

February 25, 2019

Reference Number 18-0125

Sheila Evans-Peguese
One South Van Ness Avenue
6th Floor
San Francisco, CA 94103

Dear Ms. Evans-Peguese:

G&C Equipment Corporation (G&C) appeals the California Unified Certification Program's¹ June 19, 2018, decertification of the firm as a Disadvantaged Business Enterprise (DBE). We remand for CUCP to reconsider the issue of G&C's continuing eligibility, in accordance with the instructions a guidance below.

Facts & Procedural History

G&C's certification history and Mr. Eugene Hale's 100% ownership and control are not in dispute. The appeal arises from CUCP's actions in response to information Mr. Hale reported on, or omitted from, his Personal Net Worth (PNW) statements dated October 25 and December 31, 2017. The issue is whether his PNW at December 31, 2017,² exceeded the \$1.32 million cap specified in §26.67(a). If so, G&C is ineligible and the Regulation required CUCP to remove certification.

Mr. Hale reported net worth of **REDACTED** at December 31, 2017. While Metro accepted several of the line-item valuations and characterizations, it contested others. Metro disputed numbers, methods, inclusions, and exclusions. It concluded that Mr. Hale's PNW, properly computed, exceeded the cap. By letter dated February 8, 2018, Metro notified Mr. Hale (§26.87(b)) that it proposed to decertify G&C. Metro stated that the reason for the proposed action was excess personal net worth, and it set out the rationale and specific evidence in support.

¹ CUCP member Los Angeles County Metropolitan Transit Authority (Metro) is the certifying entity. Metro proposed to decertify on the basis that Mr. Hale is no longer socially and economically disadvantaged (SED), within the meaning of the governing Regulation found at 49 CFR Part 26. Our citations of sections in this decision refer to specific rules within Part 26.

² The October 2017 PNW statement values are points of reference helpful in assessing year-end values. As part of the administrative record, they constitute evidence we may consider under §§26.89(d) and (e).

Metro's most significant adjustments pertain to retirement accounts, investment accounts, assets held in trust, an unreported receivable, and the inclusion of a purported liability for unpaid taxes. Metro advised G&C of its right to an informal hearing, and CUCP conducted that hearing at G&C's request. Affirming Metro's ineligibility determination, the CUCP hearing panel further adjusted these and other PNW line-items. CUCP significantly adjusted most of Metro's asset valuations, even where Metro had accepted the exact values Mr. Hale reported.³ CUCP sent Mr. Hale notice of its decision (NOD) on June 19, 2018, to remove G&C's certification, effective that day. CUCP concluded that Mr. Hale's PNW at year-end 2017 was **REDACTED**. The NOD explains CUCP's rationale⁴ and sets out specific evidence in support (§26.87(g)). The NOD advises G&C of its right to appeal to the Department.

G&C appealed on June 22, 2018, accepting some of CUCP's adjustments and rejecting others. The appeal in effect provides a fourth set of values to consider. We respectfully request that CUCP revisit the issues identified below and apply the PNW rules as the Department interprets them. We ask that CUCP re-evaluate its adjustments to Mr. Hale's PNW and, if indicated, issue a new NOD based on conforming methods and calculations, not later than April 1, 2019. We note that Mr. Hale's December 31, 2017 PNW statement remains the subject of these proceedings.

In the event of a new NOD, G&C has the usual 90 days within which to appeal to the Department.

Discussion & Analysis

Mr. Hale reports bottom-line net worth that is **REDACTED** under the Regulation's \$1,320,000 cap. Accordingly, a greater dollar value of net additions (supported by appropriate evidence) renders Mr. Hale non-disadvantaged and the firm ineligible.

1. Cash and Cash Equivalents

³ Most of CUCP's new numbers, for assets and liabilities, apparently arise from a different view of the effect that California community property law may have on PNW reporting under the (federal) DBE rules in §26.67. The §26.69(i) rule concerning marital assets explicitly applies narrowly to (DBE applicant) firm ownership (and the assets used to acquire the firm) determinations not at issue here. CUCP did not decertify on the basis that the Regulation considers the SED owner not to "own" a majority of the shares of G&C. It decertified G&C because it determined that the owner is no longer SED. We also note the specificity of the §26.67(a)(2)(iii)(A) rules. They plainly apply to the *individual's* specified assets, liabilities, deemed distributions, and (implicitly) contingent debt. See generally 17-0013 Jacobsen/Daniels Associates (June 9, 2017) (CUCP properly included entire value of SED owner's investment accounts and real property when he alone held title) and the Department's formal guidance cited; 18-0038 Epic Land Solutions (October 19, 2018) at n.3 (the term "ownership" is to be given its common meaning: "When we refer to the 'owner's assets' we refer to 100% of the value of the portion of any asset titled in her name (the value of her ownership interest) and the portion (generally but not always 50%) of joint or marital assets that she presently owns, and 100% of any assets in which her ownership is a tenancy by the entirety.")

⁴ The NOD explains only some of CUCP's adjustments, with the remainder aired more fully in the hearing and related correspondence. The tenor of the appeal arguments indicates that G&C understood CUCP's reasons. We find no evidence that any deficiency in the NOD resulted in fundamental unfairness or substantial prejudice (§26.89(f)(3)) to G&C in this appeal. Should there be a new NOD, we suggest that CUCP carefully review the requirements of section 26.87(g) in drafting it.

If CUCP wishes to retain its large upward adjustment of cash and cash equivalents, it must cite *specific* evidence (typically cash balances on bank and other account statements) that supports the adjustment. We find no authority in the Regulation for imputing the proceeds to an account of accounts where they do not reside.

2. *Investments (Intangible Property)*

The PNW report and the appeal show that Mr. Hale began his calculations for reporting the includible value of his investments at a higher gross value **REDACTED** than that which CUCP used **REDACTED**. CUCP provided no explanation for its value. We believe the higher starting value controls for reasons we explain in *Epic Land* at 6: ELS cannot be heard to disown the assets or disavow the values [the owner] herself reported on penalty of perjury.”

Neither party applied the rule properly in gross asset value. Instead each explicitly reduced the (collective) asset’s value by 50%, as if the Regulation provides for an automatic, across-the-board, property division with a spouse. It does not, and neither party cites authority to the contrary. In this case, the record suggests that most of the assets are in accounts that Mr. Hale owns outright. To the extent Ms. Hale lacks dominion and control of the accounts sufficient to sell, alienate, or otherwise dispose of the assets within them, CUCP must consider that Mr. Hale owns all of the account and must report its full value as contributing to his PNW.

3. *Retirement Assets*

Again, CUCP and the appellant agree that the gross value of these accounts is **REDACTED**, and again both make an unwarranted, automatic 50% cut. Neither party’s methodology appears to be consistent with, or limited to, the exclusion that section 26.67(a)(2)(iii)(D) provides. The rule states that the SED owner, “[w]ith respect to assets held in *vested pension plans*, Individual Retirement Accounts, 401(k) accounts, or other retirement savings or investment programs in which the assets cannot be distributed *to the individual* at the present time without significant adverse tax or interest consequences, *include* only the *present value of such assets*, less the tax and interest penalties that would accrue if the asset were distributed at the present time.”

The Department has long interpreted the rule to mean what it says. Pension and IRA assets belong to “the individual” who owns them and who is currently entitled to distributions/payments, whether actual or constructive—the person who directly benefits. The rule states that the owner reports the gross value of the account/s on the date of the PNW statement, minus applicable tax and penalties.⁵ This is consistent with the generally applicable present circumstances rule.

⁵ Although the tax liability normally derives from the owner’s top marginal rate on ordinary income (not capital gain), the provision nowhere requires that the distributed “assets” be reduced to cash. We have long opined that the reduction should be construed narrowly, without assuming the worst possible tax outcome, however remote.

We advise CUCP to carefully consider the underlying evidence is reassessing the amount of Mr. Hale's asset inclusion accordingly.

4. *Loans to & from Mr. Hale's Companies*

The correct way to determine the value of Mr. Hale's asset (the loan from Gence) and his liability (his debt to G&C) is in accordance with the principles outlined above.

5. *"Other" Liabilities*

Section 26.67(a)(2)(iii)(C) provides that there is no PNW reduction for contingent liabilities. CUCP correctly determined that 2017 tax of \$15,950 was not an includible liability at the time of the PNW statement.

6. *Mortgages, Real Estate*

The parties' agree on the total value of two properties and the total value of two mortgages on them. However, there is no evident breakdown of what each property is worth and who owns it. Forms 1098 in the record show that Mr. Hale is the sole debtor one mortgage while Mr. and Ms. Hale are joint mortgagors in the second case. CUCP must take account of these facts in its re-evaluation and also determine what each asset is worth and who owns it. The proper adjustment depends on facts the NOD neither states nor supports with specific evidence. We trust that CUCP will employ the principles above and rectify the error.

7. *Trust Assets*

Metro determined that Mr. Hale should have reported half **REDACTED** the value of the family trust's assets on his PNW statement. Mr. and Ms. Hale are the two trustees. CUCP apparently considers the trust assets non-reportable in whole or part. The NOD does not rely on trust assets in reaching its result. We cannot tell why Metro included Mr. Hale's half of the trust's assets and the CUCP panel did not. We ask CUCP to reconsider the question of Mr. Hale must include half of the trust's assets. Section 26.69(d) does not provide an answer because it, like the section 26.69(i) rule, explicitly applies "for purposes of determining *ownership of the firm*." We offer our view, that in the absence of a rule to the contrary, the analysis should be similar to the one we have repeated several times above: the assets "belong" to the person/s who has/have dominion and control over them. Hence a trustee's PNW reporting likely turns on the extent to which the he has the power to liquidate the trust and dispose of its assets as he sees fit.

Conclusion

We direct CUCP to restore G&C's certification forthwith and to reconsider the evidence in the record in accordance with this guidance. We direct CUCP to conduct a careful review and to communicate its decision to G&C and to us by April 1, 2019. If the result is a conclusion that G&C is ineligible on grounds of its owner's excess PNW, we urge CUCP to comply scrupulously with applicable provisions of the Regulation and our clarifications in crafting a Regulation-compliant NOD. G&C may then appeal under the usual rules.

Should CUCP not act by April 1, 2019, we will consider the matter resolved in G&C's failure, close the current appeal, and wish the parties well.

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

Samuel F. Brooks
Appeal Team Lead
Disadvantaged Business Enterprise Division

cc: IRMA LICEA
EUGENE HALE