

March 29, 2019

Reference Number 18-0160

Marylee Miglino, Office Chief
California Department of Transportation
1823 14th Street
Sacramento, CA 95811

Dear Ms. Miglino:

This is in response Preferred Power Solutions, Inc.'s (PPS) appeal of the decision of the California United Certification Program (CAUCP) to deny its application for certification. We remand for further proceedings consistent with this opinion.

I. Procedural History

Preferred Power Solutions (PPS) first applied for DBE certification in 2012. CAUCP denied the application through a letter dated November 19, 2012. The firm then reapplied in November 2017. CAUCP conducted an on-site review of the firm on March 20, 2018. CAUCP again denied the firm's application, this time through a letter dated May 23, 2018. The firm appealed the decision to the Department of Transportation through a letter dated August 21, 2018.

II. Burden of Proof and Standard of Review

(a) Burdens of Proof

As provided in 49 CFR 26.61(b) of the rule, an applicant firm must demonstrate, by a preponderance of the evidence, that it meets Part 26 requirements concerning business size, social and economic disadvantage, ownership, and control. That is, the applicant must show that it more likely than not meets these requirements. A certifier is not required to prove that a firm is ineligible. A certifier can properly deny certification on the basis that an applicant did not submit sufficient evidence that it meets eligibility criteria.

In the case of a request to be certified in additional NAICS codes, this means that the applicant must demonstrate to the certifier that its disadvantaged owners are able to independently control the firm with respect to the additional type of work involved.¹

(b) Standard of review for certification appeals

On receipt of an applicant's appeal from a denial of certification, the Department makes its decision "based on the entire administrative record as supplemented by the appeal..."²

The Department does not make a *de novo* review of the matter..."³ The Department affirms (a certifier's) decision unless it determines, based on the entire administrative record, that (the certifier's) decision is unsupported by substantial evidence or inconsistent with the substantive or procedural provisions of this part concerning certification."⁴

This language means that the Department does not act as though it were the original decision maker in the case or substitute its judgment for that of the certifier. If the certifier's decision – including a finding that an applicant failed to meet its burden of proof – is supported by substantial evidence, then the Department will affirm the certifier's decision.

III. Basis for Denial and Appeal

CAUCP's rationale for denial

CAUCP denied the firm's application both on the basis of ownership and the basis of control. With respect to ownership, CAUCP said that Ms. Cleveland, the 100 percent owner of PPS, had not verified that her capital contribution to the firm was substantial. This is because, the denial said, she and her non-disadvantaged husband, Bill Cleveland, had contributed **REDACTED** for the startup of PPS in 2011, in which they owned a 51 percent interest. There having been no formal renunciation of Mr. Cleveland's portion of the community assets used for this contribution (California is a community property state), CAUCP recognized only half the contributed amount as attributable to Ms. Cleveland. This was a key factor in CAUCP's 2012 denial of the firm's application.

The other 49 percent of the 2011 incarnation of PPS was owned by Tri-Technic, Inc. (TT), owned by Dennis Ledbetter, a non-disadvantaged individual. In 2014, according to CAUCP, Ms. Cleveland bought out TT's share of PPS for **REDACTED**, using PPS corporate funds.⁵

¹ 49 CFR 26.71(n).

² 49 CFR 26.89(e).

³ *Id.*

⁴ 49 CFR 26.89(f)(1).

⁵ The record does not specify whether PPS simply redeemed TT's shares or TT transferred its shares to Ms. Cleveland.

CAUCP cites an October 24, 2012, site visit interview in which Ms. Cleveland admitted using joint funds as her contribution to the firm, which it called an inconsistency with her statement in the March 13, 2018, site visit interview that she used corporate funds. These inconsistencies, CAUCP said, do not substantiate her assertion of 100 percent ownership.

In the same vein, CAUCP added that the entire **REDACTED** that had been contributed to PPS (i.e., the original \$9,068 plus the additional **REDACTED** contributed in 2014) should be regarded as having come from joint funds. Therefore, as CAUCP characterized the facts and the operation of the DBE rules, only half this amount should be attributed to Ms. Cleveland, meaning that she should be regarded as owning 50 percent of the firm, as distinct from the 100 percent she claimed or even the 51 percent required by the Department's regulations.

With respect to control, CAUCP first asserted that PPS had failed to update its original 2011 corporate documents to reflect the 2014 change in ownership structure. Consequently, Ms. Cleveland lacked sufficient documentation that she controlled the company. Moreover, Mr. Cleveland is also authorized to sign checks for the firm, and his annual compensation, as shown by tax information, is considerably higher than hers.

CAUCP asserts that Mr. Cleveland's experience in the substantive work of the company considerably exceeds Ms. Cleveland's and that Ms. Cleveland has not provided evidence that she has gained training or new knowledge since the 2012 application to perform the firm's primary functions and services (i.e., electrical construction, high-voltage utility substations, electrical infrastructure, utility scale solar, and several other related specialties).

Ms. Cleveland, the denial adds, does not possess a C-10 electrical license from the state regulatory agency involved. It is Mr. Cleveland who possesses this license, as well as over 30 years' experience directly related to the firm's core functions. Ms. Cleveland's resume does not provide information to support her decision-making ability regarding the technical aspects of the firm, without input from her husband, who alone has the ability the ability to control its day-to-day operations. The denial then paraphrases the language of section 26.71(g) of the Department's regulations, which says that experience limited to office management, administration, or bookkeeping unrelated to the principal business activities of the firm is insufficient to demonstrate control.

Arguments by appellant

With respect to ownership, the appeal states that the **REDACTED** used to buy out Tri-Technic's share in PPS came from a PPS corporate account, not joint personal funds of Ms. Cleveland and her husband. A copy of the check for the transaction verifies this assertion.⁶ The appeal further asserts that Ms. Cleveland never alleged that any joint funds were ever used in the purchase of the business.⁷ Her husband has never been listed

⁶ Appeal letter, Exhibit A

⁷ She concedes, however, that her application mentioned a **REDACTED** initial contribution, which she says came from TT for its 49 percent of PPS. This is necessarily a reference to the 2012 application, since there is no such mention in the 2017 application that is part of the record of this case.

as an owner of the firm; his compensation on tax returns is designated as being from his role as an officer of the company, not from his being an owner. Ms. Cleveland holds 100 percent of the shares in the company, and she is the only owner.

In responding to CAUCP's control arguments, the appeal asserts that Ms. Cleveland has controlled the management, policy, and operations of the business from its beginning. It adds that Mr. Cleveland is a union member and is required to be paid union scale for his work. Several other employees, the appeal asserts, also union members, likewise receive higher compensation than does Ms. Cleveland. Like many business owners, the appeal argues, Ms. Cleveland chooses to keep a majority of the firm's income within the company as working capital rather than to take it as compensation, in order to maintain the firm's financial health.

The fact that Mr. Cleveland, as well as the corporate secretary, can sign checks is simply a matter of convenience, and does not reflect negatively on Ms. Cleveland's control of the business.

With respect to her expertise and experience in the electrical field, the appeal states that Ms. Cleveland, in her 10 years with the firm, has worked with all aspects of its business, including field as well as office work. Ms. Cleveland submitted statements from her husband and Ms. Rebecca Robison-Cudworth, a marine contractor, attesting to her experience and expertise in the technical and policy as well as the administrative side of PPS's work.⁸ Ms. Cleveland says she is qualified for a state C-10 license and applied for one June 2018, intending to replace her husband as the firm's qualifying individual.

IV. Discussion

Control

CAUCP is correct in saying that PPS should have updated its corporate documents and transmitted updated documents as part of the certification process. This bit of carelessness on the firm's part is not fatal to its case for Ms. Cleveland's control, however. What matters in evaluating applications is less a firm's paperwork than who controls the firm with respect to its real work. It is obvious from the record that TT, despite remaining on outdated documents, is no longer part of PPS's corporate structure. Also, having multiple participants in a firm the size of PPS authorized to sign checks, as a matter, as the appeal states, of administrative convenience, need not significantly undermine the owner's ability to control the firm. The Department's rules do not insist that one person solely perform every function of a firm.

With respect to the disparity in compensation between Mr. and Ms. Cleveland, the appeal's contentions are plausible and persuasive. Unionized contractors are obligated to pay union wages, which for skilled trades can be substantial.⁹ Nothing in the Department's rules mandates that, to be regarded as controlling a firm, a disadvantaged

⁸ See Appeal letter, Exhibits C and D.

⁹ The "schedule of salaries" in the record notes that Mr. Cleveland makes \$63.20 per hour.

owner must receive the highest compensation in the business. To the contrary, the rule provides that

*You may consider differences in remuneration between the socially and economically disadvantaged owners and other participants in the firm in determining whether to certify a firm as a DBE. Such consideration shall be in the context of the duties of the persons involved, normal industry practices, the firm's policy and practice concerning reinvestment of income, and any other explanations for the differences proffered by the firm. You may determine that a firm is controlled by its socially and economically disadvantaged owner although that owner's remuneration is lower than that of some other participants in the firm.*¹⁰

Note that considering differences in remuneration among company participants is permissive (“may”), not mandatory. It is intended to be considered in context, specifically including a firm’s policy and practice concerning reinvestment of income. Explanations proffered by the firm, such as those mentioned in the appeal, are intended to be taken into account. Finally, if the owner’s remuneration is lower than that of some other participants, it is still permissible to determine that the owner controls it. Under the circumstances, the difference in Ms. Cleveland’s compensation and her husband’s does not, in our view, provide substantial evidence that she fails to control PPS.

The most important control issue in this case, as in many cases involving women-owned firms in which the owner’s husband or other male relatives participate, is whether the female owner is sufficiently involved in substantive aspects of the firm’s operations other than generic office work.

CAUPC is correct in saying that Mr. Cleveland’s resume shows extensive experience and expertise in a wide variety of electrical industry areas and projects. But any fair and complete reading of Ms. Cleveland’s resume would also take into account her substantial involvement in field operations and project management of various kinds.¹¹ Her involvement in both the substantive and business sides of the firm are similarly reflected in the “Duty Statement” in the record. The CACUP’s site visit questionnaire lists some of these same responsibilities.¹² Unaccountably, the CAUPC decision fails to mention this evidence.¹³

¹⁰ 49 CFR 26.71(i)(1).

¹¹ See Karen Cleveland resume, paragraph 2.

¹² See site visit questionnaire, p. 4.

¹³ See 2018 denial letter, p. 7, first paragraph. Also, unless we assume that an owner is uncommonly incapable, it seems unlikely that the owner will have gained no experience the six years from 2012-2018, as the first full paragraph on p. 2 of the denial letter suggests.

As Exhibits to the appeal, PPS includes testimonial letters from Mr. Cleveland and another contractor concerning Ms. Cleveland's abilities. Even discounting Mr. Cleveland's undoubted interest in the success of the appeal, his letter provides substantial detail concerning the scope of his wife's functions in the firm. Ms. Robison-Cudworth's letter attests to Ms. Cleveland's "technical acumen, experience, and on-the-ground know how" as well as to her proposal-writing and business development skills. These letters were written after CAUCP's decision to deny the firm's application, and consequently CAUCP was not able to have considered them. However, because these letters simply amplify and provide additional detail concerning matters already mentioned in the record that was before CAUCP, they can fairly be considered part of the "entire administrative record as supplemented by the appeal"¹⁴ that the Department may take into account when making an appeal decision.

CAUCP is also correct in pointing out that Mr. Cleveland has a C-10 license, while Ms. Cleveland does not.¹⁵ Holding a license is an important function recognized in the Department's regulation. However, absent a state law to the contrary, the fact that a disadvantaged owner is not personally the license holder in a firm does not mean that she cannot be regarded as controlling it. Rather, it is but "one factor in determining whether the socially and economically disadvantaged owners actually control the firm."¹⁶

Ultimately, the key decision to be made in considering PPS' application is the determination spelled out in section 26.71(g) of the Department's rules, which provides as follows:

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.

¹⁴ 49 CFR 26.89(e).

¹⁵ Per Exhibit E of the Appeal letter, Ms. Cleveland applied for a C-10 license in June 2018 and believes she is qualified to receive it, but the result of her application is not in the record.

¹⁶ 49 CFR 26.71(h).

Taking the record as a whole fully into account, Ms. Cleveland has provided sufficient evidence that she has an overall understanding of, and experience and technical and managerial competence in, the electrical industry. She does not have greater experience or expertise in the technical side of the business than her husband, but the rule does not require her to. Her long-term involvement in the business, technical, and field components of PPS' operations amply demonstrate that she has the ability to intelligently and critically evaluate information by her husband and others in the firm's activities and make independent decisions. She is not, as the CAUCP decision tends to picture her, someone whose functions are merely "limited to" administrative office duties.

CAUCP's misunderstanding of section 26.71(g) is most clearly expressed when the denial letter complains that Ms. Cleveland is unable to make "unilateral decisions regarding the technical aspects of the business, without the input from Bill Cleveland."¹⁷ An executive who makes unilateral decisions without considering input from colleagues having relevant experience and expertise would be a poor executive indeed, one unlikely to lead a business successfully. The Department's rules do not demand such a dysfunctional approach to running a business as a prerequisite to being viewed as controlling it.

We find that CAUCP's control-based conclusion is unsupported by substantial evidence and/or inconsistent with applicable rules. We cannot affirm on this basis.

Ownership

Given the information in the (previous) record surrounding Ms. Cleveland's and TT's initial capital contributions in 2011, CAUCP's 2012 denial on the basis of ownership made sense. Absent a spousal renunciation, CAUCP relied on California community property principles, as is proper under 49 CFR 26.69(i), to conclude that Ms. Cleveland contributed half of the money and purchased half the 51-percent ownership interest.

The effect of the 2014 transactions is less straightforward. The parties agree that PPS funded the purchase and differ on the result. However, it is not clear to us that Ms. Cleveland can claim any part of the **REDACTED** payment as her own.

We neither affirm nor reverse. *See generally* 49 CFR 26.61(b), 26.69(c) and (e), and 26.89(f)(1), (2), and (5).

V. Conclusion

The Department remands under 49 CFR 26.89(f)(4) for further proceedings consistent with the interpretive guidance above and the following instructions.

We consider any control-based grounds for decision to be resolved in favor of eligibility; they are not to be revisited.

¹⁷ 2018 denial letter, p.7, lines 1-2.

We direct CAUCP to reconsider its ownership decision in light of any new evidence PPS presents under the terms of this letter.

We intend to clarify the ownership-based reasons why the firm is or is not eligible for certification. Thus, we grant PPS until May 1, 2019, to make any changes (e.g., spousal renunciation) that it believes serve that purpose, and CAUCP until May 31, 2019, to reconsider these ownership matters (and no others) in light of those changes and the interpretive guidance provided above. CAUCP must notify the firm of its decision not later than May 31, with a courtesy copy, please, to this Office.

In the event of an adverse determination, PPS has the usual appeal rights.

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: Karen S. Cleveland