April 24, 2017

Reference Number: 17-0004

Katherine Williams
Civil Rights Program Manager
Colorado Department of Transportation
Office of Certification
4201 East Arkansas Avenue, Room 150
Denver, CO 80222

Dear Ms. Williams:

Information Logistics, Inc. (Information Logistics) appeals the Colorado Department of Transportation's (CDOT) denial of its application for interstate certification as a Disadvantaged Business Enterprise (DBE) under the rules of 49 C.F.R. Part 26 (the Regulation). At the time of its May 2015 Colorado application, Information Logistics was certified as a DBE in its home state of New Jersey and several other states, including Pennsylvania, California, and Virginia. For the reasons stated below, we reverse and direct CDOT to certify Information Logistics without delay.

Background

The company was formed in February of 1997. Mary Farell is the disadvantaged majority owner. On October 27, 2011, Information Logistics entered into a subscription agreement (Agreement) with John Sullivan (a non-disadvantaged individual who is Ms. Farrell's brother) that granted Mr. Sullivan a 19% ownership interest in the company, in the form of preferred stock, in exchange for his contribution of assets valued at **REDACTED** The Agreement also provided that Information Logistics' Board of Directors would convert Mr. Sullivan's preferred shares to common shares upon repayment of the **REDACTED**

On the same day, Information Logistics, pursuant to a "Joint Unanimous Consent in Lieu of Special Meeting of the Board of Directors and Shareholders" (Unanimous Consent October 2011), resolved (1) to adopt the terms of the Agreement and (2) that Mr. Sullivan's stock would be considered "preferred stock." The Unanimous Consent October 2011 further resolved: "[t]here shall be equal voting rights for Common and Preferred Shares. The only difference in Shares is that the Preferred Shares shall not be subject to dilution and shall require payment of a conversion fee to become Common Shares." (Unanimous Consent October 2011, page 2).

Thus, since October of 2011, Information Logistics had two classes of voting stock, common and preferred. Ms. Farrell owned **REDACTED** of the shares of common stock and John Sullivan owned 100% of the preferred stock. Five minority shareholders owned the remaining **REDACTED** shares of common stock. It is undisputed that Ms. Farrell is the majority shareholder, sole director, and president of Information Logistics.

Information Logistics applied for interstate certification in Colorado in May 2015. CDOT's certification analysts requested extensive amounts of information from the disadvantaged owner, Mary Farrell, beyond those materials specifically described in the pertinent interstate certification rule, §26.85(c). CDOT made over sixteen (16) supplemental requests for additional information and documentation from August 2015 through February of 2016.

On May 19, 2016, CDOT notified Information Logistics of its intent to deny its request for DBE certification. CDOT's notice of intent (NOI) based its good cause determination on §26.85(d)(2)(iii), namely that Information Logistics home state of New Jersey made a decision to certify the firm that was inconsistent with the requirements of the Regulation. More specifically, CDOT indicated that Mary Farrell, the disadvantaged owner, did not possess the necessary ownership of the firm as required under §26.69(b), which provides that for a corporation to be an eligible DBE, the disadvantaged individual must own at least 51% of *each class of voting stock* outstanding and 51% of the aggregate of all stock outstanding. Ms. Farrell owns the majority share of all stock outstanding, but does not own any of the preferred stock. Since each class of stock had voting rights attached, CDOT reasoned that Information Logistics' home state certified the firm in a manner inconsistent with the Regulation.

CDOT provided Information Logistics with an opportunity to respond to the good cause finding set forth in its NOI, as required under §26.85(d)(4). Written responses were to be submitted by June 20, 2016.

Information Logistics, by letter from its attorney dated June 10, 2016, provided a timely written response to the NOI. The response acknowledged that the Regulation required the disadvantaged owner to own the majority of each class of voting stock and that Ms. Farrell did not own any of the company's preferred voting shares. Thus, Information Logistics' response stated that on June 8, 2016, the company executed a "Unanimous Consent in Lieu of Special Meeting of the Board of Directors and Shareholders" (Unanimous Consent June 2016) that removed the voting rights of the preferred shares. The response included a copy of the executed document and represented that by officially removing the voting rights of its preferred shares, Information Logistics now met all DBE eligibility requirements and should be certified by CDOT.

CDOT issued its denial letter on July 20, 2016. CDOT's letter acknowledged the Unanimous Consent June 2016 that removed the voting rights of the preferred stock. However, CDOT then raised an argument that was not included in its NOI. CDOT now based its denial upon §26.69(h)(1), which requires a certifier to presume that a disadvantaged individual does not hold sufficient ownership interest in assets obtained by a transfer without adequate consideration from a non-disadvantaged individual who remains involved in the firm seeking certification.

On October 12, 2016, Information Logistics appealed CDOT's decision to the U.S. Department of Transportation, Departmental Office of Civil Rights (the Department).[1]

Decision

After carefully reviewing the entire administrative record and considering all the facts in the record viewed as a whole, as §§26.61(e) and 26.89(e) require, the Department determines that CDOT's decision is inconsistent with substantive and procedural provisions concerning interstate certification. *See* §§26.89(f)(1) and (2). We reverse under §26.89(f)(2) and direct CDOT to certify Information Logistics without delay.

Discussion

Interstate Certification Procedures

CDOT neither certified the firm under §26.85(b) nor limited itself to an evaluation of the materials described in §26.85(c). These are the only choices that the interstate certification rule affords. Instead, CDOT requested from the firm numerous types of new or different information for which it lacked authority to request under the Regulation.

These supplemental requests included: requests for resumes with a chronology of minority shareholders' work experience; resume of Ms. Farrell's spouse; annual meeting minutes for requested years; documentation of the consideration for shares issued; outside employment statement; list of corporate directors and officers; family relationship explanation; explanation of the company's growth in wages between 2012 and 2013; an explanation of the shareholder loan and supporting documentation; an explanation of the common stock and preferred stock breakout for the company; a request to describe the nature of Information Logistics' relationship with two other companies, Voicenet Communications, Inc. and American Voice; information about payments made by the firm to acquire some of Voicenet's customers, including, how much of the company's current customer base is comprised of Voicenet's former customers, whether a firm named Omni Telecom is still in business, and if so, does Information Logistics share any of its employees, management, facilities, or contracts; cancelled checks from the each of the firm's 2% owners; copies of 1099 forms and explanations of services provided from each vendor; and information on the source of the paid-in capital on the firm's balance sheets.

The record reveals that CDOT improperly sought information beyond that which an interstate applicant must produce under §26.85(c). The Department has found this type of request to be in error. *See, e.g.*, 16-0146, *Doon Technologies, Inc.* (Feb. 27, 2017) (subsequent certifier may not request new information not described in §26.85(c) relating to owner's control of firm).

[1] Ms. Farrell contacted the department by email on October 12, 2016, asking for assistance in contesting CDOT's denial. Since the email was timely and included copies of the letters described above, the Department considers the email to constitute a timely appeal.

The purpose of the interstate certification rule is to *facilitate certification* and remove unnecessary barriers to DBE firms that seek to work as a DBE in other states. *See, e.g.,*76 Fed. Reg. at 5088 (Jan. 28, 2011) (preamble to final rule). Interstate certification is not automatic reciprocity in the sense that each state must honor others states' certification decisions without review. However, under the rule, the home state's certification decision is to be given deference by states in which the applicant seeks certification thereafter. The subsequent certifier's review is, therefore, narrower in scope than would be the case for an original application for certification.

Recipients may not require a DBE to supplement its home state certification package or on-site materials with information which an out-of-state certifier believes to be missing or that the out-of-state certifier believes the home state should have collected but did not. *See* 16-0164, *JP and Concepts Co.* (March 20, 2017). Recipients must make decisions on whether to certify a DBE from another state based on their evaluation of the information delineated in the rule. *See* §26.85(c); Interstate Certification Guidance (July 9, 2014) at 2.

Majority Ownership of Each Class of Voting Stock Outstanding

CDOT based its May 19, 2016 NOI upon the fact that Mary Farrell, the disadvantaged owner of Information Logistics, did not possess 51% of each class of voting stock outstanding. Ms. Farrell was the majority shareholder of the firm's common stock, but 100% of the preferred stock was held by her brother, a non-disadvantaged minority owner. Both classes of stock were designated as voting stock. This information was readily available in the home state's file. (*See* Unanimous Consent October 2011, which resolved that the 19% of preferred stock issued to Mr. Sullivan in exchange for his capital contribution would be voting shares.) Because Information Logistics' home state certified the firm despite the fact there was information in the file that revealed the firm's disadvantaged owner did not meet all ownership requirements, CDOT had a legitimate good cause basis under§26.85(d)(2)(iii) to believe that the home state's certification was erroneous: "State A's certification was factually erroneous or *was inconsistent with the requirements of this part.*" *(Id.* emphasis added.) CDOT's NOI was supported by the Regulation.

Information Logistics timely provided a written response from its attorney dated June 10, 2011, prior to the June 20, 2016 deadline for written responses as specified included in CDOT's NOI. The response contained a copy of the fully executed Unanimous Consent June 2016 in which the company resolved to remove the voting rights of its preferred shares.

The fact that Ms. Farrell did not own the majority of all classes of the corporation's voting stock *was the only good cause objection* identified in CDOT's NOI. Thus, once CDOT received Information Logistics' written response that eliminated the good cause objection, CDOT was obliged to either certify the firm or provide the firm with a new NOI that gave the firm an opportunity to respond to additional issues identified as discussed in the *Transfer of Ownership without Adequate Consideration*.

The purpose in providing the applicant firm with an NOI with specific information as to why the certifier intends to deny the interstate certification request, and providing the firm with an opportunity to provide a written response or request a meeting, is largely the same as the similar due process requirement in §26.87. Once a firm, interstate or otherwise, is informed of the agency's intent to deny or remove certification, the firm is given the opportunity to discuss the concerns either in person or in writing. Such an opportunity may also properly include presenting documentation that resolves the very issues identified by the certifier. The fact that it was the certifier's NOI that alerted the DBE to the problem does not prevent the DBE from "curing" the problem prior to the final agency decision. This is the case even if it seems to the UCP that it is instructing the DBE how to be eligible for certification. Again, a primary goal of the interstate certification rule is to facilitate certification in other states.

This principle was pointed out by the Department in its recent reversal of a decision by a certifier to deny an initial application for certification:

> There is no general provision within the Regulation that permits a certifier to exclude an applicant firm from the DBE Program solely because it takes steps to conform to the eligibility requirements of the Regulation. Firms may take steps, including corrective actions, to ensure that they satisfy the regulatory standards. The mere fact that a firm takes an action designed to make it eligible generally does not render it ineligible.

16-0105, *C&S Seckerson Trucking, LLC* (November 9, 2016).

The Department similarly articulated the same principle—that DBEs may take corrective action or submit clarifying information to retain eligibility prior to the agency's final decision—in an appeal of an interstate certification denial. *See* 15-0146, *Belle Fontaine Interests, LLC* (April 25, 2017).

Transfer of Ownership without Adequate Consideration, §§26.69(h)(1) and (2)

Rather than considering the Unanimous Consent June 2016 as resolving the concerns identified in the NOI, CDOT's July 20 letter based its denial on a new issue. CDOT contended that removing the voting rights of the preferred stock triggered a new ownership concern under §26.69(h)(1). This section of the Regulation requires a certifier to presume that a disadvantaged individual does not hold sufficient ownership interest in assets obtained by a transfer without adequate consideration from a non-disadvantaged individual who remains involved in the firm seeking certification. [2]

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[2]§26(h)(1): You must presume 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—

CDOT's argument uses the following logic: Mr. Sullivan, a non-socially and economically disadvantaged individual and a 19% owner of Information Logistics, contributed assets valued at **REDACTED** in consideration for receiving **REDACTED** of preferred stock with voting rights. The **REDACTED** was, in effect, a non-interest bearing loan to the company, but because the loan was in exchange for **REDACTED** of the company's preferred shares, Mr. Sullivan had superior rights to profits and voting rights, both of which, according to CDOT, amounted to adequate consideration. When Information Logistics removed Mr. Sullivan's voting rights after receiving CDOT's NOI, it effectively altered the **REDACTED** loan to a transfer without adequate consideration. Therefore, CDOT argues that there should be a presumption that Ms. Farrell does not possess the necessary ownership interest in the firm.

CDOT properly acknowledges that the §26.69(h)(1) presumption can be overcome if Information Logistics can prove, by clear and convincing evidence, that:

> "(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)(2).

CDOT contends, in essence, that because Information Logistics executed the Unanimous Consent June 2016 *after* it received the NOI, the company failed to prove that the change was made for reasons other than to qualify for DBE certification. Thus, CDOT determined that the firm failed to satisfy one of the Regulation's two conjunctive requirements necessary to overcome the presumption that Ms. Farrell lacked the necessary ownership in the company.

The Department notes that CDOT's July 20 denial letter based its decision upon information that was not included in the NOI. Even if CDOT believed that the firm's response to the NOI, i.e., the removal of the preferred stock voting rights, triggered a new ownership concern, CDOT was obliged to issue a new notice of intent that identified the new issue and provide Information Logistics with an opportunity to respond. Were Information Logistics given the opportunity to respond to the new concerns, as the Regulation's due process procedures require, CDOT may have reached a different conclusion. Instead, CDOT denied the application without providing

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(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.

the firm with an opportunity to bear the burden of demonstrating that the removal of voting rights from the preferred stock did not affect Ms. Farrell's ownership interest. [3,4]

Conclusion

We conclude that CDOT failed to follow the interstate certification procedures by: (1) requesting numerous documents and explanations outside of those permitted under §26.85(c); and 2) failing to either certify Information Logistics when it resolved the only issue identified in the NOI or to provide the firm an opportunity to respond when it raised a new concern in its denial letter. We therefore reverse and direct that CDOT certify Information Logistics promptly.

This decision is administratively final and not subject to petitions for review. Thank you for your continued cooperation.

Sincerely,

Samuel F. Brooks, DBE Appeal Team Lead
Disadvantaged Business Enterprise Division
Departmental Office of Civil Rights

[3] CDOT assumed that Mr. Sullivan would not have agreed to the **REDACTED** without receiving preferred stock with voting rights. CDOT further assumed that Mr. Sullivan, as a non-disadvantaged owner, was involved in the firm's major decisions. According to Mr. Sullivan, however, it was never contemplated that his preferred stock would be voting stock, and even if it was, the agreement was that Ms. Farrell would still have a clear controlling interest. Mr. Sullivan further contended that he is retired and there is no question that his sister owns and controls the company as she is the president, sole board member, and majority shareholder.

[4] After Information Logistics received its letter of denial, Information Logistics' lawyer sent a letter to CDOT dated July 27, 2016, requesting reconsideration. The letter included, as an attachment, a letter dated July 17, 2016, from John Sullivan in which he contended that CDOT misconstrued his involvement in Information Logistics; he conveyed that he has never been an employee or executive, was given the "honorary title" of Vice President, and that he is retired and lives on a farm in Northern Pennsylvania. Both letters emphasize the fact that Mary Farrell is majority shareholder, sole director, and president of Information Logistics who controls its daily operations. Ms. Farrell sent a letter to CDOT dated July 29, 2016, objecting to the denial determination.