.F.R. §26.89(f)(6).

Discussion and Decision

Section §26.61(b) of the Regulation requires that applicant firms satisfy each eligibility requirement.[1] A firm's failure to meet its burden of proof regarding any substantive certification requirement results in a determination that it is ineligible. After reviewing the entire administrative record, we find that substantial evidence supports COH's conclusion and that it is consistent with the substantive and procedural certification provisions of the rule. We affirm COH's decision under §26.89(f)(1) for the following reasons.

1. TAI was formed by your father, Lonnie Parr, in 1981. It provides civil engineering services for residential and commercial development, public infrastructure, and other services. (Uniform Certification Application (UCA) Feb. 9, 2015, p. 5, and COH On-Site Review Report June 8, 2015). TAI has three owners: you (holding 50%); Vice President, Danny Sepulveda, a disadvantaged individual (25% owner); and Board of Directors Chairman Kevin Polasek, also a Vice President and a non-disadvantaged individual (25% owner). (UCA, pp. 8, 9). On March 17, 2015, you provided COH a letter describing your inheritance of 25% of stock from Lonnie Parr as of June 1, 2008. This correspondence indicates that your spouse, Lyle Henkel (TAI's President), inherited the same amount on the same date and that on the very next day, Mr. Henkel transferred his 25% ownership interest to you, making you the 50% owner of TAI.

Along with Mr. Henkel, all three owners of TAI are members of the Board of Directors. COH determined that the structure of the firm's bylaws prevent the disadvantaged owners (you and Mr. Sepulveda) from controlling the board, contrary to §26.71(d),[2] and that they place formal restrictions on your customary discretion, not in accordance with §26.71(c).[3] The following bylaw provisions address the quorum requirements for the Board of Directors and shareholder meetings, the manner of voting, removal of directors, and how the bylaws may be amended by the principals.

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[1] §26.61(b) states: "The firm seeking certification has the burden of demonstrating to [the recipient], 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." As explained herein, CUCP appropriately applied the higher burden of proof standard found in §26.71(l).

2 §26.71(d) states: "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."

[3] §26.71(c) states: "A DBE firm must not be subject to any formal or informal restrictions which limit the customary discretion of the socially and economically disadvantaged owners. There can be no restrictions through corporate charter provisions, by-law provisions, contracts or any other formal or informal devices (e.g., cumulative voting rights, voting powers attached to different classes of stock, employment contracts, requirements for concurrence by non-disadvantaged partners, conditions precedent or subsequent, executory agreements, voting trusts, restrictions on or assignments of voting rights) that prevent the socially and economically disadvantaged owners, without the cooperation or vote of any non-disadvantaged individual, from making any business decision of the firm. This paragraph does not preclude a spousal co-signature on documents as provided for in §26.69(j)(2)."

> Article 2, §2.05: Quorum. The holders of 100% of the shares issued and outstanding and entitled to vote thereat, present in person or represented by proxy, shall be requisite and constitute a quorum at all meetings of the shareholders for the transaction of business. . .
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> Article 2, §2.06: Majority Vote: Withdrawal of Quorum. When a quorum is present at any meeting, the majority vote of the holders of a majority of the shares having voting power, present in person or represented by proxy, shall decide any question brought before such meeting. The shareholders present at a duly organized meeting may continue to transact business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum.
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> Article 2, §2.09: Action Without Meeting. Any action required by statute to be taken at a meeting of the shareholders, or any action which may be taken at a meeting of the shareholders, may be taken without a meeting if a consent in writing, setting forth the action so taken, shall be signed by all the shareholders entitled to vote. . .
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> Article 3, §3.04: Removal. Any director may be removed either for or without cause at any special or annual meeting of shareholders by the affirmative vote of shareholders owning 100% of the shares authorized to vote . . .
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> Article 3, §3.11: Quorum. At all meetings of the Board of Directors a majority of the number of directors fixed by these bylaws shall constitute a quorum for the transaction of business. The act of the directors present at any meeting at which a quorum is present shall be the act of the Board of Directors. If a quorum is not present at a meeting of the Board of Directors, the directors present thereat may adjourn the meeting from time to time, without notice other than announcement at the meeting, until a quorum is present.
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> Article 3, §3.14. Action Without Meeting. Any action required or permitted to be taken at a meeting of the Board of Directors, may be taken without a meeting if a consent in writing, setting forth the action so taken, is signed by all the members of the Board of Directors. . .
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> Article 7, §7.08: Amendment of Bylaws. These bylaws may be altered, amended, or repealed at any meeting of the shareholders at which a quorum is present or represented by the affirmative vote of the holders of 100% of the shares entitled to vote thereat, provided notice of the proposed alteration, amendment, or repeal is contained in the notice of such meeting.

These provisions place restrictions on your ability to manage TAI because the cooperation of Kevin Polasek, a non-disadvantaged individual, is necessary to have a quorum for a meeting of the shareholders (Art. 2, §2.05), to take action in lieu of a shareholder meeting (Art.2, §2.09), remove a director (Art. 3, §3.04), and amend the bylaws (Art. 7, §7.08). Similarly, in the case of

the Board of Directors, you require the presence of Kevin Polasek to constitute a quorum for the transaction of business (Art. 3, §3.11) and both his presence and that of Mr. Henkel (also a non-disadvantaged individual) if action is taken outside board meetings (Art. 3, §3.14). Therefore, TAI does not meet its burden of proof that you are able to control the firm within the meaning of §§26.71(c) and (d). The non-disadvantaged board members and shareholders (as appropriate) also possess the power to control the firm by virtue of these provisions, contrary to §26.71(e).[4]

2. With respect to Mr. Henkel, your control of TAI must meet the "clear and convincing" burden of proof standard set forth in §26.71(l), which COH cites and which states:

> Where a firm was formerly owned and/or controlled by a non-disadvantaged individual (whether or not an immediate family member), ownership and/or control were transferred to a socially and economically disadvantaged individual, and the nondisadvantaged individual remains involved with the firm in any capacity, there is a rebuttable presumption of control by the non-disadvantaged individual unless the disadvantaged individual now owning the firm demonstrates to you, by clear and convincing evidence, that: (1) The transfer of ownership and/or control to the disadvantaged individual was made for reasons other than obtaining certification as a DBE; and (2) The disadvantaged individual actually controls the management, policy, and operations of the firm, notwithstanding the continuing participation of a nondisadvantaged individual who formerly owned and/or controlled the firm.

As noted above, Lyle Henkel formerly owned the firm and transferred his ownership interest to you in 2008. There is no question of Mr. Henkel's continued involvement in the firm after this transfer took place. In such instance, the rebuttable presumption is that he remains in control of the firm unless you as the disadvantaged individual show, by clear and convincing evidence, that: (1) the transfer of ownership and/or control to you was made for reasons other than obtaining certification as a DBE; and (2) you actually control the management, policy, and operations of the firm, notwithstanding his continued participation.

With respect to the first requirement to overcome the presumption, TAI presented no evidence as to why Mr. Henkel transferred his ownership to you or evidence that this occurred for reasons other than obtaining DBE certification. As for the second requirement, it is clear that Mr. Henkel exercises control over at least the management of the firm. In addition to Mr. Henkle's influence over the Board of Directors as described above, he and Kevin Polasek can independently sign checks on the firm's bank account with the Bank of Texas, with two signatures required to process checks for transactions over **REDACTED**. Furthermore, in comparing your résumé to that of Mr. Henkel, he serves as TAI's President and handles business development, project manager, strategic planning and personnel oversight, whereas your role as CEO is limited to office management and human resources. These facts support COH's conclusion that you have not met the control requirements of §26.71(l).

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[4] This provision states: "Individuals who are not socially and economically disadvantaged or immediate family members may be involved in a DBE firm as owners, managers, employees, stockholders, officers, and/or directors. *Such individuals must not, however possess* or exercise *the power to control the firm*, or be disproportionately responsible for the operation of the firm." (Emphasis added)

In summary, substantial evidence supports COH's conclusion that TAI did not meet its burden of proof under the Regulation's requirements. Accordingly, COH correctly found that the firm is ineligible for DBE certification. Pursuant to Regulation §§26.89(g) and (j), this determination is administratively final and is not subject to petition for reconsideration. TAI may reapply to the DBE program after the appropriate waiting period has passed.

Sincerely,

Marc D. Pentino
Lead Equal Opportunity Specialist
Departmental Office of Civil Rights

cc: City of Houston