September 12, 2017

Reference Number: 17–0082

Laura Ballew, President
DMV Fire & Flood, LLC
7800 Airpark Road, Unit 9
Gaithersburg, MD 20879

Re: DMV Fire & Flood, LLC Appeal of DBE Certification Denial

Dear Ms. Ballew:

DMV Fire & Flood, LLC (DMV) appeals the Maryland Department of Transportation's (MDOT) denial of its application for Disadvantaged Business Enterprise (DBE) certification, pursuant to the DBE Program Regulation, 49 C.F.R. Part 26 (the Regulation).

DMV applied for DBE certification on October 17, 2016. MDOT conducted an on-site visit to the firm's offices on September 16, 2016, and held an eligibility review meeting with you on December 7, 2016. MDOT denied DMV's application on March 2, 2017 because DMV was unable to demonstrate that you, the firm's majority owner, own and control the firm as required by §§26.69(c), 26.71(c), (d), (f) and (g). The firm appealed MDOT's decision to the U.S. Department of Transportation, Departmental Office of Civil Rights (the Department), on April 13, 2017. After carefully reviewing the entire administrative record, affirm the agency's conclusions with regards to §§26.71(c) and (d).[1]

Control Grounds §§26.71(c) and (d)

As the applicant firm, DMV bears the burden of demonstrating to MDOT by a preponderance of the evidence, that it meets the requirements for the DBE program, including the provisions related to group membership or individual disadvantage, business size, ownership, and control. *See* §26.61(b).

[1] When a firm appeals a certification denial determination, 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. §26.89(e). The Department affirms 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." §26.89(f)(1). The Department's decision is based on the status and circumstances of the firm as of the date of the decision being appealed; the Department does not consider new evidence that was not before the certifier when making a decision. §26.89(f)(6).

You and Craig Rosenthal, a non-disadvantaged individual, began DMV in 2016, and own 51 and 49% of the firm, respectively. MDOT found that the "supermajority requirement" contained in DMV's Operating Agreement prevents you from making business decisions of the firm, because under its terms you need the cooperation of Mr. Rosenthal, contrary to §26.71(c) and (d). Section 26.71(c) prohibits restrictions in the firm's by-laws that prevent disadvantaged owners, without the cooperation or vote of any non-disadvantaged individuals, from making firm decisions,[2] while §26.71(d)(2) requires that disadvantaged owners must control the board of directors.[3] In MDOT's view, Mr. Rosenthal's cooperation is needed if you and/or the firm wished to bind the company (§6.2.1); incur debt more than **REDACTED** (§6.2.2(b)); obligate the company as surety or guarantor (§6.2.3); and execute agreements, documents; and other instruments (§6.2.2). In addition, any difference arising as to the authority of a member shall be decided by a majority of members.

We agree that these provisions are not in accordance with the rule. *See* 16-0015, *Tollie's Landscaping & Lawn, Inc.* (June 10, 2016) (disadvantaged director needed non-disadvantaged director's presence and assent to form a quorum and concurrence to carry any board vote). Mr. Rosenthal can effectively veto your actions as DMV's disadvantaged owner; and therefore, you do not control the company within the meaning of §26.71(d). Accordingly, the firm does not satisfy the requirements of §26.71(c) because there are provisions 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."

The first counter argument presented by your appeal is that §1.1 of the Operating Agreement cures any provision that is contrary to the rule. Section 1.1. states: "Any provision of this agreement that would prevent the company from obtaining a certification as a majority owned business shall be invalid and unenforceable and shall be null and void *ab initio*." Adopting your position would circumvent §26.73(b)(1), which requires a certifier to "evaluate the eligibility of a firm on the basis of present circumstances." The Department's decisions have uniformly rejected this position. *See, e.g.*, 16-0064, *RBCD Engineering* (August 11, 2016) (fact that disadvantaged directors could vote in future, in their capacity as shareholders, to replace non-disadvantaged directors did not alter present circumstance that disadvantaged directors did not control board). In a similar situation, the Department concluded that "[p]rojected events are generally not, in the Department's view, ones within the certifier's purview under §26.73(b)." *Id*. (*citing* 16-0015,

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[2] §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)."

[3] §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."

Tollie's Landscaping & Lawn, Inc. (June 10, 2016)). The certifier and the Department must ground their determinations of control based on the firm's facts and circumstances at the time of the DBE certification application. *See* §§26.73(b)(1) and 26.89(f)(6). The circumstances at the time of MDOT's decision were that you did not have the mathematical voting ability to control the firm's decision-making, contrary to the requirements of §§26.71(c) and (d)(2).

The second counter argument is that the firm revised its Operating Agreement. However, as you indicated in your appeal, this information was never presented to MDOT. As stated above, the Department does not conduct a de novo review on appeal, but rather makes a decision "based solely on the entire administrative record as supplemented by the appeal." §26.89(e). The de novo review standard limits the Department's review to the evidence and grounds presented to MDOT. In this case, the supplemental information does not clarify the record presented to MDOT, but rather introduces new information. The Department, however, is limited by the Regulation in how it reviews DBE appeals. As the Regulation's Preamble states:

> [t]he purpose of the appeal is to provide the appellant an opportunity to point out to the Department, through facts in the record and/or arguments in the appeal letter, why the certifying agency's decision is not ''supported by substantial evidence or inconsistent with the substantive or procedural provisions of [Part 26] concerning certification.'' It is not an opportunity to add new factual information that was not before the certifying agency. (79 Fed. Reg. at 59579 (Oct. 2, 2014)).

As a result, the provided information is inadmissible, and the Department bases its affirmation on the record DMV provided to MDOT. We therefore affirm.

Ownership §26.69(c)

We do not uphold the MDOT's conclusions regarding §§26.69(c). The record contains a notarized statement indicating that your mother, an owner of a fire and flood restoration business, gifted you equipment and vehicles from her company, valued at $28,710.00. MDOT stated that your initial investment of **REDACTED** to acquire your 51% ownership interest in DMV did not meet the requirements of §26.69(c), a provision that require in part, the disadvantaged owner demonstrating a real, substantial, and continuing (non-pro-forma) contribution of capital or expertise to acquire their ownership interests.[4]

[4] §26.69(c) states: "(1) The firm's ownership by socially and economically disadvantaged individuals, including their contribution of capital or expertise to acquire their ownership interests, must be real, substantial, and continuing, going beyond pro forma ownership of the firm as reflected in ownership documents. Proof of contribution of capital should be submitted at the time of the application. When the contribution of capital is through a loan, there must be documentation of the value of assets used as collateral for the loan. (2) Insufficient contributions include a promise to contribute capital, an unsecured note payable to the firm or an owner who is not a disadvantaged individual, mere participation in a firm's activities as an employee, or capitalization not commensurate with the value for the firm. (3) The disadvantaged owners must enjoy the customary incidents of ownership, and share in the risks and be entitled to the profits and loss commensurate with their ownership interests, as demonstrated by the substance, not merely the form, of arrangements. Any terms or practices that give a non-disadvantaged individual or firm a priority or superior right to a firm's profits, compared to the disadvantaged owner(s), are grounds for denial. (4) Debt instruments from

MDOT stated in its denial decision: "When asked how the membership interest was issued, Laura Ballew indicated she received 51% membership interest because she was the minority, female owner. In light of the above, when examined in conjunction with the control issues discussed. . .the ownership and control by Ms. Ballew in the applicant firm is not real, substantial, and does not go beyond pro forma ownership of the firm as reflected in the ownership documents."

MDOT appears to be concluding that the gift of equipment from your mother that you used to capitalize DMV is not in accordance with the rule; i.e., is not real and substantial. Gifts of ownership interests or other assets are generally permissible. The one caveat appears in §26.69(h), a provision that "presume[s] 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." This presumption may be overcome and the interests and assets may be counted provided that the owner demonstrates by the higher "clear and convincing" evidence standard additional criteria.[5]

To uphold MDOT's decision in this regard, the Department would need to see more analysis—First, whether the gift or transfer to you was made for reasons other than obtaining certification as a DBE and second; how you, as the disadvantaged owner, control the management, policy, and operations of the firm, notwithstanding the continuing participation of the non-disadvantaged individual who provided the gift or transfer (in this case, your mother). As MDOT did not cite this provision nor analyze the facts of the case in any way, we do not uphold the agency's decision on this ground.

We remind MDOT that when a certifier denies an applicant DBE certification, §26.86(a) requires the certifier to provide the applicant a written explanation of the reasons for the denial specifically referencing the evidence in the record that supports each reason for the denial.

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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.

Examples to paragraph (c): (i) An individual pays **REDACTED** to acquire a majority interest in a firm worth $1 million. The individual's contribution to capital would not be viewed as substantial. (ii) A 51% disadvantaged owner and a non-disadvantaged 49% owner contribute **REDACTED** and **REDACTED**, respectively, to acquire a firm grossing $1 million. This may be indicative of a pro forma arrangement that does not meet the requirements of (c)(1). (iii) The disadvantaged owner of a DBE applicant firm spends **REDACTED** to file articles of incorporation and obtains a **REDACTED** loan, but makes only nominal or sporadic payments to repay the loan. This type of contribution is not of a continuing nature.

[5] The two criteria are: "(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." §26.69(h).

Control Grounds §§26.71(f) and (g)

In general, the focus of §§26.71(f) and (g) requirements are on the disadvantaged owner(s)' overall expertise, ability to make independent decisions, and the level of delegated functions to other participants in the firm.[6] The Department is not rendering a decision on these elements of the case at this time. Although MDOT explored these requirements during its eligibility hearing, MDOT did not provide a full explanation of how the firm and you the applicant owner fail to meet §§26.71(f) and (g) requirements for each of the NAICS codes requested. If MDOT issues a new denial decision on this basis, the agency should make an explicit determination explaining the grounds on which it found the firm ineligible and the factual support from the entire record on which it relies for each ground.[7] MDOT complied with this requirement in the agency's §§26.71(c) and (d) analysis, and we therefore affirm the certification denial of DMV as a DBE under §26.89(f)(1).[8]

This decision is administratively final and is not subject to petition for reconsideration. **DMV may reapply to the DBE program; the applicable waiting period established by MDOT has passed**.[9]

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[6] §26.71(f) states: "The socially and economically disadvantaged owners of the firm may delegate various areas of the management, policymaking, or daily operations of the firm to other participants in the firm, regardless of whether these participants are socially and economically disadvantaged individuals. Such delegations of authority must be revocable, and the socially and economically disadvantaged owners must retain the power to hire and fire any person to whom such authority is delegated. The managerial role of the socially and economically disadvantaged owners in the firm's overall affairs must be such that the recipient can reasonably conclude that the socially and economically disadvantaged owners actually exercise control over the firm's operations, management, and policy."

§26.71(g) states: "The socially and economically disadvantaged owners must have an overall understanding of, and managerial and technical competence and experience directly related to, the type of business in which the firm is engaged and the firm's operations. The socially and economically disadvantaged owners are not required to have experience or expertise in every critical area of the firm's operations, or to have greater experience or expertise in a given field than managers or key employees. The socially and economically disadvantaged owners must have the ability to intelligently and critically evaluate information presented by other participants in the firm's activities and to use this information to make independent decisions concerning the firm's daily operations, management, and policymaking. Generally, expertise limited to office management, administration, or bookkeeping functions unrelated to the principal business activities of the firm is insufficient to demonstrate control."

[7] A recipient's denial decision should be based on evidentiary support from the record that is communicated to the applicant so that they may form a basis for their appeal and have a meaningful opportunity to respond. As the Department stated in the 2014 rule: "The purpose of the appeal is to provide the appellant an opportunity to point out to the Department, through facts in the record and/or arguments in the appeal letter, why the certifying agency's decision is not "supported by substantial evidence or inconsistent with the substantive or procedural provisions of [Part 26] concerning certification." (Fed. Reg. Vol. 79, Oct. 14, 2014, p. 59579). In this case, MDOT cites only evidence from the UCA and résumés, but none from the hearing record that contains your testimony of limited experience in some areas and reliance upon Mr. Rosenthal.

[8] The Department's decision that a recipient's certification decision was supported by substantial evidence is not a decision that the firm is ineligible. Rather, it is a finding that the recipient had enough evidence to reach that decision. *See* 64 Fed. Reg. 5096, at p. 5124 (Feb. 2, 1999).

[9] MDOT erroneously stated in its denial decision that the firm may reapply "either 5 months from the date of [the] decision, or 12 months from the date of final determination by [the Department] if an appeal to the Department is

Sincerely,

Marc D. Pentino
Lead Equal Opportunity Specialist
Disadvantaged Business Enterprise Program Division
Departmental Office of Civil Rights

cc: MDOT

made." Pursuant to §26.86(c), recipient may impose a waiting period of up to 12 months for reapplication following an adverse decision (**whether appealed to the Department or not**). In this case, DMV may reapply for DBE certification immediately at which time MDOT would examine whether DMV meets all eligibility factors.