

STATE OF CALIFORNIA
STATE WATER RESOURCES CONTROL BOARD

In the Matter of the Petition of)
)
NORVALD LAWRENCE ULVESTAD TRUST)
)
For Review of a Determination of)
the Division of Clean Water)
Programs, State Water Resources)
Control Board, Regarding)
Participation in the Underground)
Storage Tank Cleanup Fund.)
OCC File No. UST-14.)
_____)

ORDER NO. WQ 93-12-UST

BY THE BOARD:

The Norvald Lawrence Ulvestad Trust (petitioner) seeks review of a Final Division Decision (Decision) by the Division of Clean Water Programs (Division) regarding a claim filed by the petitioner seeking reimbursement from the Underground Storage Tank Cleanup Fund (Fund).

The ultimate issue involved in this petition is the priority class to which the petitioner's claim ought to be assigned. Petitioner sought placement of its claim in Priority Class B, commonly referred to as the Small Business Priority Classification. The petitioner's claim was eventually assigned to a lower priority class, Priority Class D. For the reasons hereafter stated, this order determines that petitioner's claim qualifies for Priority Class B and remands this matter to the Division for placement of petitioner's claim in this Priority Class.

I. STATUTORY, REGULATORY, AND FACTUAL BACKGROUND

Chapter 6.75 of the California Health and Safety Code, commencing with Section 25299.10, authorizes the State Water Resources Control Board (State Water Board) to conduct a program to reimburse certain owners and operators of petroleum underground storage tanks for corrective action costs incurred by such owners and operators.¹ Section 25299.77 of the Health and Safety Code authorizes the State Water Board to adopt regulations to implement the reimbursement program. On September 26, 1991, the State Water Board adopted regulations, (hereafter referred to as Cleanup Fund Regulations or Regulations). These Regulations are contained in Chapter 18, Division 3, Title 23 of the California Code of Regulations, and became effective on December 2, 1991. Among other things, the Regulations provide for submittal of reimbursement claims to the State Water Board by owners and operators of petroleum underground storage tanks, for acceptance or rejection of these claims by the Division, and for appeal of any discretionary Division decision to the State Water Board.

Both the statutes which authorize the reimbursement program and the Cleanup Fund Regulations address the issue of prioritization of reimbursement claims. Section 25299.52(b) of the Health and Safety Code provides in relevant part that:

"In awarding claims pursuant to Section 25299.57 or 25299.58, the Board shall pay claims in accordance with the following priorities:

¹ Unless otherwise indicated, all statutory references in this order are to the California Health and Safety Code.

"(1) Owners of tanks who are eligible to file a claim pursuant to subdivision (e) of Section 25299.54.

"(2) Owners and operators of tanks who meet the requirements of subdivision (a) of Section 15399.12 of the Government Code"

Subdivision (a) of Section 15399.12 of the Government Code refers to a "small business" as defined by subdivision (c) of Section 14837 of the Government Code. Subdivision (c) of Section 14837 of the Government Code defines a "small business". That definition in relevant part reads as follows:

"`Small business' means a business, in which the principal office is located in California, and the officers of such business are domiciled in California, which is independently owned and operated, and which is not dominant in its field of operation.

"In addition to the foregoing criteria the director [of the California Department of General Services], in making a detailed definition, shall use dollar volume of business as a criterion. The maximum dollar volume which a small business may have under the definition shall vary from industry to industry to the extent necessary to reflect differing characteristics of such industries. In addition, when the character of any given industry so requires, the director may consider financial ... arrangements of any applicant seeking classification under the definition The director may take account of other relevant factors as determined by regulation."

The general thrust of the statutes just referenced is that second priority in reimbursement of claims from the Fund, which corresponds with Priority Class B under the Cleanup Fund Regulations, is to be given to small businesses as defined in regulations promulgated by the California Department of General Services, Office of Small and Minority Business (OSMB). OSMB has promulgated regulations which define those entities which qualify

as small businesses. (Chapter 8, Title 2, California Code of Regulations.) In relevant part, Section 1896(n)(3) of the OSMB regulations provides:

"`Small Business', when used in reference to a service firm means:

"A business concern in which the principal place of business is located in California and the owners (or officers in the case of a corporation) of such business are domiciled in California, which is independently owned and operated and which is not dominant in its field of operation; and which has been classified by Office of Small and Minority Business in one of the following industry groups, and does not have, together with any affiliates, annual receipts for the preceding three years, exceeding the maximum receipts specified below for the applicable industry groups"
(Emphasis supplied.)

The OSMB regulations then proceed to lay out a number of industry groups and to assign a maximum three-year, gross receipts limit to each industry group. Applicants to OSMB for small business certification are assigned to an industry group. An applicant who meets the gross annual receipts limit of the industry group to which it is assigned qualifies as a "small business"; an applicant who exceeds the assigned receipts limit does not so qualify.

On the subject of qualification as a "small business", the Cleanup Fund Regulations were intended to and essentially do mirror the OSMB regulations. The Cleanup Fund Regulations provide in pertinent part:

"`Small Business' means a business which complies with all of the following conditions

"(a) The principal office is located in California;

"(b) The officers of the business are domiciled in California;

"(c) The business is independently owned and operated;

"(d) The business is not dominant in its field of operation; and

"(e) Gross revenues from the business do not exceed the limits established by Section 1896 of Title 2 of the California Code of Regulations." (Cleanup Fund Regulations, § 2804.)

State Water Board staff developed industry groups and three-year, maximum-receipts limits which generally coincide with the industrial groups and receipts limits established in OSMB regulations. One of the industry groups established by staff was designated "Real Estate Operators, Accountants, Auditors, Appraisers, and Business Services Not Elsewhere Classified" (Real Estate Operator Industry Group). A three-year, maximum-receipts limit of \$3 million was established for this industry group.²

As indicated above, under applicable statutes and OSMB regulations, qualification as a "small business" depends in part on the "receipts" of the "business concern" involved, including "affiliates" of the applicant. OSMB regulations define the relevant terms as follows:

² The development of this industry group is fully discussed in the Matter of the Petition of Melvin and Sylvia Marlowe, State Water Board Order No. WQ 93-7-UST. In view of the fact that neither the nature of this industry group nor assignment of petitioner's claim to this group for purposes of determination of whether that claim qualifies for Priority Class B is at issue in this appeal, no further discussion of the creation of this industry group is included in this order.

"`Business Concern' means: (1) an entity organized for profit, including but not limited to, an individual, partnership, corporation, joint venture, association or cooperative

"`... Receipts' means all pecuniary receipts (less returns, allowances and interaffiliate transactions), the assignment of such receipts notwithstanding, of a business concern from whatever source derived, as entered or to have been entered on its regular books of account for its most recently completely fiscal year (whether on a cash, accrual, completed contracts, percentage of completion or other commonly recognized and accepted accounting method)

"`Affiliate' means a business concern which is a subsidiary of or owned in part by another business concern such that the applicant business concern is subject to the control of a non-applicant business concern(s). As an alternative to actual ownership, an affiliation may be based upon the existence of other appropriate factors including common management, shared or common employees and existing contractual relationships" (Chapter 8, Title 2, § 1896(a), (b), and (j), California Code of Regulations.)

As indicated by the definition of "affiliate", whether another party or business concern is considered to be an "affiliate" depends on the element of "control". This term is defined by OSMB regulations as follows:

"`Control' means the authority or ability to regulate, direct, dominate or directly influence the day to day operations of any business concern. Every business concern is considered as having one or more parties who directly or indirectly control or have the power to control it. Control may be affirmative or negative, and it is immaterial whether it is exercised so long as the power to control exists. If the concern under consideration is a corporation, it should be noted that a party is considered to control or have the power to control a business concern if such party controls or has the power to control fifty percent or more of its voting stock" (Chapter 8, Title 2, Section 1896 (c), California Code of Regulations.)

As interpreted by OSMB, the OSMB regulations provide that in determining whether an applicant meets the gross receipts limit that applies to that applicant, OSMB will look to the gross receipts of both the applicant and any "affiliates" of the applicant; that is, to the gross receipts of both the applicant and any other business concerns controlled by the applicant.

Early on, the Division decided that in determining what constituted a "small business" for purposes of assignment to Priority Class B, the Small Business Priority Classification, the Division would apply both the regulations and OSMB interpretations and applications of those regulations as closely as possible and practicable. In substance, this means that, insofar as possible, a claim against the Fund seeking the Priority Class B will be treated by the Division in the same manner that OSMB would treat an application for small business certification by the same applicant.

Turning to the factual situation involved in this petition, the petitioner is a living trust created on May 27, 1981, by Norvald Lawrence Ulvestad for estate planning purposes. The general purpose of the Trust is to provide support to Mr. Ulvestad during his lifetime and to facilitate distribution of the Trust res (the property or assets that are the subject of the trust) upon his death. From available information, the Trust appears to involve a fairly standard type of living trust, with Mr. Ulvestad being the settlor, the trustee, and the current income beneficiary of the Trust. The Trust is a "revocable

trust"; that is, under the terms of the Trust, Mr. Ulvestad at his option, can terminate the Trust and revest the Trust res, or any part thereof, in himself.

A portion of the current Trust res consists of four pieces of income producing property (two commercial and two residential) which are administered by Mr. Ulvestad as trustee of the Trust. One of the parcels held by the Trust is a site located at 2074 Main Street, Santa Ana, California. Although this property was formerly used as a service station, it was being used as a parking lot when it was added to the Trust res in the early 1980s. While it was thought that all petroleum underground storage tanks had been removed prior to transfer of this site to the Trust, one remaining tank was discovered in 1989. Upon removal of this tank, soil contamination was discovered. The claim filed by the petitioner indicates that over \$30,000 has been spent to date in remedial activity and estimates that an additional expenditure of \$80,000 will be required to complete corrective action at this site.

At the time of filing the claim against the Fund, the Trust res also included 68.9 percent of the voting stock of the United California Savings Bank (Bank), making the Trust the majority holder of the voting stock of that Bank. Since that time, pursuant to the power of revocation vested in Mr. Ulvestad, this Bank stock has been withdrawn from the Trust and title to the stock revested in Mr. Ulvestad as his separate property. At the present time, Mr. Ulvestad personally is the owner of a majority of the voting stock of the Bank.

As previously indicated, the petitioner requested placement of its claim in Priority Class B. Because of the nature of the Trust res and the Trust activities, principally real estate rental, the petitioner's claim was assigned to an industry group which includes Real Estate Operators and which has a three-year, maximum gross receipts limit of \$3 million. Staff then reviewed relevant information to determine whether or not the petitioner met the applicable gross receipts limit. After review, the Division determined that the petitioner did not meet the applicable receipts limit, and that the claim was not entitled to placement in Priority Class B.

The reasoning which resulted in the Division's determination is as follows. For purposes of qualification for Priority Class B, the Division considered the Trust, Mr. Ulvestad, and the Bank to be "affiliates". Because of this determination, in determining whether the applicable gross receipts limit was satisfied, the Division considered it appropriate to take into account the receipts of the Trust, Mr. Ulvestad, and the Bank. Gross receipts of the Bank (principally interest on depositors' funds) for the relevant three-year period amounted to almost \$203 million. Since this amount, in and of itself, greatly exceeded the applicable \$3 million receipts limit for the industrial group to which the Trust claim was assigned, the Division pursued the matter of

gross receipts no further and concluded that the petitioner's claim was not entitled to Priority Class B.³

In connection with the receipts of the Bank, it is appropriate to note that while the Bank had gross receipts of almost \$203 million during the relevant three-year period it sustained a loss in excess of more than \$21 million during this same period. The Bank is a savings and loan association which does business under comprehensive and strict federal rules, regulations, and laws. The significant loss experienced by the Bank so impaired the capital of the Bank that applicable federal regulations effectively precluded use of Bank receipts for the benefit of shareholders of the Bank.

II. CONTENTIONS AND FINDINGS

Contentions: The petitioner contends that its claim was entitled to placement in Priority Class B, the Small Business Priority Classification. This contention is based on several arguments.

First, it is contended that the Division's approach improperly disregards the legal form of the Trust and in effect declares Mr. Ulvestad, rather than the Trust, to be the true claimant.

Second, it is argued that the Division should not have applied the OSMB regulations on "receipts" of "affiliates" to

³ The claim was eventually placed in Priority Class D with an indication from the Division to the petitioner that the claim would be reassigned to Priority Class C upon furnishing of information showing that the petitioner and all affiliates employed less than 500 full and part-time employees.

attribute to the claimant receipts of the Bank or other persons or entities. Petitioner objects to the Division's reliance on OSMB regulations. Petitioner also contends that even if the OSMB regulations are applicable, they do not support the result reached by the Division. Petitioner points to the definition of "affiliate", arguing that the definition is based on "control" of the applicant business concern. In petitioner's view, for the Bank to be an "affiliate" of the Trust for purposes of attributing Bank income to the Trust, the Trust would have to be subject to the control of the Bank. Petitioner argues that, far from the Bank controlling the Trust, if anything the reverse is true--the Trust or Mr. Ulvestad, as principal shareholder of the Bank, controls the Bank.⁴

Third, it is argued that the Bank "revenues" attributed to Mr. Ulvestad actually involved depositor funds which are not available to Mr. Ulvestad personally under federal law. The petitioner argues that while Mr. Ulvestad is the principal shareholder of the Bank, the Bank actually lost some \$21 million during the relevant three-year period, has never declared a dividend, and could not legally declare a dividend because of the financial condition of the Bank.

Findings: The critical issues in this matter are as follows. Given the particular circumstances of this case, who should be considered to be the "owner" of the site in question

⁴ It is noted that, at least as OSMB interprets its regulations, "affiliate" income includes not just the gross receipts of those businesses which control the applicant but also the gross receipts of those business which are deemed to be controlled by the applicant.

and the "claimant" against the Fund for purposes of assignment to a priority class? Should it be the Trust or should it be Mr. Ulvestad? When an answer to this issue has been reached, the second critical issue is what gross receipts should be attributed to this "claimant" for purposes of determining whether or not this "claimant" meets or does not meet the applicable receipts limit? Should the Trust gross receipts be attributed to this "claimant"? Should Bank receipts be attributed to this "claimant"? If Bank receipts should be so attributed, what type of Bank receipts should be included in the calculations?

Turning to the first issue, who should be considered to be the "owner" of the site in question and the "claimant" for purposes of assignment to a priority class, the State Water Board, like the Division, is more concerned with substance than with form. The titular claimant is a revocable trust, with Mr. Ulvestad as the settlor of the Trust, the current trustee, and the current income beneficiary of the Trust. Mr. Ulvestad, as trustee, has virtually total control over the site involved in the claim. Moreover, Mr. Ulvestad has the absolute power, at his sole option, to remove the site in question from the Trust and retransfer legal title to the site to himself, just as he removed the Bank stock from the Trust and revested title to that stock in himself. Under these circumstances, the State Water Board believes that Mr. Ulvestad should be considered to be the "owner"

of the site in question and the real "claimant" against the Fund for purposes of assignment to a priority class.⁵

Turning to the second critical issue, what gross receipts should be attributed to Mr. Ulvestad for the purposes of calculation of Mr. Ulvestad's receipts for the relevant three-year period?

Although petitioner argues that it was improper for the Division to look to these OSMB regulations on "receipts" of "affiliates", these regulations clearly should be applied in determining which claims qualify for Priority Class B.

The relevant legislation authorizes OSMB to adopt regulations to define "small businesses" and then expressly limits Priority Class B to those entities who qualify as a small business under OSMB regulations. Given the statutory directions which are involved, it would be improper not to utilize pertinent OSMB regulations which define and control which entities qualify as "small businesses", including those regulations which speak to determination of receipts of the businesses under consideration.

⁵ Two comments are appropriate on this point. First, the State Water Board is not unmindful of the possibility that a different conclusion could open the door to inappropriate manipulation of the priority system. Conceivably, if the revocable trust were to be considered to be the "owner" and "claimant" for purposes of assignment to a priority class, persons not otherwise eligible for Priority Class B could establish a living trust with limited assets and income, assign the contaminated site involved to that trust, and then seek placement in Priority Class B on the grounds that the trust, as "owner" and "claimant", met the gross receipts limitation. Such a result would obviously be inconsistent with the legislative intent in establishing the current priority system. Second, the determination in this matter is not intended to speak to the issue of who is to be considered to be the appropriate "owner" and "claimant" against the Fund in cases where an irrevocable trust is involved. The State Water Board will speak to this issue when and if it arises.

While the Cleanup Fund Regulations may not directly address this issue, in the opinion of the State Water Board, the relevant statutes themselves essentially require this approach.

Discussions with OSMB have indicated that their approach to similar problems revolves around the issue of control. If an applicant to OSMB has substantial control over other business concerns, the gross receipts of all the business concerns involved are considered in determining whether or not the applicable gross receipts limit is complied with. For example, if an applicant to OSMB owns 50 percent or more of the voting stock of another corporation, the gross receipts of that corporation would normally be added to the applicant's other receipts to determine if applicable income limits were complied with.

In this particular case, for purposes of priority classification, the State Water Board considers the "owner" and "claimant" to be Mr. Ulvestad. Under normal circumstances, it would be appropriate to include the gross receipts of all businesses and assets which are substantially owned and controlled by Mr. Ulvestad, as well as Mr. Ulvestad's personal income, in calculating whether or not the applicable gross receipts limit of \$3 million has been satisfied. This approach is fully supported by the legislative intent behind establishment of the current priority classes. The obvious legislative intent behind the current priority system is that those persons who are least able to defray the costs of site cleanup ought to receive highest priority. Mr. Ulvestad is the controlling shareholder of

the Bank, and has virtually total control over the Trust and the Trust assets. The State Water Board will not blind itself to the fact that, absent unusual circumstances, income from all of these sources, in addition to Mr. Ulvestad's personal income would normally be under the practical control of Mr. Ulvestad.

The gross receipts which should be attributed to Mr. Ulvestad for purposes of priority classification clearly should include the personal receipts of Mr. Ulvestad (wages, salary, interest, dividends, etc.). Likewise, the gross receipts of the Trust also ought to be included, Mr. Ulvestad being for all practical purposes the owner of the Trust res and the current income beneficiary of the Trust. From the information available, it appears that Mr. Ulvestad's gross receipts from the sources just mentioned for the relevant three-year period amounted to almost \$2.5 million.⁶

The gross receipts of the Bank normally should be included in the overall calculation of the gross receipts of Mr. Ulvestad. Mr. Ulvestad is the holder of a majority of the voting stock of the Bank. Under OSMB regulations and regulatory interpretations, Mr. Ulvestad and the Bank are considered to be "affiliates" and Bank receipts would normally be attributed to Mr. Ulvestad for purposes of calculating the total gross receipts of Mr. Ulvestad.

However, this case presents unusual circumstances. Given the particular facts of this case, what Bank "receipts"

⁶ *It is worth noting that for tax purposes these receipts include all rental income from the real property held by the Trust.*

should be included in calculating the total receipts attributable to Mr. Ulvestad? Division staff included all Bank income attributable to use of depositor funds as being Bank income for purposes of calculating Mr. Ulvestad's gross receipts. In the estimation of the State Water Board, this approach is not supportable under the facts of this case.

The Bank is not the normal type of corporation. As a banking institution, the Bank is subject to extensive and specific federal regulation and control. In this particular case, the Bank lost over \$21 million during the relevant three-year period. This loss does not involve simply a bookkeeping loss. The loss was such that it severely impaired the Bank's capital. The capital impairment was such that it brought into play federal regulations which severely limit the manner in which Bank receipts can be utilized. One of the consequences of the capital impairment sustained by the Bank was that Bank receipts effectively could not be used for the benefit of Bank shareholders, even shareholders who, like Mr. Ulvestad, hold a majority of the voting shares of the Bank.

As has been indicated, under OSMB approaches, the income of an "affiliate" is attributed to another person or business entity on the theory that this other person or entity controls the "affiliate" and hence has practical control over the gross receipts of the affiliate. In this case, due to the capital impairment sustained by the Bank, for practical purposes, Mr. Ulvestad did not and does not have effective control over the Bank receipts, since applicable federal regulations essentially

preclude Mr. Ulvestad from use of the gross receipts of the Bank for the benefit of himself or other shareholders of the Bank. Under the circumstances of this case, for purposes of priority classification, it would be unfair to attribute the gross receipts of the Bank to Mr. Ulvestad since he is, for practical purposes, precluded from beneficial use of these receipts under federal regulations.

III. SUMMARY AND CONCLUSIONS

1. In the case of a revocable living trust, where the Trust res includes a site contaminated by unauthorized releases of petroleum products and this site may be revested in the settlor at the option of the settlor, and where a person is the settlor of the trust, the trustee of the trust, and the income beneficiary of the trust, that person shall be considered to be the owner of the site and the claimant for purposes of placement in a priority class. Compliance with the gross receipts limits for Priority Class B shall be based on the income attributable to that person.

2. In this case, for purposes of placement in a priority class, the owner of the site and the claimant shall be deemed to be Mr. Norvald Lawrence Ulvestad. Gross receipts attributable to Mr. Ulvestad for the relevant three-year period should include his personal gross receipts and the gross receipts of the Trust.

3. Where a claimant owns or controls 50 percent or more of the voting stock of a corporation, the corporation is

deemed to be an affiliate of the claimant, and the gross receipts of that corporation are normally attributable to the claimant for purposes of determining whether the claimant complies with the applicable gross receipts limit for placement in Priority Class B.

4. In this particular case, although Mr. Ulvestad controls more than 50 percent of the voting stock of the Bank, due to the capital impairment of the Bank and the impact of applicable federal regulations, Mr. Ulvestad does not have practical control over utilization of the Bank's gross receipts and these gross receipts should not be attributed to Mr. Ulvestad for purposes of priority classification.

5. The maximum three-year gross receipts limit applicable to Mr. Ulvestad is \$3 million. Gross receipts appropriately attributable to Mr. Ulvestad under the facts of this case do not exceed \$3 million, and Mr. Ulvestad's claim should be assigned to Priority Class B.

6. This order is limited to the specific facts of this case, that is, to a situation where the corporate "affiliate" of the majority shareholder is a financial institution subject to

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federal regulations where the circumstances are such that the federal regulations effectively preclude use of the institution's gross receipts for the benefit of its shareholders.

V. ORDER

IT IS THEREFORE ORDERED that this matter is remanded to the Division for placement of petitioner's claim in Priority Class B.

CERTIFICATION


The undersigned, Administrative Assistant to the Board, does hereby certify that the foregoing is a full, true, and correct copy of an order duly and regularly adopted at a meeting of the State Water Resources Control Board held on August 19, 1993.

AYE: John Caffrey
 Marc Del Piero
 James M. Stubchaer
 Mary Jane Forster
 John W. Brown

NO: None

ABSENT: None

ABSTAIN: None


Maureen Marché
Administrative Assistant
to the Board

