

January 13, 2005

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Reference Number.: 04-0143

Mr. Frank Lavanier
President
Syntech Automation, Inc.
8245 Ronson Road, Suite G
San Diego, CA 92111

Dear Mr. Lavanier:

This is in response to the appeal that you filed on behalf of your firm, Syntech Automation, Inc. ("Syntech"). We have carefully reviewed the material from the California Unified Certification Program ("CUCP") City of San Diego ("COSD") as well as information you provided and concluded that the denial of your firm's certification as an eligible Disadvantaged Business Enterprise (DBE) under criteria set forth in 49 CFR Part 26 ("the Regulation") is supported by substantial record evidence.

Your appeal is denied based upon our determination that substantial evidence supports CUCP's conclusion that the disadvantaged business owner's contribution of capital to acquire his ownership interest in the firm was not real, substantial, and continuing within the meaning of the Regulation.

The specific reasons for the denial of your appeal include the following:

OWNERSHIP

According to the Regulation at §26.61(b), the firm seeking certification has the burden of demonstrating to you, by a preponderance of the evidence, that it meets the requirements of this subpart concerning group membership or individual disadvantage, business size, ownership, and control.

The Regulation at §26.69(b) states that to be an eligible DBE, a firm must be at least 51 percent owned by socially and economically disadvantaged individuals.

The Regulation at §26.69(c) provides in part, that contributions of capital or expertise by the disadvantaged owner to acquire an ownership interest in the participating DBE business be real and substantial and continuing, going beyond pro forma ownership of the firm as reflected in ownership documents.

According to the Regulation §26.69(f)(1) and (2), the following requirements apply to situations in which expertise is relied upon as part of a disadvantaged owner's contribution to acquire ownership: the owner's expertise must be (i) In a specialized field; (ii) of outstanding quality; (iii) in areas critical to the firm's operations; (iv) indispensable to the firm's potential success; (v) specific to the type of work the firm performs; and (vi) documented in the records of the firm. These records must clearly show the contribution of expertise and its value to the firm. The individual whose expertise is relied upon must have a significant financial investment in the firm.

The Regulation at §26.69(h)(1) states that you must presume as not being held by a 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 (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 record indicates that you are the 30 percent owner of Syntech, a firm established in January, 1999, to perform process control design and system integration. Mr. Bruce Robuck, a non-disadvantaged individual, and Mr. Roger Gedminas, a disadvantaged individual, own 48 and 22 percent of the firm, respectively.

According to the firm's DBE application, you acquired 21,875 shares of stock in the firm with a cash contribution in February 2000 and February 2001. The application indicates that Mr. Gedminas acquired 16,420 shares in February 2001 and January 2004 with a cash contribution. The firm's January 23, 2004 meeting minutes states:

The following people have offered to purchase shares of the corporation's common stock for the cash consideration set forth below and the corporation deems it in the best interest to accept such offer and issue such shares for that consideration:

| | Number of Shares | Consideration per Share | Total Consideration |
|----------------|---------------------|----------------------------|---------------------|
| Frank Lavanier | 1,875 | \$5.00 | \$9,375.00 |
| Roger Gedminas | 1,042 | \$5.00 | \$5,210.00 |

. . . the Board determines the fair value of each share to be \$5.00 and that the consideration to be received upon the issuance and sale of such shares shall be added to appropriate capital accounts on the books of the Corporation.

In a May 19, 2004, correspondence to COSD Bruce Robuck stated:

Upon one year of successful business operations, we incorporated on January 3, 2000. Having met this milestone and as previously agreed, Mr. Lavanier was offered and purchased 15,000 shares of Syntech for the price of \$15.00. Subsequently he has purchased 6,875 additional shares for a total investment of \$34,390.00.

In an August 18, 2004 letter to COSD, you stated:

The stock purchased by myself was not the result of a gift, or transfer without adequate consideration. I acquired the referenced 15,000 shares of Syntech stock in February 2000 as noted. The company entered into business January 1, 1999. Prior to forming the company, I actively participated in the development of the business plan, and all phases of planning the company including structure, administration, operations, sales and marketing. It was also prior to forming the company on January 1, 1999, that an agreement was entered into that I would be provided with a stock option to purchase 15,000 shares for .001 dollars per share. This agreement was made 6 months prior to forming the company. There are three main reasons for this consideration: 1) in consideration of my time and effort of involvement in planning of the business and from mid 1998 to January 1, 1999 (prior to the company forming) without compensation; 2) in consideration of reduced salary during the first two years of business (1999 and 2000); and 3) insofar as at the time of the stock option agreement (prior to January 1999), the company did not formally exist [and] had no assets or contracts, yet I devoted significant time and effort towards development of the future company. Note that in years 2001 and 2004, I purchased additional stock shares at \$5.00 per share. Due to the company prospering, this was the estimated value per share at the time and the price paid by myself and other stockholders.

The stock option agreement was executed prior to forming the company, more than 5 years prior to our application. Executing the option over a year later did not place a majority of the stock into the hands of disadvantaged individuals. During the first 5 years in business, we have made no application to become a DBE.

The Regulation §26.69(c) requires all disadvantaged business owners in a firm to contribute real and substantial capital or expertise to obtain their ownership in the business. Based on the record evidence, it does not appear that you made a real and substantial contribution to acquire your ownership interest in Syntech. According to the site visit report, the owners used cash and checks to invest in the firm. The record contains bank statements for the firm's account at [REDACTED] Bank and correspondence from Bruce Robuck which describes various check payments to you, Roger Gedminas, and himself. The record also contains copies of loan agreements with [REDACTED] Bank and [REDACTED] signed by you and Mr. Robuck as borrowers.

While it appears that you pledged to repay these loans on the firm's behalf, and were reimbursed for your loans to the firm, this is not real and substantial contribution of capital within the meaning of the Regulation. It does not appear that you contributed capital from your personal funds to acquire your ownership interest, but rather received your shares for your past involvement in the firm. For your expertise to be considered your contribution to acquire ownership in the firm, under the Regulation §26.69(f)(1), your expertise must be (i) in a specialized field; (ii) of outstanding quality; (iii) in areas critical to the firm's operations; (iv) indispensable to the firm's potential success; (v) specific to the type of work the firm performs; and (vi) documented in the records of the firm. In addition, these records must clearly show the contribution of expertise and its value to the firm; and 2) the individual whose expertise is relied upon must have a significant financial investment in the firm. This requirement has not been met. Substantial record evidence therefore supports COSD's determination that his contribution of capital was not real and substantial and did not meet the requirements of the Department's Regulation.

CONTROL

Under the Regulation at §26.71(c), a DBE firm must not be subject to any formal or informal restrictions which limit the customary discretion of the socially and economically disadvantaged owners. There can be no restrictions through corporate charter provisions, by-law provisions, contracts or any other formal or informal devices (e.g., cumulative voting rights, voting powers attached to different classes of stock, employment contracts, requirements for concurrence by non-disadvantaged partners, conditions precedent or subsequent, executory agreements, voting trusts, restrictions on or assignments of voting rights) that prevent the socially and economically disadvantaged owners, without the cooperation or vote of any non-disadvantaged individual, from making any business decision of the firm.

Under the Regulation at §26.71(e) individuals who are not socially and economically disadvantaged may be involved in a DBE firm as owners, managers, employees, stockholders, officers, and/or directors. Such individuals must not, however, possess or exercise the power to control the firm, or be disproportionately responsible for the operation of the firm.

Under the Regulation at §26.71(i), 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. In a case where a non-disadvantaged individual formerly controlled the firm, and a socially and economically disadvantaged individual now controls it, you may consider a difference between the remuneration of the former and current controller of the firm as a factor in determining who controls the firm, particularly

when the non-disadvantaged individual remains involved with the firm and continues to receive greater compensation than the disadvantaged individual.

According to the Regulation §26.71(l), where a firm was formerly owned and/or controlled by a non-disadvantaged individual (whether or not an immediate family member), ownership and/or control were transferred to a socially and economically disadvantaged individual, and the non-disadvantaged individual remains involved with the firm in any capacity, the disadvantaged individual now owning the firm must demonstrate to you, by clear and convincing evidence, that 1) the transfer of ownership and/or control to the disadvantaged individual was made for reasons other than obtaining certification as a DBE; and (2) the disadvantaged individual actually controls the management, policy, and operations of the firm, notwithstanding the continuing participation of a non-disadvantaged individual who formerly owned and/or controlled the firm

According to the firm's January 23, 2004, meeting minutes, you, Bruce Robuck, and Roger Gedminas constitute the three directors of Syntech. In its certification denial, COD determined that 1) the disadvantaged owners in the firm are restricted in their authority and cannot independently control the company, 2) the configuration of the board permits deadlock, and 3) you do not have sufficient stock to break a deadlock. The firm's bylaws contain the following provisions:

Article I § 5 – The present in person or by proxy of the holders of a majority of the shares entitled to vote at any meeting of the shareholders shall constitute a quorum for the transaction of business.

Article I § 7.1- . . . each shareholder . . . shall be entitled to one vote for each share on each matter submitted to a vote of the shareholders. . . . [T]he affirmative vote of a majority of the shares represented and voting at a duly held meeting at which a quorum is present (which shares voting affirmatively also constitute at least a majority of the required quorum) shall be the act of the shareholders.

Article I § 7.2 - Except for the election of Directors, any holder of shares entitled to vote on any matter may vote part of the shares in favor of the proposal and refrain from voting the remaining shares or vote them against proposal. If the shareholder fails to specify the number of shares such shareholder is voting affirmatively, it will be conclusively presumed that the shareholder's affirmative vote is with respect to all shares such shareholder is entitled to vote.

Article I § 8 – Every shareholder entitled to vote in any election for directors shall have the right to cumulate his votes. . . .

While both you and Mr. Gedminas, both disadvantaged individuals, collectively own 52 percent of the company's shares and, together, can outvote Mr. Bruce Robuck, the non-disadvantaged owner, individually, you and Mr. Gedminas could not control the board of directors if either one of you were absent from a shareholders meeting and a quorum was present to vote on a particular

issue. The question of whether you control the board of directors is thus inconclusive and COSD needs to look deeper into this issue in order to make a decision in this regard. Because of this reason, the Department will not issue an opinion on this issue in its current form.

In summary, the information provided cumulatively supports a conclusion that Syntech does not meet the criteria as required for DBE certification under 49 CFR Part 26. The company is, therefore, ineligible to participate as a DBE on COSD's Federal financially assisted projects. This determination is administratively final as of the date of this correspondence.

Sincerely,

Joseph E. Austin, Chief
External Policy and Program Development Division
Departmental Office of Civil Rights

cc: CUCP (COSD)