

NEW YORK STATE
DEPARTMENT OF ECONOMIC DEVELOPMENT
633 THIRD AVENUE
NEW YORK, NY 10017

In the Matter

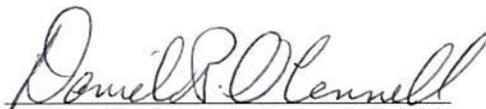
- of -

the Application of
Coverco, Inc.
for Recertification as a Woman-owned Business Enterprise
pursuant to Executive Law Article 15-A.

NYS DED File ID No. 54730

RECOMMENDED ORDER

- by -



Daniel P. O'Connell
Administrative Law Judge

January 23, 2017

SUMMARY

The determination of the Division of Minority and Women's Business Development (Division) of the New York State Department of Economic Development to deny the application by Coverco, Inc. (Coverco) for recertification as a woman-owned business enterprise (WBE) should be modified and, as so modified, affirmed for the reasons set forth below.

PROCEEDINGS

This matter considers the appeal, pursuant to New York State Executive Law Article 15-A and Title 5 of the Official Compilation of Codes, Rules, and Regulations of the State of New York (5 NYCRR) Parts 140-144, by Coverco challenging the determination of the Division that its application does not meet the eligibility requirements for recertification as a woman-owned business enterprise.

In 2010, the Division certified Coverco as a woman-owned business enterprise (Transcript [Tr.] at 20-21). On behalf of Coverco, Elizabeth H. Schaab submitted the application for recertification to the Division on May 20, 2014 (*see* WBE Exh. 14). Subsequently, by letter dated January 15, 2016, the Division denied the application to recertify Coverco as a WBE enterprise for failing to meet four of the eligibility criteria outlined at 5 NYCRR 144.2 with respect to Elizabeth Schaab's ownership and operation of Coverco (*see* WBE Exh. 1).

By letter dated February 11, 2016, Ms. Schaab filed a notice of appeal on behalf of Coverco, and requested a hearing. In a notice of appeal hearing dated June 8, 2016, the Division scheduled the hearing for 11:00 a.m. on August 25, 2016 at the Division's offices in Albany, New York.

The hearing convened as scheduled. Linda H. Joseph, Esq. (Schröder, Joseph & Associates, LLP [Buffalo, New York]) represented Coverco. Elizabeth Schaab testified on behalf of Coverco. Phillip Harmonick, Assistant Counsel, New York State Department of Economic Development, appeared on behalf of the Division. Glenn Butler, Senior Certification Analyst, testified for the Division. During the hearing, the parties offered 19 exhibits, all of which were received into evidence. An exhibit chart is attached to this recommended order.

An audio recording of the proceedings was made. Subsequently, Coverco's counsel had the audio recording transcribed, and the transcript was emailed to the parties and the ALJ on September 16, 2016. The hearing record closed on October 21, 2016 upon the timely receipt of the parties' written closing statements.

ELIGIBILITY CRITERIA

For the purposes of determining whether an applicant should be granted or denied recertification as a woman-owned business enterprise, the regulatory criteria, outlined at 5

NYCRR 144.2, regarding the applicant's ownership, operation, control, and independence are applied on the basis of information supplied through the application process.

The Division reviews the enterprise as it existed when the application was made, based on representations in the application itself, and on information presented in supplemental submissions, as well as any interviews that the Division's analyst may have conducted. (*See* 5 NYCRR 144.5[a].)

STANDARD OF REVIEW

On this administrative appeal, Coverco bears the burden of proving that the Division's denial of the applicant for WBE recertification is not supported by substantial evidence (*see* State Administrative Procedure Act [SAPA] § 306[1]). The substantial evidence standard "demands only that a given inference is reasonable and plausible, not necessarily the most probable," and Coverco must demonstrate that the Division's conclusions and factual determinations are not supported by "such relevant proof as a reasonable mind may accept as adequate" (*Matter of Ridge Rd. Fire Dist. v Schiano*, 16 NY3d 494, 499 [2011] [internal quotation marks and citations omitted]).¹

POSITIONS OF THE PARTIES

The Division

In the January 15, 2016 denial letter (*see* WBE Exh. 1), the Division asserted that the application failed to meet four of the criteria for WBE recertification as outlined at 5 NYCRR 144.2 with respect to the ownership and control of Coverco by Elizabeth Schaab, its president and majority shareholder. Regarding ownership, the Division concluded that Coverco did not demonstrate that Ms. Schaab enjoys the customary incidents of ownership and shares in the risks and profits in proportion to her ownership interest in the enterprise, as required by 5 NYCRR 144.2(c)(2). In addition, the Division determined that Coverco did not show that Ms. Schaab's capital contributions are proportionate to her equity interest in the business enterprise as demonstrated by, but not limited to, contributions of money, property, equipment, or expertise, as required by 5 NYCRR 144.2(a)(1).

Concerning operation, the Division concluded that Coverco failed to demonstrate that Ms. Schaab has either the experience and technical competence, working knowledge, or ability needed to operate the enterprise, as required by 5 NYCRR 144.2(b)(1)(i) and (ii). The Division also determined that Coverco did not show that the Ms. Schaab makes decisions pertaining to the operations of the enterprise, as required by 5 NYCRR 144.2(b)(1), or devotes time on an ongoing basis to the daily operation of the enterprise, as required by 5 NYCRR 144.2(b)(1)(iii).²

¹ In its post-hearing brief (at 17), Coverco cited *People ex rel. Vega v Smith*, 66 NY2d 130, 139 (1985), and *Matter of Deresky v Scully*, 156 AD2d 362 (2d Dept 1989) concerning the substantial evidence standard. Both *Vega* (66 NY2d at 139), and *Ridge Rd. Fire Dist.* (16 NY3d at 499) refer to *Matter of 300 Gramatan Ave. Assoc. v State Div. of Human Rights* (45 NY2d 176, 180-181 [1978]).

² Coverco's compliance with the eligibility criteria at 5 NYCRR 144.2(b)(1)(iii) is not at issue in this matter (Tr. at 130-131).

Coverco, Inc.

In her February 11, 2016 letter, Elizabeth Schaab stated that the application and phone interview process for recertification did not afford Coverco the opportunity to present all of the facts that demonstrate woman ownership and operational control of the business enterprise. Because Coverco is a multi-state, multi-faceted business enterprise, Ms. Schaab stated further that the recertification application and the additional documents requested during the review did not properly reflect business operations.

At the hearing, Coverco asserted a due process concern. First, Coverco argued that the Division's January 15, 2016 denial letter did not provide a factual basis for the denial. Coverco asserted that the lack of detail with respect to the Division's denial prejudiced Coverco. Coverco concluded that the cure would be to reverse the Division's determination, and to recertify Coverco as a woman-owned business enterprise. (Tr. at 7-9.)

Second, Coverco objected to the Division's response to Coverco's discovery demand (Tr. at 8-13). With a cover letter dated July 19, 2016, Coverco's counsel served a discovery request upon the Division as authorized by 5 NYCRR 145.1(d). The Division responded on July 27, 2016. Subsequently, with a letter dated August 18, 2016, Coverco's counsel noted that the Division's January 15, 2016 denial letter did not provide a factual basis for the denial, and renewed its request for, among other things, copies of all notes of any interviews conducted by Division staff as part of the Division's review of Coverco's application for WBE recertification. The Division stated that its response was limited to the documents that the Division intended to offer at the hearing pursuant to the requirement outlined at 5 NYCRR 145.1(d)(1). During the hearing, the Division provided Coverco with copies of Division staff's notes, and the notes were marked for identification as WBE Exhibits 15 and 16 (Tr. at 99 and 115). Subsequently, these documents were received into evidence (Tr. at 101 and 142).

In its post-hearing brief, Coverco also argued that the information presented in its first application (*see* WBE Exh. 4), which resulted in WBE certification in 2010, was substantially the same as the information presented in the application filed for recertification on May 20, 2014 (*see* WBE Exh. 14). Based on the principle of administrative precedent, particularly in the absence of a reasoned determination by the Division to deny recertification, Coverco argued that the Division's January 15, 2016 denial is arbitrary and capricious and, therefore, not supported by substantial evidence. Coverco contended that the Division's January 15, 2016 determination should be overturned. (*See* Coverco's Post-Hearing Brief [Coverco] at 18-20.)

FINDINGS OF FACT

I. General

1. In 1973, William A. Schaab founded Wm. Schaab Co., Inc. In 1988, William Schaab's son, Richard, joined the company as a full time employee. (*See* WBE Exh. 17.)

2. In 1998, the Wm. Schaab Co. was renamed Coverco, Inc., and Richard Schaab became its president (*see* WBE Exh. 17). In February 2010, Elizabeth Schaab, who is Richard Schaab's spouse, became the president of Coverco (*see* WBE Exh. 16 and 17; Tr. at 27).
3. Coverco has business offices located at 2517 Long Road, Grand Island, New York 14072. The company designs, fabricates, and installs commercial and industrial heating, ventilating, and air conditioning (HVAC) systems. In addition, Coverco designs, manufactures, and installs removable insulation covers. Coverco has 34 full time employees and, on a seasonal basis, hires additional full time employees. (*See* WBE Exh. 14.)
4. In 2010, the Division certified Coverco as a woman-owned business enterprise (Tr. at 17, 20-21).
5. On May 20, 2014, Elizabeth Schaab filed a renewal application with the Division to recertify Coverco as a woman-owned business enterprise (*see* WBE Exh. 14).
6. By letter dated January 15, 2016, the Division denied Coverco's recertification application (*see* WBE Exh. 1).

II. Ownership

7. In 2013, Elizabeth Schaab's compensation was [REDACTED]. However, William Schaab's compensation from Coverco was [REDACTED], and Richard Schaab's compensation was [REDACTED]. (*See* WBE Exhs. 16, and 18; Tr. at 149-150.)
8. In 2014, Elizabeth Schaab's compensation from Coverco was [REDACTED]. William Schaab's compensation from Coverco was [REDACTED], and Richard Schaab's compensation was [REDACTED]. (*See* WBE Exhs. 16 and 19 at 9; Tr. at 152.)
9. The record of the hearing does not include any information about the compensation that Elizabeth, William, and Richard Schaab may have received from Coverco in 2015.
10. In 1998, William Schaab gifted his shares of the company's stock to Richard Schaab. At that time, the company redeemed any remaining shares owned by Richard Schaab's siblings. As a result, Richard Schaab became the sole shareholder of Coverco. (*See* WBE Exhs. 16 and 17; Tr. at 54-55.)
11. In February 2010, Richard Schaab gifted 51% of his Coverco stock shares to Elizabeth Schaab to ensure that she obtained full executive control over the business enterprise. Mr. Schaab retained ownership of 49% of Coverco's stock shares. In addition, Elizabeth Schaab became the president of Coverco, and Richard Schaab became the vice-president. (*See* WBE Exhs. 14, 16, 17; Tr. at 30-31, 54-55.)

III. Operation

12. From 1996 to 2007, Elizabeth Schaab owned a company call Fringe Benefit Analysts, Inc., which employed 20 people (*see* WBE Exh. 3; Tr. 15, 18, 24-25).
13. Since 2010, Elizabeth Schaab has been president of Coverco. As president, she oversees the following: (1) accounts payable and receivable; (2) human resources including payroll and employee benefits, among other duties; and (3) the company's finances. (*See* WBE Exhs. 3, 7, 17; Tr. at 27-28, 35-36.)
14. To manage Coverco as its president, Elizabeth Schaab has relied upon her prior work experiences as the president and owner of Fringe Benefit Analysts. In addition, when she began working at Coverco, Ms. Schaab received training from William Schaab about its operations. (Tr. at 18, 25-26, 170, 172.)
15. When Elizabeth Schaab took over as the president of Coverco and Richard Schaab assumed the role of vice-president, Mr. Schaab's responsibilities at Coverco did not change (Tr. at 63-64). Then as now, Richard Schaab fabricates custom orders and supervises work at the jobsites. He, and other employees of Coverco, have contact with customers. Mr. Schaab oversees equipment maintenance, and makes decisions, as appropriate, about repairs and updates. (*See* WBE Exhs. 7 and 17; Tr. at 30-31.)³
16. At Coverco, Richard Schaab, Dean Massaro, and Scott Brown undertake job estimates (Tr. at 154-155, 171). Elizabeth Schaab does "not personally get involved in sitting in front of our application, or system, and taking off a job," which means reviewing the specifications from a set of plans and inputting the data into the company's computer software system (Tr. at 171). However, with respect to job estimates, Ms. Schaab's role is to update the inputs that Messrs. Schaab, Massaro and Brown rely upon. The updated inputs are essential to developing accurate estimates and bids. (*See* WBE Exh. 7 and 17; Tr. at 28, 30, 171.)
17. Other than the occasional consultation with Richard Schaab, Elizabeth Schaab has sole authority to make decisions about estimates (Tr. at 75).

DISCUSSION

This recommended order considers the appeal from the Division's determination to deny Coverco's application for recertification as a woman-owned business enterprise pursuant to Executive Law Article 15-A. The discussion that follows first addresses the procedural objections raised by Coverco at the hearing, and the legal issues asserted in Coverco's post-hearing brief. The discussion then turns to the Division's January 15, 2016 denial letter, which identifies four bases related to Ms. Schaab's ownership and operation of Coverco. Each is discussed below.

³ WBE Exhibit 7 responds to inquiry No. 8 (*see* WBE Exhibit 14 at 6), and is an excerpt from WBE Exhibit 17.

I. Coverco's Procedural Objections

A. Due Process

At the hearing, Coverco alleged that its due process rights were violated because the Division's January 15, 2016 letter did not provide a factual basis for the denial. Coverco argued that the lack of detail with respect to the Division's denial prejudiced Coverco. Coverco contended that the cure would be to reverse the Division's determination, and recertify Coverco as a woman-owned business enterprise. (Tr. at 7-9.)

In addition, Coverco objected to the Division's response to Coverco's discovery demand (Tr. at 8-13). With a cover letter dated July 19, 2016, Coverco's counsel served a discovery request upon the Division, as authorized by 5 NYCRR 145.1(d). The Division responded on July 27, 2016. Subsequently, with a letter dated August 18, 2016, Coverco's counsel noted that the Division's January 15, 2016 denial letter did not provide a factual basis for the denial, and renewed its request for, among other things, copies of all notes of any interviews conducted by Division staff as part of the Division's review of Coverco's application for WBE recertification.

The Division objected to Coverco's proposed cure to its due process claim. The Division argued that neither SAPA, nor 5 NYCRR parts 144-145 authorize the relief sought by Coverco. In addition, the Division stated that its response was limited to the documents that the Division intended to offer at the hearing consistent with the requirement outlined at 5 NYCRR 145.1(d)(1). (*See* Division's Closing Argument [Division] at 9.)

Coverco's characterization of the January 15, 2015 denial letter concerning the lack of detail is accurate. The Division did not offer any additional information until the hearing.

Pursuant to 5 NYCRR 144.4(d), Coverco chose to exercise its right to appeal from the Division's January 15, 2015 denial which, under such circumstances, is not a final agency determination. A purpose of the administrative appeal hearing is to provide the parties with the opportunity to be heard. At the August 25, 2016 hearing, the parties had the opportunity to develop the record that serves as the basis for my recommendations, as well as the Division's final determination, about whether Coverco should be recertified as a woman-owned business enterprise. During the hearing, the Division provided more details about why it denied Coverco's renewal application. Coverco fully participated in the proceedings. Consequently, the parties have had the opportunity to develop all issues associated with the denial of Coverco's renewal application for WBE recertification.

With respect to its discovery request, Coverco's objection is unsupported. SAPA § 305 authorizes each agency to adopt rules for discovery in the manner appropriate to its proceedings. With respect to the Division's administrative appeal proceedings, discovery is authorized, but limited to the documents in the Division's possession that will be introduced at the hearing (*see* 5 NYCRR 145.1[d][1]). During the hearing, Coverco made no claim that the Division attempted to introduce requested documents not previously disclosed. Therefore, the disclosure provided by the Division was consistent with the regulation outlined at 5 NYCRR 145.1(d)(1).

As previously noted, the Division provided Coverco with copies of staff's notes during the hearing. The notes were marked for identification as WBE Exhibits 15 and 16 (Tr. at 99 and 115). Subsequently, I received these documents into evidence (Tr. at 101 and 142).

B. Administrative Precedent

Coverco asserted that the information presented in its first application (*see* WBE Exh. 4), which resulted in WBE certification in 2010, was substantially the same as the information presented in the renewal application filed for recertification on May 20, 2014 (*see* WBE Exh. 14). (Tr. at 19-20.) Based on the principle of administrative precedent, particularly in the absence of a reasoned determination by the Division to deny WBE recertification, Coverco argued that the Division's January 15, 2016 denial is arbitrary and capricious and, therefore, not supported by substantial evidence. As a result, Coverco concluded that the Division's January 15, 2016 determination should be overturned. (*See* Coverco at 17-20.)

To support its argument, Coverco identified the following cases: (1) *Matter of Charles A. Field Delivery Service (Roberts)*, 66 NY2d 516 (1985); (2) *Matter of Richardson v Commissioner of N. Y. City Dept. of Social Servs.*, 88 NY2d 35 (1996); (3) *Matter of Lantry v State of New York*, 6 NY3d 49 (2005); and (4) *Matter of 20 Fifth Ave., LLC v New York State Div. of Hous. & Community Renewal*, 109 AD3d 159 (1st Dept 2013). (*See* Coverco at 17.)

Each case concerns the judicial review of administrative determinations made after hearing. At issue in *Field Delivery Service* was whether the drivers for the delivery service were employees or independent contractors. Depending on the status of the drivers, the delivery service would be required to make contributions to the unemployment insurance fund. (*See Field Delivery Service*, 66 NY2d at 517-518.) Upon review, the court determined that the facts in *Field Delivery Service*, were indistinguishable from two previous cases.⁴ The court held that in the absence of an explanation by the Commissioner of Labor, the agency's decision with respect to Field Delivery Service was contrary to the prior determinations and, therefore, arbitrary and capricious. The court remanded the matter to the Department of Labor for further proceedings. (*See Field Delivery Service*, 66 NY2d at 518, 522).

In *Richardson* (88 NY2d at 39), the court held that the denial of an emergency grant by the New York City Department of Social Services to prevent the eviction of Ms. Richardson's family was arbitrary, capricious, and contrary to law. The court's determination cited the principle from *Field Delivery Services* (66 NY2d at 517, 520) that in the absence of an explanation, the failure to conform to precedent would require reversal on the law (*see Richardson*, 88 NY2d at 40).

Marke Lantry, a construction subcontractor, asked the Department of Labor to classify the nature of work⁵ associated with a public project to determine the appropriate pay rate. The

⁴ *See Matter of DiMartino (Buffalo Courier Express Co. – Ross)*, 59 NY2d 638, *affg* 89 AD2d 829, and *Matter of Wells (Utica Observer-Dispatch & Utica Daily Press – Roberts)*, 59 NY2d 638, *affg* 87 AD2d 960.

⁵ The workers were tasked with installing windows. The question was whether the pay rate should be that given to ironworkers, or to carpenters. (*See Lantry*, 6 NY3d at 52.)

court held that the agency's determination was not arbitrary and capricious because the determination was consistent with the practice outlined in the Labor Law (*see Lantry*, 6 NY3d at 52, 56). The court concluded that the final agency determination was consistent with the principle established in *Field Delivery Service* (66 NY2d at 517, 520) (*see Lantry*, 6 NY3d at 58).

In *20 Fifth Avenue, LLC* (109 AD3d at 161, 163, 165), the court applied the principle in *Field Delivery Service* (66 NY2d at 517, 520) to a decision by the Division of Housing and Community Renewal (DHCR) to revoke authorization for a major capital improvement (MCI) rent increase for an entire residential building when only 10 of 72 rent-regulated apartments experienced water infiltration and peeling paint, among other things, after exterior renovations were completed. The court observed that DHCR had a long standing policy of exempting the particular apartments with a defect from the MCI increase, rather than all apartments in the entire building. In this case, however, DHCR revoked the MCI rent increase for all the rent-regulated apartments in the building without setting forth its reasons for doing so. The court noted, in particular, that DHCR made no attempt to harmonize the facts with prior DHCR decisions. (*See 20 Fifth Avenue, LLC*, 109 AD3d at 165-166.)

The Division is not bound to recertify Coverco simply because Coverco had been previously certified. Pursuant to Executive Law § 314(5), a WBE certification is effective for three years. Therefore, business enterprises must periodically re-apply to extend the certification, as Coverco has done here. During the recertification process, Coverco has the burden to demonstrate its compliance with the eligibility criteria outlined at 5 NYCRR 144.2. The cases referenced by Coverco, do not change Coverco's burden. Rather, the case law requires the Division to provide a reasoned final determination subsequent to this administrative hearing (*see Field Delivery Service*, 66 NY2d at 520). Through this hearing process, the Division has detailed the reasons why it denied Coverco's application for WBE recertification consistent with the requirements in *Field Delivery Service*.

II. The Division's January 15, 2016 Denial

A. Ownership

In its January 15, 2016 letter (*see* WBE Exh. 1), the Division cited two grounds for denial based on the ownership criteria. First, the Division determined that Coverco failed to demonstrate that Ms. Schaab enjoys the customary incidents of ownership, and shares in the risks and profits in proportion to her ownership interest in the business enterprise, as required by 5 NYCRR 144.2(c)(2). With respect to this criterion, the basis for the Division's determination is the disparity in the compensation that Elizabeth Schaab received in 2013 and 2014 compared to the compensation that William Schaab and Richard Schaab received during the same period.

According to Form 1120-E from Coverco's 2013 corporate tax return, William Schaab's compensation was [REDACTED], and Richard Schaab's compensation was [REDACTED]. However, Elizabeth Schaab's compensation was [REDACTED]. (*See* WBE Exh. 16 and 18; Tr. at 149-150.)

For 2014, Coverco provided copies of its employees' W-2 forms. In 2014, William Schaab's compensation from Coverco was [REDACTED], and Richard Schaab's compensation was [REDACTED]. Elizabeth Schaab's compensation from Coverco was [REDACTED]. (See WBE Exhs. 16 and 19 at 9 [Box 1]; Tr. at 152.) Though greater than William Schaab's compensation, Elizabeth Schaab's compensation in 2014 was less than half that received by Richard Schaab.

Based on Coverco's 2013 tax return and the 2014 payroll records, Division staff found that William Schaab and Richard Schaab received substantially more compensation than Elizabeth Schaab. Accordingly, staff concluded that Ms. Schaab does not enjoy the customary incidents of ownership by sharing in the risks and profits in proportion to her ownership interest in the enterprise, as required by 5 NYCRR 144.2(c)(2). The Division also noted that Ms. Schaab did not share in the profits of the business enterprise through any other means such as dividend payments. (Tr. at 150; see Division at 4-5).

In its post-hearing brief, Coverco claimed that it had the right to introduce evidence at the hearing to rebut the Division's conclusion that Elizabeth Schaab does not enjoy the customary incidents of ownership, and share in the risks and benefits in proportion to her ownership interest in Coverco, as required by 5 NYCRR 144.2(c)(2). Coverco noted that Ms. Schaab had advised Mr. Butler, during the telephone interview, that her compensation had been deferred, rather than reduced, and that Ms. Schaab's compensation was not less than that received by William Schaab and Richard Schaab (Tr. at 47-48). Coverco observed that Division staff apparently ignored this information when considering this eligibility criterion. Because Division staff did not consider all relevant information, Coverco contended that the Division's conclusion that Coverco does not comply with 5 NYCRR 144.2(c)(2) was not based on substantial evidence. (See Coverco at 11-13.)

Because Ms. Schaab discussed the deferral of her income during the telephone interview with Division staff as part of the review of Coverco's renewal application for recertification, the evidence Coverco offered to substantiate this circumstance should be considered. During the hearing, Coverco offered WBE Exhibits 10 and 11. WBE Exhibit 10 consists of copies of minutes from two special meetings of the board of directors held on March 19, 2013 and June 23, 2014. At the March 19, 2013 meeting, the minutes show that the board of directors agreed to reduce the annual salaries of William Schaab and Richard Schaab to set the salaries at [REDACTED] and [REDACTED] respectively. According to the minutes, the reason for the reduction in the salaries was "to provide some cash/bottom line profit that could be used for a reduced year-end bonus to key employees" (WBE Exh. 10). The minutes also show that Elizabeth Schaab's salary would be deferred in order to improve cash flow until William Schaab retired. (See WBE Exh. 10.)

The minutes from June 23, 2014 meeting show, among other things, that in March 2014, Coverco reimbursed William Schaab and Richard Schaab for the previous salary reductions they took during fiscal year 2013. According to the June 23, 2014 minutes, Elizabeth Schaab agreed to continue to accept a reduced salary to help provide liquidity until William Schaab retired. The minutes state further that Ms. Schaab's salary would increase subsequently, and that she would receive all back pay to a level commensurate with her responsibilities, when the company's cash flow improves. (See WBE Exh. 10.)

In addition to the minutes from the board meetings held on March 19, 2013 and June 23, 2014 (*see* WBE Exh. 10), Coverco offered a copy of its payroll register dated July 25, 2016, which provides year to date information about the compensation that Elizabeth and Richard Schaab received from January 1, 2016 to July 31, 2016 (*see* WBE Exh. 11). For this period, Elizabeth Schaab's total compensation, before taxes and other withholdings, was [REDACTED]. This amount included [REDACTED] identified as "RETRO PA," which presumably means retroactive pay or payments. For the same period, Richard Schaab's total compensation, before taxes and other withholdings, was [REDACTED]. (Tr. at 52-53.) WBE Exhibit 11 does not include any information about the salary and other compensation that William Schaab may have received from Coverco from January 1, 2016 to July 31, 2016. (*See* WBE Exh. 11.)

For the following reasons, the record concerning whether Elizabeth Schaab enjoys the customary incidents of ownership, and shares in the risks and benefits in proportion to her ownership interest in Coverco, as required by 5 NYCRR 144.2(c)(2), remains incomplete. First, Coverco offered nothing to show what is Elizabeth Schaab's compensation, as the president and majority shareholder, and how Ms. Schaab's compensation compares to that received by William Schaab and Richard Schaab.

The minutes from the March 19, 2013 and June 23, 2014 board meetings lack significant details relevant to the eligibility criterion at issue here. For example, the minutes are silent about: (1) when Elizabeth Schaab's salary would increase; (2) by how much; (3) whether the forthcoming salary increases for Ms. Schaab would be more than any increases given to Richard Schaab and William Schaab; and (4) how much back pay Coverco actually owed Ms. Schaab. Neither these minutes, nor any other evidence in the hearing record,⁶ demonstrate that Coverco actually compensated Elizabeth Schaab at a higher rate than Richard Schaab and William Schaab, and that Coverco fully compensated Ms. Schaab for back pay, as promised in the June 23, 2014 minutes.

Second, Coverco offered no information about Elizabeth, William, and Richard Schaab's compensation in 2015, such as additional payroll records or tax returns, as well as any minutes from board meetings held subsequent to June 2014.

Finally, WBE Exh. 11 post-dates the Division's January 15, 2016 determination. Consequently, WBE Exh. 11 is not relevant to this matter, given that the scope of this appeal is limited to the information before staff at the time the Division made its determination (*see* 5 NYCRR 144.5[a]). The information offered in WBE Exhibit 11, however, may have merit as part of a subsequent application for WBE certification.

Coverco argued that deferring a portion of Elizabeth Schaab's salary demonstrates that she shared in the risks in proportion to her ownership interest (Tr. at 47-49; Coverco at 11-12). Whether Ms. Schaab shares in either the risks, or the benefits, in proportion to her ownership interest, the proof would be the same. Such proof requires documentation about the salaries and

⁶ At hearing, Coverco offered WBE Exhibit 6, which is a set of its federal income tax returns for 2007, 2008, and 2009 (Tr. at 22-23). Ms. Schaab is identified as a corporate officer only in the 2009 return on Schedule E. In 2009, Ms. Schaab's compensation was [REDACTED]. In contrast, William Schaab's compensation was [REDACTED], and Richard Schaab's compensation was [REDACTED].

any other forms of compensation paid to Elizabeth Schaab, Richard Schaab, and Coverco's other employees. The only credible proof of this nature in this hearing record, which was available to staff prior to the Division's January 15, 2016 determination, was Coverco's 2013 tax return (*see* WBE Exh. 18), and the 2014 payroll records (*see* WBE Exh. 19). Therefore, Coverco offered nothing to substantiate its argument.

WBE Exhibits 18 and 19 show a significant disparity in the compensation that Elizabeth Schaab received in 2013 and 2014 compared to William Schaab and Richard Schaab. In *Matter of CW Brown, Inc. v Canton* (216 AD2d 841, 843 [3d Dept 1995]), the court held that staff's review of tax returns, such as those considered in the captioned matter, was substantial evidence to support the Division's determination whether an application for WBE certification meets the eligibility criterion at 5 NYCRR 144.2(c)(2). Therefore, I conclude that the Division's determination with respect to Coverco's compliance with the eligibility criterion at 5 NYCRR 144.2(c)(2) is based on substantial evidence, and recommend that the Director conclude the same.

As an additional basis for denial, the Division determined that Coverco did not show that Elizabeth Schaab's capital contributions are proportionate to her equity interest in the business enterprise as demonstrated by, but not limited to, contributions of money, property, equipment or expertise, as required by 5 NYCRR 144.2(a)(1) (*see* WBE Exh. 1). To evaluate Coverco's compliance with this eligibility criterion, Division staff requested additional information (*see* WBE Exh. 14 at 7 [Question Nos. 12 and 13]). Coverco provided two responses, which are identified in the hearing record as WBE Exhibits 9 and 17 (Tr. at 40-42, 147).⁷

WBE Exhibit 9 consists of copies of loan agreements and cancelled checks concerning a series of loans made to Coverco. Elizabeth Schaab and Richard Schaab periodically loaned money to Coverco from their personal bank account, which they jointly own. The purpose of the loans was to provide the company with cash. Coverco repaid each loan in full. (Tr. at 41-42.) Both parties agree that these loan transactions are not relevant to the eligibility criteria outlined at 5 NYCRR 144.2(a)(1) (*see* Coverco at 13-14; Division at 2). Consequently, no further consideration is given to WBE Exhibit 9, and any related testimony.

Based on WBE Exhibit 17, William Schaab gifted his shares of the company's stock to Richard Schaab in 1998. At that time, the company redeemed any remaining shares owned by Richard Schaab's siblings. As a result, Richard Schaab became the sole shareholder of Coverco. (*See* WBE Exhs. 16 and 17; Tr. at 54-55.)

In February 2010, Richard Schaab gifted 51% of his Coverco stock shares to Elizabeth Schaab to ensure that she obtained full executive control over the business enterprise. Richard Schaab retained ownership of 49% of Coverco's stock shares. After the stock transfer, Elizabeth Schaab became the president of Coverco, and Richard Schaab became the vice-president. (*See* WBE Exhs. 14, 16, 17; Tr. at 30-31, 54-55.)

⁷ The narrative response (Item #8) provided in WBE Exhibit 17 is nearly identical to the response (Question #8) provided in WBE Exhibit 13. Coverco provided WBE Exhibit 13 as part of the initial application for WBE certification, which is identified in the hearing record as WBE Exh. 4.

Based on WBE Exhibit 17, Division staff found that Elizabeth Schaab's majority shares were a gift from Richard Schaab (Tr. at 147). Division staff also found that Ms. Schaab did not contribute any property, equipment or uncompensated expertise to the business enterprise (Tr. at 141-142). Staff concluded that Ms. Schaab did not provide any personal contribution to the business enterprise, as required by 5 NYCRR 144.2(a)(1). (*See* WBE Exhs. 16 and 17; Tr. at 147.)

During the hearing, staff testified that the Division frequently considers applications for WBE certification where the business enterprise has been either inherited or gifted. Even under such circumstances, the Division maintained that an applicant must, nevertheless, demonstrate that the woman-owner's contribution is proportionate to her equity interest in the business enterprise. (Tr. at 139-140.)

In its closing statement, the Division asserted that Elizabeth Schaab did not identify any contribution of expertise that she provided to Coverco as part of the WBE application for recertification. According to the Division, a representation that Ms. Schaab possesses managerial experience from prior work experiences, as the former president of Fringe Benefit Analysts, Inc., and the current president of Coverco, does not show that Ms. Schaab contributed expertise to the business enterprise. The Division interpreted the requirement at 5 NYCRR 144.2(a)(1) to include money, property, equipment or expertise conferred upon the business without consideration. The Division contended that compensated work would not be consistent with the plain meaning of the term, "contribution." If that were the case, the Division concluded that every employee of every business seeking WBE certification would have made a contribution to that business. (*See* Division at 4.)

With reference to WBE Exhibit 14, Coverco accurately observed, however, that the WBE application form for recertification does not request information about contributions from the woman-owner (*compare* WBE Exh. 4 at 4 [Question No. 8], *with* WBE Exh. 14 at 3 [Question No. 3]). The WBE application for recertification inquires whether the ownership of the business enterprise has changed (*see* WBE 14 at 3 [Question No. 3.C]). Coverco noted that since it initially obtained WBE certification, the majority shareholder has been, and continues to be, Elizabeth Schaab. (*See* Coverco at 4-5.)

Despite the differences between an application for WBE certification, and the one for WBE recertification, Coverco did not identify, nor could I find, any provision of the applicable statute, or implementing regulations, that obviates the need for an applicant to demonstrate that the woman-owner has made a contribution of money, property, equipment, or expertise, as required by 5 NYCRR 144.2(a)(1). The hearing record shows that prior to making its January 15, 2016 determination, Coverco had not provided information to show that Ms. Schaab made a contribution of money, property, equipment, or expertise to the business enterprise in proportion to her equity interest. Therefore, I conclude that the Division's determination with respect to Coverco's compliance with the requirement at 5 NYCRR 144.2(a)(1) is based on substantial evidence, and recommend that the Director conclude the same.

B. Operation

In its January 15, 2016 letter (*see* WBE Exh. 1), the Division cited two grounds for denial based on the operation criteria. First, the Division determined that Coverco failed to demonstrate that Elizabeth Schaab has the experience or technical competence, working knowledge, or the ability needed to operate the enterprise, as required by 5 NYCRR 144.2(b)(1)(i) and (ii). Because Ms. Schaab's professional experience is primarily in the health insurance and third-party benefits industry, the Division argued, on the one hand, that Elizabeth Schaab did not have any training or experience in the insulation industry prior to joining Coverco. On the other hand, Richard Schaab, who was once Coverco's president, has decades of experience in the insulation industry. Under such circumstances, staff found that Elizabeth Schaab relied upon Richard Schaab to operate Coverco, and concluded that Coverco did not comply with the eligibility criteria at 5 NYCRR 144.2(b)(1)(i) and (ii). (*See* WBE Exh. 17; Tr. at 153-155; Division at 8.)

Based on the wording of the eligibility criterion, Coverco contended that it complies with the eligibility criteria at 5 NYCRR 144.2(b)(i) and (ii) because Elizabeth Schaab has extensive managerial experience (Coverco at 7). The eligibility criterion at 5 NYCRR 144.2(b)(i) states in full that:

[m]inority group members or women must have adequate managerial experience or technical competence in the business enterprise seeking certification.

Coverco noted that the adjective, "managerial" modifies the term "experience," which distinguishes the nature of the experience from the alternative standard of technical competence. Coverco also noted that the conjunction "or" between the terms, "managerial experience" and "technical competence," provides the woman-owner with the option to demonstrate either managerial experience or technical competence in order to comply with this eligibility criterion. (Coverco at 7-8.)

Coverco asserted that Elizabeth Schaab has significant managerial experience. According to Coverco, Ms. Schaab has relied upon her prior managerial experiences as the president and owner of Fringe Benefits Analysts, Inc., and that these managerial skills and experiences transferred to her position as president of Coverco (*see* WBE Exh. 3,⁸ Tr. at 15, 17-18, 24-27; Coverco at 8). Coverco argued that good leaders delegate duties and responsibilities, as necessary, to those employees who have the appropriate skills. In addition, Coverco noted that Ms. Schaab has been president of Coverco for the past six years, and that during this time, she has further refined her management skills as they specifically relate to the insulation industry. (*See* Coverco at 7-8.)

The wording of the eligibility criterion at 5 NYCRR 144.2(b)(i) requires an applicant for WBE certification to demonstrate that the woman-owner has either adequate managerial

⁸ WBE Exhibits 2 and 3 are copies of Elizabeth Schaab's résumé. Coverco submitted a copy of WBE Exhibit 2 with the original application for WBE certification (*see* WBE Exh. 4) in December 2010 (Tr. at 17). Subsequently, Coverco submitted a copy of WBE Exhibit 3 with the renewal WBE application for recertification (*see* WBE Exh. 14) (Tr. at 17-18).

experience, or technical competence in the business enterprise. With respect to Coverco's renewal application for WBE recertification, I conclude that Coverco effectively showed that Elizabeth Schaab, as the woman-owner, has adequate managerial experience to operate the business enterprise, as required by 5 NYCRR 144.2(b)(i). The basis for this conclusion is Ms. Schaab's prior managerial experience as the president and owner of Fringe Benefits Analysts, Inc., as well as the experiences that Ms. Schaab's has acquired, and the skills that she has refined, over the past six years, as Coverco's president. I find that Division staff had the information about Ms. Schaab's extensive managerial experiences during the review of the renewal application for WBE recertification prior to the Division's January 15, 2016 determination. I conclude that the Division's determination with respect to Coverco's compliance with the requirement at 5 NYCRR 144.2(b)(1)(i) was not based on substantial evidence. Therefore, I recommend that the Director modify the January 15, 2016 denial with respect to this basis.

The second basis asserted for denial on operational grounds was that Coverco did not show that Elizabeth Schaab makes decisions pertaining to the operations of the enterprise, as required by 5 NYCRR 144.2(b)(1). To evaluate whether an applicant complies with this eligibility criterion, the Division argued that staff may consider whether the woman-owner manages functions critical to the operation of the business enterprise. To support this argument, the Division cited *Matter of Northeastern Stud Welding Corp. v Webster*, 211 AD2d 889, 890 (3d Dept. 1995).

In determining Coverco's core functions, the Division staff reviewed the company's description in the application, and Coverco's supplemental responses (*see* WBE Exhs. 7, 14 and 17; Tr. at 153, 156-157, 171). Coverco designs, fabricates, and installs commercial and industrial heating, ventilating, and air conditioning (HVAC) systems. Coverco also designs, manufactures, and installs removable insulation covers. (*See* WBE Exhs. 14 and 17.)

Division staff found that Richard Schaab makes decisions related to the core revenue-generating functions at Coverco. For example, Richard Schaab fabricates custom insulation orders, and supervises work at the jobsites. He, and other employees of Coverco, have contact with customers. Mr. Schaab oversees equipment maintenance, and makes decisions, as appropriate, about repairs and updates. (*See* WBE Exhs. 7 and 17; Tr. at 30-31.) In addition, Richard Schaab, Dean Massaro, and Scott Brown undertake job estimates (*see* WBE Exhs 7 and 17; Tr. at 154-155, 171). Staff concluded that Elizabeth Schaab did not make decisions pertaining to the operation of Coverco, as required by 5 NYCRR 144.2(b)(1). (*See* Division at 7.)

According to Coverco, Elizabeth Schaab plays a key role with respect to preparing job estimates. Ms. Schaab updates the inputs to the computer software program that Messrs. Schaab, Massaro and Brown use for this purpose. Ms. Schaab explained that costs associated with personnel, such as, workers' compensation, and health insurance, fluctuate. These costs and other business expenses are factors considered in preparing job estimates and bids. Consequently, updating these inputs is an essential task to developing accurate estimates and bids to keep the company profitable. (*See* WBE Exh. 7 and 17; Tr. at 27-28, 30, 171.) Although

Richard Schaab, and others at Coverco, prepare the estimates, Elizabeth Schaab has sole authority to make decisions about estimates (Tr. at 75). (*See Coverco Closing at 10.*)

Ms. Schaab testified that when she took over as the president of Coverco, Richard Schaab assumed the role of vice-president. Nevertheless, Mr. Schaab's responsibilities at Coverco did not change. Then as now, Richard Schaab continues to fabricate custom insulation orders, and supervises work at the jobsites, among other things. (Tr. at 63-64.) Based on this testimony, I find that control of Coverco's day-to-day operations is, at best, shared between Elizabeth Schaab and Richard Schaab. Therefore, Elizabeth Schaab does not engage in the core revenue-generating functions at Coverco in the way that Richard Schaab does. (*See Northeastern Stud Welding Corp.*, 211 AD2d at 890). I conclude that the Division's determination that Coverco does not comply with the eligibility criterion at 5 NYCRR 122.4(b)(1) is based on substantial evidence, and recommend that the Director conclude the same.

CONCLUSIONS

1. Coverco did not demonstrate how Elizabeth Schaab enjoys the customary incidents of ownership and shares in the risks and profits in proportion to her ownership interest in the enterprise, as required by 5 NYCRR 144.2(c)(2).
2. Coverco did not show that Ms. Schaab made any contribution in proportion to her equity interest in the business enterprise as demonstrated by, but not limited to, contributions of money, property, equipment, or expertise, as required by 5 NYCRR 144.2(a)(1).
3. Coverco demonstrated that Ms. Schaab has the managerial experience needed to operate the enterprise, as required by 5 NYCRR 144.2(b)(1)(i).
4. Coverco did not show that Ms. Schaab makes decisions pertaining to the operations of the enterprise, as required by 5 NYCRR 144.2(b)(1).

RECOMMENDATIONS

The Division's determination to deny Coverco, Inc.'s application for recertification as a woman-owned business enterprise should be modified and, as so modified, affirmed for the reasons stated in this recommended order.

Attachment: Exhibit Chart

Division of Minority and Women's Business Development

Exhibit Chart
Matter of Coverco, Inc.

Hearing Date: August 25, 2016

| WBE Exhibit No. | Description |
|----------------------------|---|
| 1 | The Division's January 15, 2016 denial letter |
| 2 | Résumé of Elizabeth H. Schaab (initial) |
| 3 | Résumé of Elizabeth H. Schaab dated August 28, 2015 [Professional Profile] |
| 4 | New York State Certification Application Minority and Women's Business Develop Coverco, Inc. <i>Form Dynamic 10-05-08</i> |
| 5 | Erie County/City of Buffalo Joint Certification Committee Supportive Documents – Narrative to Item 5 |
| 6 | Department of Treasury, Internal Revenue Service Form 1120 US Corporation Income Tax Return Coverco, Inc. and Affiliated Corporations 2007 2008 2009 |
| 7 | Coverco's responses to Items #8, #9, #10, and #11. |
| 8 | Correspondence dated January 4, 2016 and January 7, 2016 from <i>First Niagara</i> |
| 9 | Coverco, Inc. Loan Documents First page dated September 19, 2014 |
| 10 | Coverco, Inc. Board of Directors Minutes of a Special Meeting March 19, 2013 June 20, 2014 |

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| 11 | Paychex of New York, LLC Coverco, Inc. Payroll Register with YTD Check date 07/29/2016, Week 30 Period: 07/16/2016 to 07/31/2016 |
| 12 | Six page Document First page: "In every single case below & other public job we are asked about WBE when quoting." |
| 13 | New York State WBE Certification Application Question #8 Response |
| 14 | Coverco Inc. Certification Application Application Type: Recertification Application Application Number: 0406117 Submitted: 5/20/2014 7 pages |
| 15 | WBE Phase 3 Application Analysis Coverco, Inc. Notes prepared by Glenn Butler |
| 16 | WBE Phase 3 Application Analysis Coverco, Inc. Notes prepared by Glenn Butler with phone interview |
| 17 | Coverco's responses to Items #1 and #12, #8, #9, #10, and #11 |
| 18 | Department of Treasury, Internal Revenue Service Form 1120 US Corporation Income Tax Return Coverco, Inc. and Affiliated Corporations 2013 |
| 19 | Department of Treasury, Internal Revenue Service W-3 Transmission of Wage and Tax Statements 2014 Coverco, Inc. Form W-2 Wage and Tax Statements 2014 Coverco, Inc. – Employees |

As noted throughout the transcript, all above listed exhibits were received into evidence.