

September 1, 2017

Reference No: 17-0041

Ms. Ruth Byrd-Smith  
MBEC Director  
Pennsylvania Unified Certification Program  
204 County Office Building  
542 Forbes Avenue  
Pittsburg, PA 15219

Dear Ms. Byrd-Smith:

Power Tool and Supply Co. (PTSC), appeals the Pennsylvania Unified Certification Program's (PAUCP)<sup>1</sup> December 5, 2016 denial (Notice of Decision, or NOD) of its interstate application for Disadvantaged Business Enterprise (DBE) certification under the criteria set forth in 49 C.F.R. part 26 (the Regulation). After considering the entire administrative record, the U.S. Department of Transportation (the Department) reverses PAUCP's decision under Regulation §26.89(f)(2).<sup>2</sup>

PAUCP cites §§26.69(h), 26.71(b), 26.71(e), and 26.71(i) as its principal grounds for concluding that PTSC's socially and economically disadvantaged owner does not own and control the firm. We find that PAUCP's denial rationales do not establish that the firm's home state certification is erroneous.

## I. Background

The pertinent facts are uncontroverted. PTSC supplies/repairs power tools and was formed in 1961. Lisa Springier started working at PTSC in 1985 and acquired minority ownership in 1995.<sup>3</sup> See Ohio Department of Transportation On-site Review (May 23, 2016) at 1. Ms. Springer became majority owner when the firm redeemed then-owner/President James Jones's

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<sup>1</sup> The Allegheny County Department of Minority, Women, and Disadvantaged Business Enterprise is the certifying agency that issued the decision in this case. Allegheny County is a member of PAUCP.

<sup>2</sup> Section 26.89(f)(2) states:

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.

<sup>3</sup> PTSC has experienced several ownership changes over the years. Ms. Springer acquired her minority ownership as a gift from her father (a former part owner and employee of PTSC). On-site at 1.

ownership interest in 2013.<sup>4</sup> PTSC issued a promissory note for \$1,276,969.42 to finance the redemption. The terms of the note include four installments of \$80,000 due in July 2013-2016, then 84 monthly installments of \$13,682.33. It is undisputed that PTSC continues to meet the note's payment obligation. PTSC retained Mr. Jones as its Assistant Vice President of Purchasing until June 30, 2016.<sup>5</sup> *See generally* Jones Employment Agreement. Ms. Springer is PTSC's current President and 100% owner.<sup>6</sup>

The Ohio Department of Transportation (ODOT) certified PTSC as a home-state DBE on June 30, 2016.<sup>7</sup> PTSC then applied for interstate certification in Pennsylvania. PAUCP chose not to verify the Ohio certification and certify the firm in Pennsylvania as §26.85(b) allows. Instead, PAUCP reviewed the interstate application under the procedures described in §26.85(c).

PAUCP issued a notice of its intent to deny (NOI) PTSC's interstate application on October 4, 2016. The NOI claimed that PTSC does not satisfy several of the Regulation's provisions. PAUCP took particular issue with unsigned agreements in PTSC's home state file that relate to the Jones stock redemption and Mr. Jones's continued relationship with the firm. The NOI does not cite a §26.85(d)(2) good cause reason for objecting to PTSC's certification, but we infer (see below) that the reason is that the home state certification is "factually erroneous" or "inconsistent with" applicable certification provisions within the meaning of §26.85(d)(2)(iii).<sup>8</sup>

PTSC filed a written response to the NOI's findings on November 18, 2016 and attended an informal hearing on the matter on November 28, 2016. PTSC asserted that Ms. Springer owns and controls all aspects of the firm's business. PTSC also offered to give PAUCP copies of executed agreements to resolve the concern raised in the NOI.<sup>9</sup>

PAUCP issued its decision to deny PTSC's interstate application on December 5, 2016, expressly rejecting PTSC's proffer. The decision states that:

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<sup>4</sup> Ms. Springer has worked at PTSC since 1985 performing in inside and outside sales roles. She has been a member of PTSC's board of directors since 2002. Before assuming the role of President, she served as the Board's Vice President and Secretary. *See* L. Springer Résumé.

<sup>5</sup> PTSC asserts that, "[t]his employment relationship was negotiated as further consideration for the purchase of his 82 shares of common stock primarily so that the Company would continue to provide James Jones with hospitalization and major medical insurance coverage." PTSC Appeal at 4; *see also* PTSC Response to NOI (November 18, 2016). Mr. Jones has no voting rights under the redemption arrangement.

<sup>6</sup> Ms. Springer later became 100% owner after PTSC redeemed minority owners Laurie Ramsey's (Mr. Jones' daughter) and Carrie Sturgeon's shares. Ms. Ramsey and Ms. Sturgeon left the firm after a dispute with Ms. Springer. *See* PTSC Appeal at 7.

<sup>7</sup> The West Virginal Unified Certification Program granted PTSC DBE certification on August 26, 2016.

<sup>8</sup> The Department has repeatedly ruled that §26.85 *requires* the certifier to state good cause in its NOI. We admonish PAUCP to comply with the rule.

<sup>9</sup> At the hearing, PTSC explained that the firm's attorney has the executed copies of the agreements.

As a result of the meeting, our concerns regarding the erroneousness of your home state DBE certification as outlined in our denial letter were confirmed. During the meeting, you stated that your lawyer advised you that it was not necessary to fulfill our request to provide signed copies of the various agreements but you would be willing to do so now. Although the copies of the agreements provided to us and your home state were not signed, you confirmed that they had been executed and have been or are being satisfied per the terms of the agreements. *Please be advised that submitting signed documents wouldn't affect our decision.*

Consequently, you are hereby notified that we find your home state DBE certification erroneous and your firm does not meet the qualifications for certification as a DBE. Therefore, our decision to deny your [firm's application for interstate certification] stands.

PAUCP Denial Letter (December 5, 2016) at 1. (Emphasis added.)

## II. Discussion and Decision

The interstate certification provision was specifically drafted to limit the grounds for not honoring a home state (State A) certification to the five “good cause” reasons set forth in §26.85(d)(2). Although PAUCP does not cite a §26.85(d)(2) good cause reason to deny PTSC's interstate application we infer that the good cause ground for denial is §26.85 (d)(2)(iii). This ground states that a subsequent certifier (State B) may deny an interstate application if “State A's certification was factually erroneous or was inconsistent with [certification] requirements.” §26.85(d)(2)(iii).

The Department's Interstate Certification Guidance clarifies the meaning of the terms “factually erroneous” and “inconsistent with the requirements [of the Regulation].” *See generally* Interstate Certification Guidance (July 9, 2014) at 4-5. Our Guidance explains that “[m]ere interpretive disagreements about the meaning of a regulatory provision or a factual conclusion or inferences do not form a ground for denial. Rather, *State B would have to cite information in the home state's certification material or other material submitted by the DBE that directly contradicts a provision in the regulatory text or simply gets wrong a critical fact.*” *Id.* at 4. (Emphasis added.)

As we discuss below, PAUCP's denial was inconsistent with applicable substantive or procedural Regulation provisions under §26.89(f)(2).

### A. *Unsigned Documents*

First, the Regulation does not explicitly require the provision of signed versions of certain documents to which PAUCP objected, nor does it preclude PTSC from providing them in response to PAUCP's NOI. PAUCP erred in not accepting PTSC's proffer. *See* 15-0044 *Three Oaks Engineering, Inc.* (October 16, 2015) (Applicant may introduce new information not in State A file in response to State B's NOI, and State B must consider that information in making its interstate certification decision.) Further, the fact that the home state possibly based its decision on unsigned documents does not necessarily make the home state's certification

“inconsistent with” the certification requirements—and PAUCP makes no actual case that they do. *See generally* NOI at 1-5; §§26.85(d)(4)(i), 26.86(a).<sup>10</sup> Finally, the Regulation does not preclude PTSC from amending its home state file to include executed agreements. *See Three Oaks, supra*.

We note that the unsigned documents have no effect on the substantive provisions—§§26.69(h), 26.71(b), 26.71(e), and 26.71(i)—that PAUCP cites to support its apparent position that Ohio’s certification was either factually erroneous or inconsistent with the Regulation.

#### B. §26.69(h)

Section 26.69(h) establishes a presumption of non-ownership. The provision is triggered when a socially and economically disadvantaged individual acquires her ownership interest “as a result of a gift, or transfer without adequate consideration” from a non-disadvantaged individual who remains involved in the firm, an affiliate, or a firm in a similar line of business. *See* §26.69(h)(1).<sup>11</sup>

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<sup>10</sup> It is insufficient under §26.85 simply to observe that an unexecuted promissory note and employment agreement are “unenforceable.” *See generally* §26.85(d)(2)(iii) and related guidance discussed on the previous page.

<sup>11</sup> The full provision states:

(h)(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.

Assuming *arguendo* that §26.69(h)(1) were to apply to the facts of this case, PAUCP merely takes issue with Mr. Jones’ continued relationship with the firm, which alone does not establish that its certification is factually erroneous or inconsistent with the provisions of §26.69(h). A firm may overcome the presumption of non-ownership under §26.69(h)(2), and it is undisputed that Ms. Springer holds present control of PTSC’s management, policy, and operations. Further, Ms. Springer appears to have acquired her initial shares in a §26.69(j)(1) transaction not subject to §26.69(h) at all. (Finally, PAUCP does not question Ms. Springer’s technical competence or overall

In this case, Ms. Springer became PTSC's majority owner because of PTSC's stock redemption. Ms. Springer formally acquired none of her PTSC shares "from" Mr. Jones. We find no substantial evidence that 26.69(h) applies in this case at all because there is no §26.69(h)(1) "gift" or "transfer without adequate consideration." Thus, PAUCP's objection as it pertains to this rationale does not give rise to a valid §26.85(d)(2)(iii) good cause reason to deny certification.

*C. §26.71(e)*

Section 26.71(e) 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."

PAUCP asserts that Mr. Jones could regain control of PTSC *if* the firm defaults on the required payments to Mr. Jones, which would be a future event. *See* NOI at 3. Section §26.71(e) prohibits a non-disadvantaged participant from possessing or exercising (both present tense) the power to control the firm, not from regaining such power in the future. *See also* §26.73(b)(1) (certifiers "must evaluate the eligibility of a firm on the basis of present circumstances.") PAUCP's §26.71(e) denial ground is therefore inconsistent with the Regulation's requirements and does not form a valid basis to conclude that State A's certification was erroneous.

*D. §26.71(i)(2)*

PAUCP takes issue with Mr. Jones's compensation. The three-year employment agreement gives Mr. Jones an annual salary of \$51,939, a yearly bonus of \$81,000, and fringe benefits. *See* NOI at 4. Section 26.71(i)(2) states:

In a case where a non-disadvantaged individual formerly controlled the firm, and a socially and economically disadvantaged individual now controls it, you may consider a difference between the remuneration of the former and current controller of the firm as a factor in determining who controls the firm, *particularly when the non-disadvantaged individual remains involved with the firm and continues to receive greater compensation than the disadvantaged individual.*

(Emphasis added.) We emphasize that this provision contains no actual salary requirement. It provides that the certifier *may consider* a salary *differential* between disadvantaged and non-disadvantaged participants. That differential, to elicit a control concern, normally involves the non-disadvantaged participant earning *more* than the disadvantaged participant. PAUCP identifies no differential at all.

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understanding of the business under §26.71(g) whereas Ms. Springer's years of experience and expertise performing and overseeing the PTSC's primary business activities strongly suggest that State A's certification was not erroneous in regard to that section.) PAUCP's §26.69(h) objection amounts at best to "mere interpretive disagreement" with the home state.

### E. §26.71 (b)

The record (corporate tax returns, 2013-2016) shows that in fact disadvantaged owner Ms. Springer received a *higher* salary than Mr. Jones, which tends to reinforce the home-state's determination that she controls the firm. Even if Mr. Jones made more money than Ms. Springer, however, that fact alone is merely *a factor* in determining control: it does not of itself make the home state certification "erroneous," even though PAUCP might have a difference of opinion. *See generally* Interstate Certification Guidance at 4.

PAUCP found that PTSC's office lease agreement violates the requirements of §26.71(b). Specifically, PAUCP contends that "[t]he [l]ease [a]greement gives rise to the *appearance of self-dealing*, as the lessor, PTS Associates Limited, is owned by Mr. Jones and another former, non-DBE owner of Power Tool and Supply Company. The [l]ease term is for sixty months. . . and PTS Associates Limited] is responsible for all utility payments." NOI at 4 (emphasis added).<sup>12</sup>

Section §26.71(b) states, "Only an independent business may be certified as a DBE." An independent business is defined as "one the *viability of which does not depend on its relationship with another firm or firms.*" (Emphasis added.) The provision's subsections set forth a four-part test for assessing a firm's viability in relation to other firm(s). *See* §26.71(b)(1)-(4).

The Regulation requires that a certifier examine all four independence factors as we must assume the home state did in determining PTSC eligible for certification.<sup>13</sup> In any case, PAUCP reaches its contrary conclusion based solely on §26.71(b)(1). PAUCP does not explain how the relationship with PTSAL comprises PTSC's independence (as opposed to creating the appearance of self-dealing). The specific evidence cited is unlikely sufficient to sustain even an initial denial. The mere existence of the landlord-tenant arrangement described does not alone demonstrate that PTSC's viability depends on its relationship with PTSAL. The record contains no substantial evidence that PAUCP's independence concern renders the home-state determination erroneous or inconsistent with applicable certification rules.

### III. Conclusion

In summary, PAUCP simply re-examined issues that the home state decided and substituted its own judgment for that of the home state. None of PAUCP's denial grounds, as elaborated in the NOI and summarily affirmed in the NOD, renders the home state decision factually erroneous or inconsistent with the Regulation's requirements. Accordingly, PAUCP had no valid §26.85 ground for denying interstate certification.

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<sup>12</sup> PTSC asserts that Mr. Jones no longer holds an ownership interest in PTS Associates Limited (PTSAL).

<sup>13</sup> *See* 17-0004 Information Logistics, Inc. (April 14, 2017) at 3 ("under the [interstate certification] rule, the home state's certification decision is to be given deference by states in which the applicant seeks certification thereafter").

We therefore reverse under §26.89(f)(2) and direct PAUCP to certify PTSC without delay.

This determination is administratively final.

Thank you for your continued cooperation.

Samuel F. Brooks  
DBE Appeal Team Lead  
Disadvantaged Business Enterprise Division

cc: PTSC