November 21, 2017

Reference Number 17-0053

Howard Estes, Esq.
Spotts Fan Attorneys & Counselors at Law
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Suite 600
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Dear Mr. Estes:

D.M. Conlon, Inc., appeals the Virginia Unified Certification Program's (VUCP)[1] December 12, 2016, denial of its application for interstate Disadvantaged Business Enterprise (DBE) certification, under criteria set forth at 49 C.F.R. part 26 (the Regulation). After a careful review of the entire administrative record, we find that substantial evidence supports VUCP's decision, and that the decision is consistent with the substantive and procedural provisions concerning certification. We therefore affirm under §26.89(f)(1).

Substantial evidence supports VUCP's (State B) conclusion that DMC's home state's (State A) certification of the firm was "factually erroneous or was inconsistent with the requirements of the [Regulation's certification provisions"]. *See* §26.85(d)(iii). Specifically, substantial evidence supports VUCP's conclusion that DMC did not satisfy the documentation requirements of §26.69(f)(1)(vi) or demonstrate that the disadvantaged owner controls the firm's Board of Directors (BOD). *See* §26.71(d)(2) (disadvantaged owner control the firm's BOD).

I. Procedural History

The South Carolina Department of Transportation (SCDOT) certified DMC as a home-state DBE on October 26, 2015.[2] DMC applied for interstate certification in Virginia on January 28, 2016, and VUCP issued a "good cause" notice of its intent to deny (NOI) the application on July 12, 2016.[3] DMC responded to the NOI in writing on August 8, 2016, October 17, 2016, and also

[1] The Virginia Department of Small Business and Supplier Diversity (VDSBSD) is the agency that issued the denial.

[2] In response to a previous application, SCDOT denied DMC certification based on similar control grounds and reasons at issue in this case. *See* SCDOT Denial Letter (March 11, 2014). SCDOT, however, later certified the firm as a DBE for reasons unascertainable from this administrative record.

[3] VUCP chose not to verify the South Carolina certification and certify the firm in Virginia as §26.85(b) allows. Instead, VUCP reviewed the interstate application under the procedures described in §26.85(c). Substantial evidence shows that VUCP properly followed the procedural requirements of interstate certification (e.g., issued a good cause notice and gave the firm a fair opportunity to respond to the particularized issues raised within the notice.)

presented arguments at an informal meeting with VUCP on October 24, 2016.[4] DMC sent additional arguments and supporting documents to VUCP on November 9, 2016. VUCP denied DMC's interstate application on December 12, 2016 (Denial Letter), and DMC appealed the decision to the Department on March 9, 2017 (Appeal Letter).

II. Background

Kelly Conlon and Dana Conlon (Ms. Conlon's nondisadvantaged husband) formed DMC in 1983.[5] Mr. and Ms. Conlon initially contributed **REDACTED** in marital assets to each acquire a 50% ownership interest in the firm. Mr. Conlon acted as DMC's Chairman, CEO, and President until he resigned from the positions in December 2012. After the resignation, Ms. Conlon assumed her husband's roles and responsibilities at DMC.[6]

Two years after his resignation, Mr. Conlon transferred a 35% ownership interest to Ms. Conlon and a 10% ownership interest to his nondisadvantaged son (Mr. Conlon retained the remaining 5% ownership interest). Although Ms. Conlon paid nothing for the shares Mr. Conlon transferred to her in 2014, DMC argues that she acquired the 35% interest in exchange for her contribution of expertise. *See* Response to NOI (November 9, 2017) (Response) at 4.[7] State A's file contains BOD meeting minutes from December 2014, which DMC claims prove that Ms. Conlon acquired her additional ownership by contributing expertise. *See id.* The relevant portion of the minutes provides:

> The Chairman, Kelly B. Conlon, discussed the reorganization of [DMC] following the retirement of Dana M. Conlon from the day-to-day operations of the business. The Chairman reflected upon the fact that over the past year Mr. Conlon had shifted his role from consultant to more of an on-call advisor; and, that value his services are still valued it was now up to the Chairman in her capacity as CEO to now lead the Corporation through the knowledge and experience she gained over the years from Mr. Conlon's guidance to lead the Corporation forward.
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> *Because of Mr. Conlon's retirement, the Chairman discussed the fact that his shares of stock in the Corporation were partially assigned to her*.

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[4] DMC bears the burden of demonstrating, by a preponderance of evidence, that it meets the requirements of [the Regulation's certification provisions] with respect to the particularized issues raised by State B's notice. The firm is not otherwise responsible for further demonstrating its eligibility to State B. §26.85(d)(4)(iii).

[5] DMC primarily engages in "concrete and asphalt cutting services." DMC Uniform Certification Application (UCA) at 2.

[6] Mr. Conlon remained a director, which means that §26.69(h) (which VUCP raised) could be in play. Our conclusions relating to §§26.69(f), 26.71(d)(2), and 26.85(d)(4)(iii) being sufficient to affirm VUCP's decision, however, we do not opine on the §26.69(h) ground.

[7] As the Denial Letter correctly found, "[a]t no point in the contents of the copy of the South Carolina file is it asserted that expertise was part of the contribution to gain [Ms. Conlon's] ownership. It was not until after receipt of our letter of intent to deny your firm dated July 12, 2016 and during the in-person meeting on October 24, 2016, that [she] assert that expertise was part of [her] contributions for [her] to gain ownership." Denial Letter at 6.

> . . . .
> Such re-distribution being the result of Dana M. Conlon assigning 34,000 shares to his wife, Kelly B. Conlon *in consideration of her dedication to the Corporation, her assumption of her role of Chief Executive Officer, and her capable management of the day-to-day affairs of the Corporation since his full withdrawal from daily affairs of the Corporation earlier in the year*.

Minutes of Special Joint Meeting of Shareholders and Directors of D. M. Conlon, Inc. (December 14, 2014) (December 2014 Minutes) at 1. (Emphasis added.)

Ms. Conlon is DMC's current 85% owner, Chairman/CEO, and President; Mr. Conlon is DMC's 5% owner and director; their nondisadvantaged son is the firm's 10% owner, Vice President, and director. Three other nondisadvantaged individuals serve as directors.[8] *See generally* Minutes of Special Joint Meeting of Shareholders and Directors of D.M. Conlon, Inc. (November 1, 2016) ("November 2016 Minutes"). Ms. Conlon (President), her son (Vice President), and Kelly Johnson (DMC's nondisadvantaged Secretary and Treasurer), serve as the firm's officers. UCA at 9.[9]

As it pertains the governance and control of the BOD, the relevant portions of DMC's Amended Bylaws (Bylaws) provide:[10]

> **Amended bylaws (2015) Article 3.1 General Powers.** *The business and affairs of the Corporation shall be managed by its Board of Directors* under the general direction and guidance of the Chairman of the Board/Chief Executive Officer.
>
> . . . .
>
> **Amended bylaws (2015) Article 3.6 Quorum.** *A majority of the elected officers of the Corporation shall constitute a quorum*; provided that the elected officers were elected as provided for in this Article III. Should less than a majority of the elected officers be present at the called time of a meeting of the Board, the majority of those directors present shall vote to reschedule the meeting and thereafter adjourn the meeting until such time as a quorum shall be present.
>
> **Amended bylaws (2015) Article 3.7 Manner of Acting.** *The act of the majority of the directors present at a meeting at which a quorum is present at the onset of such meeting shall be the act of the Board of Directors*.
>
> **Amended bylaws (2015) Article 3.7.1 Board Deadlock.** In the event of a vote by and among the Board of Directors on any matter brought before the Board, the vote of the Chairman of the Board shall serve as the tie-breaking vote, *if and only the*

[8] The Appeal Letter does not dispute the Denial Letter's finding that DMC's other directors are nondisadvantaged. Since nothing in the record (Virginia's or South Carolina's) demonstrates that these directors are socially and economically disadvantaged, we consider them nondisadvantaged. *See generally* §§26.61(b), (c).

[9] Ms. Johnson is considered nondisadvantaged for the reasons stated in footnote 8.

[10] The 2015 Amended bylaws are the provisions applicable to this case.

> *Board shall become deadlocked upon an issue and a secret ballot cast by the Board Members shall result in a tie-vote after a voice vote and subsequent discussion* being held. In such case, the secret ballot shall be taken of the Board with the Board Chairman circling his/her vote to identify the ballot should it have to be used as a tie breaking vote. *Should a Board Member change his/her vote and the deadlock be broken the Board Chairman's vote shall be counted as it would in any other Board matter*.

(Emphasis added.)

VUCP presents two main reasons for finding that State A's certification is inconsistent with the Regulation's certification requirements, under §26.85(d)(2)(iii).

First, VUCP concedes that Ms. Conlon initial contribution to obtain her 50% ownership was real and substantial. However, the Denial Letter takes issue with Ms. Conlon's claimed contribution of expertise to obtain her additional 35% ownership interest. *See generally* §26.69(f) (conditions for counting contribution of expertise toward disadvantaged ownership).[11] The Denial Letter found that DMC's corporate records "attribute the assignment of shares to [Ms. Conlon] based on dedication [to the firm] and [Ms. Conlon] assuming new and additional duties as CEO. [The records], however, fail[] to *clearly* show what [Ms. Conlon's] *expertise* is, and also fail[] to *clearly* show what such expertise's value is to the firm." Denial Letter at 6 (emphasis in the original); *see also* §26.69(f)(1)(vi)(documentation requirements). VUCP concludes that Ms. Conlon "did not meet all of the requirements in order for expertise to be counted towards [her] contributions to gain ownership, and [her] majority ownership resulting from the transfer from Dana Conlon is only *pro forma*." Denial Letter at 6.

Second, VUCP opines that the bylaw provisions contained within Articles 3.1, 3.6, and 3.7 create impermissible §26.71(d)(2) restrictions. The Denial Letter specifically states that:

> Even though [Ms. Conlon's] presence is required to form a quorum, there is still a requirement for the presence of a majority of the officers, which means that, even though [Ms. Conlon's] presence is required, *[she does] not have the ability to form a quorum without at least one of the other officers, and [she] still require[s] the participation, and therefore cooperation, of at least one of the officers, each of whom are not disadvantaged.* This is counter to the regulations, which state that there can be no restrictions. . . that prevent the socially and economically

[11] §26.69(f) states:

> The following requirements apply to situations in which expertise is relied upon as part of a disadvantaged owner's contribution to acquire ownership: (1) The owner's expertise must be—(i) In a specialized field; (ii) Of outstanding quality; (iii) In areas critical to the firm's operations; (iv) Indispensable to the firm's potential success; (v) Specific to the type of work the firm performs; and (vi) Documented in the records of the firm. These records must clearly show the contribution of expertise and its value to the firm. (2) The individual whose expertise is relied upon must have a significant financial investment in the firm.

> disadvantaged owners, without the cooperation or vote of any non-disadvantaged individual, from making any business decision of the firm."
>
> *[Ms. Conlon] require[s] the cooperation of at least one of the other officers to control the business and affairs of DMC*. As a result, the other officers . . . none of whom are demonstrably disadvantaged, possess the power to control DMC, which is counter to the regulations, which state that individuals who are not socially and economically disadvantaged must not possess the power to control the firm.

Denial Letter at 9. (Emphasis added.)

VUCP, in short, concluded that the BOD controls DMC, but Ms. Conlon's control of the BOD is subject to the cooperation or assent of the firm's nondisadvantaged directors, whom Ms. Conlon must rely on to transact any business through the board.[12]

III. Discussion

The Appeal Letter presents three arguments for reversal:

1) VUCP "improperly substituted its review and findings for the legitimate findings in Conlon's home state of South Carolina." Appeal Letter at 1.[13]
2) VUCP "improperly determined that there was insufficient evidence regarding acquisition of the ownership in Conlon by the socially and economically disadvantaged owner representing at least 51% of Conlon." *Id.* at 2.
3) VUCP "improperly determined that there was insufficient evidence demonstrating that the socially and economically disadvantaged owner has control over Conlon." *Id.*[14]

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[12] The bylaws and the denial letter demonstrate that both the firm and the certifier include directors in the term "officers".

[13] Specifically, the Appeal Letter argues:

> In order to even get to the denial of certification, [VUCP] had to find a discrepancy in the file from South Carolina's determination as Conlon's home state. Of note, prior to its review in Virginia, Conlon has been certified as a DBE in several other jurisdictions, including South Carolina, North Carolina, the City of Atlanta and the State of Georgia. The revisiting of the home state file to such a degree and subsequent denial misreads South Carolina law, corporate law, administrative law decisions on DBE status in South Carolina and misrepresents the file evidentiary record. [VUCP]'s efforts are a chilling effect on out of state filers, when there was no justification to make the findings and determinations in areas of record for which they have no expertise.

Appeal Letter at 1. We note that the (federal) Regulation governs eligibility for DBE certification and that it relies on state law determinations in only a handful of circumstances not directly in issue here. General South Carolina law, its corporate law, and its administrative law decisions have little to no bearing on the Virginia certifier's determination of DBE eligibility in Virginia, under the Regulation.

[14] Specifically, the Appeal Letter states:

> [VUCP] improperly has determined that the Board of Directors have been assigned control of the company by Ms. Conlon. As a practical matter and as presented in the meeting with [VUCP] on October 26, 2016, Ms.

The Department considers these arguments in the sections below.

1. The first question before the Department is whether VUCP erroneously substituted its own judgment for that of State A in violation of §26.85(d)(2)(iii).

In this instance, VUCP properly relied on several documents within State A's file (e.g. UCA, bylaws, and meeting minutes) to find valid good cause reasons, under §26.85(d)(2)(iii), to not accept DMC's home state certification and to initiate proceedings to deny DMC's interstate certification.[15] In short, the denial was not based on mere interpretive disagreements, rather the denial was consistent with §26.85(d)(2)(iii). We affirm under §26.89(f)(1).

2. The second issue is whether DMC documented Ms. Conlon's expertise and its value in the firm's records.

The pertinent provision is §26.69(f)(1)(vi), which explicitly requires, in order to be counted as a capital contribution for purposes of determining substantiality of capital and thus disadvantaged ownership under §§26.69(c) and (e), that the owner's expertise (contributed in exchange for her majority ownership interest) be *"[d]ocumented in the records of the firm. These records must clearly show the contribution of expertise and its value to the firm*." (Emphasis added.)

In this case, DMC proffered the December 2014 Minutes as proof of Ms. Conlon's documented contribution of expertise.[16] The Minutes state that Ms. Conlon became majority owner "in consideration of [Ms. Conlon's] dedication to the Corporation, her assumption of her role of Chief Executive Officer, and her capable management of the day-to-day affairs of the Corporation since [Mr. Conlon's] full withdrawal from daily affairs of the Corporation earlier in the year." December 2014 Minutes. The minutes do not "clearly show the contribution of expertise and its value to the firm." Rather, the minutes demonstrate that Ms. Conlon received her additional ownership because she assumed Mr. Conlon's responsibilities, not because she

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> Conlon manages and directs the day-today-day affairs of the company. Despite having the ability to remove a Board member at any time with or without cause, in an effort to clarify this control of the Board and the company, the Bylaws of Conlon were amended in 2016 so that Ms. Conlon must always be present for a quorum. [VUCP] speculated that the Board could vote against her wishes even with the threat of removal. This makes no sense and is contrary to South Carolina statute and administrative case law as set forth in the 2016 Appeal file. Furthermore, the speculation of Board control as that by [VUCP] has the perverse effect that no incorporated subchapter C company business with a Board can be DBE certified unless current board members are vetted periodically and accounted for individually meeting disadvantaged standards. This reaches far beyond the regulatory framework.

Appeal Letter at 3.

[15] Based on documents in State A's file, VUCP reasonably questioned whether Ms. Conlon's ownership was real and substantial and whether bylaw provisions prevented her from controlling the BOD.

[16] It is undisputed that DMC meet its burden of proof regarding the other subsections of §26.69(f). *See* Denial Letter at 6 ("[r]egarding the other six requirements regarding the expertise itself, based on the evidence, we find that your purported expertise is in a specialized field, of outstanding quality, critical to your firm's operations, indispensable to your firm's potential success, and specific to the types of work your firm performs.)

contributed qualifying expertise at all. Moreover, the Regulation does not recognize as real and substantial any ownership interest acquired exclusively in exchange for work performed as an officer or employee. The firm's corporate records simply make no mention of the specific expertise that Ms. Conlon contributed to the firm or its value in relationship to the new shares she acquired in 2014, those that resulted in her nominally owning more than 51% of DMC. The appellant simply fails to carry its burden of proof with respect to Ms. Conlon's alleged contribution of expertise.

Accordingly, we conclude that there is substantial evidence to support VUCP's determination that the purported contribution of expertise does not meet the requirements of §26.69(f). Therefore, the purported contribution of expertise (which was not contemporaneously made with receipt of the new shares) is not real and substantial under §26.69(e). Ms. Conlon's ownership of the transferred 35% interest insubstantial under §26.69(c) and her resulting real and substantial ownership interest is 50%, which is insufficient to meet the 51% disadvantaged ownership requirement of §26.69(b). We affirm under §26.89(f)(1).

3. The third issue is whether Ms. Conlon controls DMC's BOD within the meaning of §26.71(d)(2).

DMC's bylaws clearly state that "the business and affairs of [DMC] shall be managed by its Board of Directors" and not by Ms. Conlon acting in her individual capacity. Article 3.1; *see* Article 3.7 ("The act of *the majority of the directors* present at a meeting at which a quorum is present at the onset of such meeting shall be the act of the Board of Directors.") (Emphasis added). Ms. Conlon is the only disadvantaged officer and director. Because each director present has an equal vote, and Ms. Conlon cannot constitute a quorum alone, Ms. Conlon requires the cooperation or assent of nondisadvantaged persons (directors) to transact any business at all through the board, which per Article 3.1 manages DMC.[17] In short, substantial

[17] DMC called a special board meeting, on November 1, 2016 (after the informal meeting with VUCP), "in order to address the concern raised by [VUCP]." Response at 5. The BOD adopted the following proclamation:

> Be it known that the Corporation recognizes the leadership of its Chairman is indispensable, as such, no meeting of the Board of Directors, Shareholders, or joint meeting of the same shall be held or achieve a quorum in which business may be conducted unless the Chairman shall be present at the meeting at all times, unless such meeting shall be called due to the sudden/unexpected death or incapacity of the Chairman, in which case the meeting shall be called for the express purpose of temporary/succession leadership until the Chairman's health shall improve or to reveal her testamentary wishes for the successor leadership of the Corporation**. . . .** Kelly Conlon as Chairman of the Board and Chief Executive Officer of the Corporation with all powers and duties commensurate with such position, including but not limited to the power to oversee all Corporate activities, direct and control all Board of Directors meetings, create and disseminate all information regarding the Corporation's activities, and such other actions and activities usually associated with the positions of Chairman of the Board and Chief Executive Officer.

November 2016 Minutes.

The proclamation merely states that Ms. Conlon must be present to establish quorum and to conduct BOD meetings, however, the proclamation does not address the fact that Ms. Conlon needs the concurrence of nondisadvantaged directors to carry any BOD vote. *See* Articles 3.1 and 3.7. Nor does DMC discuss the Article 3.6 provision that requires the presence of nondisadvantaged officers or directors to establish a quorum.

evidence supports VUCP's conclusion that DMC's bylaws prevent Ms. Conlon from controlling the board within the meaning of §26.71(d)(2).[18]

DMC argues that:

> South Carolina law provides direct authority that directors may be removed by the majority in interest of shareholders. *See* S.C. Code Ann. § 33-8-108(a). As such, the Board of Directors serves at the pleasure of the majority in interest of the shareholders. Owning 85% of DMC, [Ms. Conlon] fully controls the Board. If the Board made or sought to make a decision contrary to [Ms. Conlon's] position or decision, she may simply rescind the decision or replace recalcitrant Board members so that a vote is consistent with her management and control decisions.

Response at 4.

We have routinely rejected similar arguments as inconsistent with the Regulation. *See, e.g.,* 16-0064 Ryan Biggs/Clark Davis Engineering and Surveying, P.C. (August 12, 2016) at 7-8 (authority under state law to replace nondisadvantaged directors did not give majority shareholders present control of BOD on which they could be outvoted.); 16-0015 Tollie's Landscaping & Lawn, Inc. (June 10, 2016) at 6 (ability to call shareholder meeting to vote to change board composition did not give majority shareholder present control of board consisting of one nondisadvantaged director and one disadvantaged director, when each director had one vote and a majority of directors was required for a quorum and to carry board votes); 15-0138 Norfolk Machine & Welding, Inc. (February 24, 2016) at 4-5.[19] The Regulation requires the Department to examine the firm's present circumstances not speculate about actions that may occur in the future. *See* §§26.89(f)(6) and 26.73(b). DMC's argument that Ms. Conlon might later change the composition of the board in the future is simply unavailing and not an omission or error described in §26.89(c).[20]

Finally, DMC provides no support for its claim on appeal that Ms. Conlon has independent authority (other than her power as the firm's 85% shareholder to remove directors by shareholder vote) to "rescind" board decisions, and we find none in the record. Her general authority to "supervise and control all of the business and affairs of the Corporation" is explicitly "subject to the control of the Board of Directors." Article 5.5.

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[18] The bylaws grant Ms. Conlon, as President, general authority to "supervise and control all of the business and affairs of the Corporation," but that authority is explicitly "subject to the control of the Board of Directors." Article 5.5.

[19] For the same reasons, we find no merit in DMC's reliance on South Carolina administrative court precedent, to which neither VUCP nor the Department is subject.

[20] §26.89(c) states that the appeal must "set[] forth a *full and specific* statement as to why the [certifier's] decision is erroneous, what significant fact that the recipient failed to consider, or what provisions of this Part the recipient did not properly apply." (Emphasis added.)

In summary, Ms. Conlon does not control the board of directors within the meaning §26.71(d)(2). Substantial evidence supports VUCP's conclusion, which we affirm under §26.89(f)(1).

IV. Conclusion

We affirm under §26.89(f)(1) VUCP's interstate ineligibility determination based on §§26.85(d)(2)(iii); 26.69(b), (c), and (f); and 26.71(d)(2) grounds because substantial evidence supports it and it is consistent with applicable certification rules.

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

Sincerely,

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

cc: VUCP