

January 13, 2020

Reference Number 20-0013

Calvin M. Thweatt
Virginia Department of Small Business and Supplier Diversity
101 North 14th Street, 11th Floor
Richmond, VA 23219

Dear Mr. Thweatt:

This is in response to the appeal of the decision of the Virginia Unified Certification Program (VUCP) to deny the application of Hamilton Consulting Solutions Corporation (HCS) for certification under the Department's Disadvantaged Business Enterprise (DBE) program, governed by the rules in 49 CFR Part 26 ("the regulation"). The Department is reversing VUCP's decision as unsupported by substantial evidence, subject to the provision by HCS of a renunciation document as described below.

Procedural Background

HCS applied to VUCP for certification on May 3, 2019. VUCP conducted an on-site interview on July 15, 2019. VUCP denied the firm's application in a letter of September 10, 2019. HCS appealed to the Department on November 15, 2019.

Burden of Proof and Standard of Review

(a) Burden of Proof

As provided in 49 CFR 26.61(b) of the rule, a firm applying for DBE certification must demonstrate by a preponderance of the evidence¹ that it meets Part 26 requirements concerning business size, social and economic disadvantage, ownership, and control. This means that 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 to meet eligibility criteria.

¹ On p. 13 of the denial letter, VUCP asserts that the applicable burden of proof is "clear and convincing evidence." There is no basis in the record to support this assertion.

(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

Issues

VUCP determined that the applicant failed to carry its burden of proof with respect to both ownership and control.

Ownership

Patricia Hamilton is the 100 percent owner of HCS. VUCP points out that her original \$9000 capital contribution made in 2008 – well before the firm applied for DBE certification -- came from her joint account with her husband, James Hamilton. The record does not include a document from Mr. Hamilton renouncing his interest in the funds. Therefore, for VUCP, Ms. Hamilton cannot, under the provisions of section 26.69(i) of the regulation, claim a capital contribution for more than 50 percent of her ownership of the firm.

The appeal responded that in the course of what it describes as a lengthy and tortuous 11-year relationship with the Virginia Department of Small Business and Supplier Diversity (VDSBSD) relating to a number of that agency's programs, including the DBE certification process itself, HCS had never been told that it needed to submit such a document. The appeal offered to submit it on request.

Control

The most significant concerns expressed by VUCP about Ms. Hamilton's ability to control HCS relate to section 26.71(c), which proscribes provisions in corporate documents that limit the customary discretion of owners. A provision that limits a disadvantaged owner's ability to control the firm, without the assent of a non-disadvantaged participant, prevents a disadvantaged owner from demonstrating control.

VUCP's concerns pertain to provisions in HCS's articles of incorporation and by-laws. Those provisions relate to shareholder and director voting and quorums. They accurately show Ms.

² 49 CFR 26.89(e).

³ Id.

⁴ 49 CFR 26.89(f)(1).

Hamilton and her husband as the only directors of the firm. For VUCP, this gives Mr. Hamilton negative control with respect to establishing quorums and taking action on behalf of the corporation in board of directors meetings.

The appeal responds to VUCP's position by pointing out that that Ms. Hamilton has 100% of the shareholder vote. Shareholder votes, accordingly, are entirely pro forma. HCS further explains that the board consists of five positions, three of which Ms. Hamilton holds. Mr. Hamilton has 2.⁵ Thus, Ms. Hamilton has a 3-2 margin for quorum and voting purposes, which gives her control under section 3.08 of the by-laws.⁶

The other ground on which VUCP challenges the firm's eligibility is that HCS proposes to purchase goods from various sources and have the goods drop-shipped to their destinations. It does not have a store or warehouse in which items are kept. Therefore, VUCP contends, HCS is not a regular dealer, and, as a mere broker, cannot be viewed as controlling its business in its requested NAICS codes.

Discussion

The Department has emphasized for decades that certification and counting are two separate matters. Section 26.73(a)(1) specifies that whether a firm performs a commercially useful function or is a regular dealer pertains solely to counting. The regulation explicitly tells certifiers that they must not consider these issues in any way in making certification decisions.

With respect to the control issues, the Department, after reviewing the corporate documents in question, does not find evidence that any provisions in the documents in fact prevent Ms. Hamilton from acting on behalf of HCS without Mr. Hamilton's concurrence. As the 100 percent owner, she controls shareholder votes. Similarly, the record shows that she herself can form a quorum and carry any vote, even over Mr. Hamilton's opposition. VUCP's apparent assumption that Mr. and Ms. Hamilton have equal voting power is unsupported by substantial evidence.⁷

Had Mr. Hamilton previously executed a formal renunciation of his portion of the [REDACTED] from the couple's joint account used for the original capital contribution to the firm, section 26.69(i)(1) would have compelled VUCP to conclude that Ms. Hamilton made a real and substantial capital contribution. That Mr. Hamilton has not yet done so does not preclude VUCP from certifying the firm. Particularly in a case like this one, in which the original contribution was made years before the application for DBE certification, section 26.69 is not intended to act as a permanent bar to eligibility because a non-disadvantaged party to a joint account did not execute a renunciation document at the time of the capital contribution. As noted in the appeal, HCS is now willing to provide such a document. Accepting this document

⁵ A structure that the appeal asserts was adopted on the advice of VDSBSD.

⁶ The record includes copies of a July 2018 email in which Ms. Hamilton informed VDSBSD staff of this structure.

⁷ See 49 CFR 26.71(d)(1)-(2).

will vindicate the interest of the Department and certifiers in ensuring adequate documentation of ownership without creating an administrative trap for applicants who are acting in good faith.

Conclusion

The Department finds that VUCP lacked substantial evidence to determine that the applicant failed to meet its burden of proof with respect control. The proffered submission by Mr. Hamilton of a legally effective document irrevocably renouncing his ownership rights and transferring them to Ms. Hamilton would eliminate any basis for questioning Ms. Hamilton's ownership under section 26.69(i) of the regulation. We believe that under these circumstances, he should be allowed to do so.

The Department reverses VUCP's denial of certification under section 26.89(f)(2) and directs VUCP, upon Mr. Hamilton's submission of the renunciation document, to certify HCS.

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

Sincerely,

Samuel F. Brooks
DBE Team Lead
Disadvantaged Business Enterprise Division

cc: Patricia Hamilton