February 19, 2019

Reference Numbers 18-0145 and 18-0146

Mr. John C. Patterson
Quality Testing LLC
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Building 6, Suite 114
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Mr. John C. Patterson
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Dear Mr. Patterson:

Quality Testing LLC (QT) and Consultant Engineering Inc. (CEI) appealed the decision of the New Mexico Department of Transportation (NM) to remove their DBE certification. After fully considering the extensive administrative record in the case under the standards of the U.S. Department of Transportation's DBE rule, 49 CFR Part 26 ("Part 26" or "the rule"), the Department is reversing the decision and directing that the firms' certifications be reinstated.

I. Procedural History

On March 13, 2017, in a letter signed by Ms. Geanette Garcia, NM proposed to decertify the firms on the basis that your average Adjusted Gross Income (AGI) for 2013-15, as reported on Mr. Patterson's individual Federal income tax returns, exceeded **REDACTED**, which it characterized as "the monetary cap" in section 26.67 of the rule. The companies replied on March 30, 2017, disagreeing with NM's calculations and conclusions. The companies waived their right to a hearing in New Mexico and elected to proceed on the basis of documentary materials in the case.

On May 10, 2018, in a letter signed by Ms. Tisha Clark, NM agreed with its previous determination that Mr. Patterson's AGI – based this time on tax returns for 2014-2016 -- exceeds **REDACTED** and that Mr. Patterson consequently was not an economically disadvantaged individual. The letter stated that the companies did not meet their burden of proof "to show that the AGI values should be reduced through the payment of taxes or otherwise" and that they consequently failed "to demonstrate continued eligibility and to overcome the presumption of ineligibility based on exceeding the PNW threshold." The companies appealed this decision to the Department in letter dated July 31, 2018.

II. Burden of Proof

One of the most significant factors in reviewing any certification decision is the proper allocation of the burden of proof. In a decision on an application for DBE certification, the applicant bears the burden of proof, and it must show the certifier that it is eligible. But this a decertification action, in which the certifier bears the burden of proof. To remove the eligibility of CEI and QT, NM is required to show, by a preponderance of the evidence, that the firms are not eligible under Part 26 certification standards (see 49 CFR 26. 87(d)((1) and (3)).[1]

Ms. Clark's letter asserts that "Mr. Patterson failed to demonstrate continued eligibility…." In so stating, the letter misunderstands the burden of proof in a decertification case. It is not the DBE firm's job to demonstrate continued eligibility; it is the recipient's job to demonstrate the firm's ineligibility.[2] NM appears to misallocate the burden of proof to the firms' detriment. Thus, its decision is inconsistent with applicable (de)certification provisions, and we cannot affirm it.

III. Ability to Accumulate Substantial Wealth (AASW)

Since 2007, the Department's guidance has said that, even if an individual meets the personal net worth (PNW) criterion of section 26.67(b), recipients can "take account of evidence that indicates assets held by an individual suggest that he or she is not economically disadvantaged…."[3] The traditional example long used by the Department was someone whose possession of a very expensive house, a yacht, or extensive real or personal property holdings suggested that he or she was not economically disadvantaged.[4]

The Department's October 2, 2014, amendments to Part 26 added section 26.67(b)(1)(ii)(A), codifying this existing concept, providing that if the information submitted in compliance with the PNW requirements of paragraph (a)(2) of that section "demonstrates that the individual is able to accumulate substantial wealth, the individual's presumption of economic disadvantage is rebutted."

To provide further guidance to certifiers, the amendment added the following language to this provision:

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[1] See 49 CFR 26.87(d))(1).

[2] However, we observe that it behooves the firm or firms to *to produce* evidence of mitigation that the certifier may not have, e.g., regarding possible offsets such as taxes, reinvestments, and irregularity of income.

[3] 79 FR 59568; October 14, 2014.

[4] Id.

In making this determination, as a certifying agency, you may consider factors that include, but are not limited to, the following:

(1) Whether the average adjusted gross income of the owner over the most recent three year period exceeds $350,000;

(2) Whether the income was unusual and not likely to occur in the future;

(3) Whether the earnings were offset by losses;

(4) Whether the income was reinvested in the firm or used to pay taxes arising in the normal course of operations by the firm;

(5) Other evidence that income is not indicative of lack of economic disadvantage; and

(6) Whether the total fair market value of the owner's assets exceed $6 million.

The preamble discussion of this language goes into considerable detail concerning its intent and limitations. Despite some comments that called for a "bright line" approach based on adjusted gross income (AGI), the preamble specifically did not adopt such an approach.[5] What the preamble does say about recipients' use of these factors merits quoting at some length in the context of this case:

(R)ecipients must be able to look beyond the individual's personal net worth bottom line and consider his or her overall economic situation in cases where the specific facts suggest the individual is obviously wealthy with resources indicating to a reasonable person that he or she is not economically disadvantaged….

The Department…is sympathetic to the concerns raised by many commenters that the subjective standard could lead to arbitrary decisions by recipients. To address this concern, we have included in the final rule specific factors recipients <u>*may*</u> *(*emphasis added) *consider in evaluating the economic disadvantaged status of an applicant or owner in this circumstance. Those factors include (the six items listed in the amendment) … Similar factors are used by the Small Business Administration in its application of the economic disadvantage criteria to individuals seeking to participate in its Small Disadvantaged Business and 8(a) programs, which has long recognized the ability to accumulate substantial wealth as a basis for a finding of no economic disadvantage….*

We stress that we are not, with this change, requiring that a recipient consider these factors for every disadvantaged owner whose PNW would be below the current regulatory cap. Instead, today's final rule merely provides recipients who have a reasonable basis to believe that a particular owner should not be

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[5] *Id*. at 59569.

> *considered economically disadvantaged, despite their PNW, with the explicit authority to look at evidence beyond the PNW to determine whether that owner is truly economically disadvantaged. Further, the listed factors are simply intended to provide guidance to recipients about the kind of evidence they may look to in making this determination; it is not intended to be a checklist. An adjusted gross income below $350,000 may in appropriate circumstances indicate a lack of economic disadvantage. The determination should be based on the totality of the circumstances (*emphasis added*)…(It is) unlikely that recipients will proceed in attempting to rebut the presumption of disadvantage in all but the most egregious cases* (emphasis added).[6]

It is important to underline that these provisions are permissive: a certifier "may" consider these factors, among others, in determining whether can accumulate substantial wealth. The individual factors are not items on a "checklist" having mandatory effect, which an individual is required to meet. Consequently, the $350,000 AGI figure cited in paragraph (ii)A)(1) is not properly regarded as a hard "monetary cap," exceeding which automatically causes an individual to be regarded as no longer economically disadvantaged.

With respect to AGI, the preamble specifically notes that an AGI below $350,000 may yet indicate a lack of economic disadvantage; it is logical to assert the converse of this statement, i.e. that there may be circumstances in which an AGI above that figure does not necessarily negate an individual's economic disadvantage. Certifiers are instructed to apply a "totality of the circumstances" test, rebutting the presumption of economic disadvantage only in "the most egregious cases."

Previous certification appeals decisions by the Department have emphasized that, consistent with the rule text and preamble concerning section 26.67 ((b)(1)(ii)(A)(1), the $350,000 AGI number is not intended to be a bright line criterion that, standing alone, negates an individual's economic disadvantage.[7] Using the AGI figure as the sole, bright line criterion in this fashion is antithetical the use by certifiers of a "totality of the circumstances" approach to judging AASW.

Unfortunately, this is precisely how NM used the $350,000 AGI factor. As Ms. Clark's letter notes, NM proposed removing the firms' eligibility on the basis that Mr. Patterson's presumption of economic disadvantage "has been rebutted because Mr. Patterson's

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[6] Id.

[7] See *17-0025 Epic Land Solutions (*June 12, 2017), at 5-6, *citing* 16-0166 *Global Engineering Solutions* (March 31, 2017) and 15-0113, *ADF Industries Inc.* (January 8, 2015). See also 17-1048, *Reiner Contracting, Inc.* (June 6, 2018) at p. 5 ("The six factors in §26.67(b)(1)(ii)(A) are not a checklist or litmus test for certifiers to examine in an AASW analysis. They are simply examples of the type of evidence that certifiers can evaluate….No single factor or number is likely determinative of an owner's AASW….Again, the proper inquiry is whether the *totality of the owner's economic circumstances* (emphasis in original) indicates that she is presently wealthy or has AASW.")

adjusted gross income (AGI) exceeded the $350,000 threshold"[8] set in section 26.67(b)(1)(ii)(A)(1). No other factors were mentioned or considered.

This is not to say that a certifier is precluded from using an individual's AGI as one factor among others in making a comprehensive finding that an individual is obviously wealthy with resources indicating to a reasonable person that he or she is not economically disadvantaged.[9] But NM's reliance on AGI as the only factor supporting its conclusion that Mr. Patterson is ineligible on grounds of AASW falls short of such a finding, preventing NM from carrying its burden of proof that Mr. Patterson is not economically disadvantaged.

IV. Conclusion

The Department reverses NM's decision under section 26.89(f)(1) of the regulation, as unsupported by substantial evidence and inconsistent with the provisions of sections 26.67(b)(1)(ii)(A) and 26.87(d)(1) of Part 26. NM is directed to promptly reinstate the DBE certifications of CEI and QT.

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

Sincerely,

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

cc: Tisha Clark

[8] NM decision letter, p. 2.

[9] See for instance 16-0071 and 16-0072, *Consulting Engineering Inc. and Quality Testing, LLC* (November 7, 2016). This case involved a decertification by the Arizona Department of Transportation of the same companies at issue in this appeal. The certifier in that case took into account a much broader array of economic factors affecting Mr. Patterson's economic disadvantage, basing its decision on a much more extensive record, than NM did in this case.