

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
FINNISH LINE MOTORSPORTS, INC.,) OTA NO. 18063369
)
APPELLANT.)
)
_____)

TRANSCRIPT OF PROCEEDINGS

Los Angeles, California

Tuesday, February 19, 2019

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken at
355 South Grand Avenue, South Tower, 23rd Floor,
Los Angeles, California, 90012, commencing at
1:49 p.m. and concluding at 2:23 p.m. on
Tuesday, February 19, 2019, reported
by Ernalyn M. Alonzo, Hearing Reporter, in and
for the State of California.

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APPEARANCES:

Panel Lead: Hon. NGUYEN DANG

Panel Members: Hon. LINDA CHENG
Hon. KENNY GAST

For the Appellant: KEL MCINTEE, Taxpayer
VINCENT W. DAVIS, Attorney

For the Respondent: State of California
Franchise Tax Board
By: SCOTT LAMBERT
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I N D E X

OPENING STATEMENT

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Los Angeles, California; Tuesday, February 19, 2019

1:49 p.m.

ADMINISTRATIVE LAW JUDGE DANG: Good afternoon, everyone. We're opening the record in the appeal of Finnish Line Motorsports, Inc., DBA Pasadena Yamaha before the Office of Tax Appeals. The Case No. is 18063369. This hearing is being convened in Los Angeles on February 19, 2019, at 1:49 p.m.

Today's case is being heard by a panel of three judges. My name is Nguyen Dang, and I will be acting as the lead judge for purposes of conducting this hearing. Also on panel with me today is Judges Kenneth Gast and Linda Cheng.

At this time will the parties please introduce themselves for the record, beginning with the Appellant.

MR. DAVIS: Good afternoon, Your Honors. Vincent Davis on behalf of the Appellant.

MR. LAMBERT: My name is Scott Lambert. To my left is Robert Tucker, and to his left is Lisa Renati. We all represent California Department Tax and Fee Administration.

ADMINISTRATIVE LAW JUDGE DANG: Thank you so much. The issue to be heard today is the imposition of the 40-percent penalty described in Revenue and Taxation

1 code Section 6597 for failing to timely remit collected
2 tax reimbursement.

3 Does that sound correct to you, Appellant?

4 MR. DAVIS: Yes, Your Honor.

5 ADMINISTRATIVE LAW JUDGE DANG: CDTFA?

6 MR. LAMBERT: That's correct.

7 ADMINISTRATIVE LAW JUDGE DANG: Thank you. Prior
8 to the hearing, the parties have stated that they intend
9 to submit as evidence the exhibits attached to their
10 briefs, which have already been previously exchanged. In
11 addition, several other documents were provided following
12 the prehearing conference, which were combined into a
13 giant electronic exhibit file that you should have
14 received by now.

15 Mr. Davis, did you receive that file? Have you
16 had a chance to review it?

17 MR. DAVIS: Yes, Your Honor. The PDF file?

18 ADMINISTRATIVE LAW JUDGE DANG: Correct.

19 MR. DAVIS: Yes.

20 ADMINISTRATIVE LAW JUDGE DANG: Are there any
21 objections into entering this files into the record?

22 MR. DAVIS: Not to that file, Your Honor.

23 ADMINISTRATIVE LAW JUDGE DANG: Okay. And to
24 Respondent, did you receive a copy of that PDF file, and
25 have had a chance to review it?

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MR. LAMBERT: I have.

ADMINISTRATIVE LAW JUDGE DANG: Okay. Are there any objections to admitting that file into the record?

MR. LAMBERT: None.

ADMINISTRATIVE LAW JUDGE DANG: Okay. And today I have noticed CDTFA, you have also brought these audit waivers as requested. Would you like to have these entered into the record as well?

MR. LAMBERT: Yes, we would.

ADMINISTRATIVE LAW JUDGE DANG: And Mr. Davis?

MR. DAVIS: We do object, Your Honor.

ADMINISTRATIVE LAW JUDGE DANG: You do object?

MR. DAVIS: Should I state my basis?

ADMINISTRATIVE LAW JUDGE DANG: Sure.

MR. DAVIS: Number one, Your Honor, I believe that introducing these three documents into evidence is violative of Prehearing Conference Minute and Orders III. The last sentence, "The parties are intended to submit additional evidence prior to the hearing."

And then in the section named "Order," it says, "No. 1, no later than February 9, 2019 Appellant, and Respondent will submit additional evidence to the Office of Tax Appeal and a copy to the other party. Documents submitted to the OTA will be directed to Claudia Lopez."

I was just given these documents, Your Honor,

1 right before we went on the record. I haven't even read
2 them. I don't know anything about these signatures. I
3 haven't discussed them with my client, so I would object.
4 I know this is an administrative hearing, but I would just
5 like to say, Your Honor, it's violative of my client's due
6 process. It's also hearsay, and there's no foundation.

7 ADMINISTRATIVE LAW JUDGE DANG: Mr. Davis, you're
8 aware that the rules of evidence --

9 MR. DAVIS: I -- I know it's an administrative
10 hearing.

11 ADMINISTRATIVE LAW JUDGE DANG: Okay. I'm going
12 to allow CDTFA a chance to respond.

13 MR. TUCKER: Your Honor, at the time that you
14 mentioned this issue, it was unclear whether or not it
15 would be coming up. You gave a number of options that it
16 had to be addressed in pre-briefing or briefing prior to
17 the hearing that could be brought up at the time of the
18 hearing or perhaps in post-hearing briefing. So it was
19 unclear whether or not this was necessary.

20 ADMINISTRATIVE LAW JUDGE DANG: Okay. Panel
21 members? Anyone?

22 Mr. Davis, my inclination is to sustain your
23 objection because it is violative of the order that was
24 sent in writing to CDTFA. However, this is information
25 that the panel would request in any instance in additional

1 briefing following this hearing.

2 So I leave it up to you in this cause of if you
3 would like to continue, we would simply request this
4 information in additional briefing following this. So I
5 can sustain your objection, but we're just going to ask
6 for this information again. Or you can withdraw your
7 objection, and then we will provide you with 30 days
8 following this hearing to file your response.

9 MR. DAVIS: Well, Your Honor. If you sustain the
10 objection and they're not admitted today and you request
11 the information, won't I have time to respond as well?

12 ADMINISTRATIVE LAW JUDGE DANG: You will.

13 MR. DAVIS: Okay. So I would ask the court to
14 sustain.

15 ADMINISTRATIVE LAW JUDGE DANG: Your objection is
16 sustained, and this is not coming in today. With that
17 being said, the electronic briefing file for this case
18 will now be admitted into the record.

19 (The Electronic Briefing File was received
20 in evidence by the Administrative Law Judge.)

21 And Mr. Davis if you're ready, you may have your
22 15 minutes to begin your presentation.

23 MR. DAVIS: Thank you, Your Honor.

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OPENING STATEMENT

MR. DAVIS: Your Honor, the petitioner or the Appellant in this case is a California corporation. It's been in operation since July of 1999. The corporation is primarily operated by the husband and wife team, Mr. Kel McIntee and his wife Terri.

Kel is president. Terri is the secretary. And this represents or is related to the petitioner's third or fourth audit during the period of January 1, through December 31, 2012, which resulted in a notice of deficiency, dated January 20th, 2015. The prior audits for these periods were in October 1st, 2001, through September 30, 2004, and April 1st, 2006, through March 31st, 2009.

During the relevant period, the Appellant used Terri to prepare its returns for the years at issues and the current audit. The mistakes made by Terri preparing these returns were unintentional, as Terri did not fully understand how to accurately report the business's sales and use tax liability. Terri was not trained in the preparation of filing of sales and use tax returns, but was used by the Appellant primarily to cut down on cost.

More importantly, Terri suffers from a debilitating condition, multiple sclerosis. The disease causes Terri to experience a shutdown of her inner ability

1 to make decisions and to think clearly. While under the
2 stress of having to prepare these returns and other
3 business matters, Terri had no proper knowledge of how to
4 do what caused these substantial mistakes.

5 Your Honors, in the PDF packet for the
6 exhibits -- and it's the document, I believe, submitted by
7 the Department -- in Exhibit I, page 115, we have
8 something called the Report of Field Audit. Down towards
9 the bottom it's under Penalty Section, 10 percent penalty
10 negligence penalty recommended. At the very last
11 sentence, negligence noted.

12 Your Honors, I believe the imposition of the
13 40 percent penalty would be unjust. I'm sure Your Honors
14 are familiar with Section 6597. The pertinent parts, I
15 think, are in (a)(1)(b). It says, "If a person's failure
16 to make a timely remittance of sales tax reimbursement or
17 use taxes due to reasonable cause or circumstances beyond
18 the person's control, and occurred notwithstanding the
19 exercise of ordinary care and absence of willful --
20 absence of willful neglect, person shall be relieved of
21 the penalty imposed by the subdivision."

22 Going further on in that section, in
23 subdivision(b) for purposes of this section: "Reasonable
24 cause or circumstances beyond the person's control"
25 includes, but is not limited to any of the following, (a),

1 the occurrence of death or serious illness of a person.

2 And that's what we have here.

3 Your Honor, on the issue from the court's
4 conference order -- minutes of conference order, the issue
5 of fraud came up and the court wanted to address that. We
6 only have one, what I believe, substantial piece of
7 evidence, and that's page 115. The person who did the
8 audit and wrote the report said this is negligence. This
9 is not fraud. I don't believe that the Department had
10 shown any evidence to substantiate fraud.

11 Fraud -- quote, "Fraud is never presumed or
12 imputed. It must be established by independent evidence
13 that establishes fraudulent intent on the taxpayer's
14 part." That's citing Knutsen-Rowell at the Tax Memo
15 2011-65, "because direct proof of the taxpayer's intent is
16 rarely available, fraud may be proven by circumstantial
17 evidence and reasonable inferences may be drawn from the
18 relevant facts," Citing the same case.

19 We often rely upon certain indicia of fraud to
20 decide whether fraud is present. The badges of fraud
21 include; 1, understatement of income; 2, maintenance of
22 inadequate records; 3, failure to file tax returns, which
23 is not the case in this situation; 4, plausible or
24 inconsistent explanations of behavior; 5, concealments of
25 income or assets; 6, failure to cooperate with facts

1 authorities. We don't have the last two here. 7,
2 engaging in illegal activities; 8, dealing in cash; 9,
3 failure to make estimated tax payments; and 10, filing
4 false documents.

5 Here petitioner did maintain adequate records,
6 and did file timely tax return. Further, the Appellant
7 has provided a plausible explanation as to why the tax
8 returns were erroneous. Petitioner had utilized the
9 services of Terri. Moreover, none of the income or assets
10 has been concealed by the Appellants from the Department.
11 On the contrary, the Appellant diligently cooperated with
12 the authorities and the audits, and did not even dispute
13 the results but the audit and the liability of the taxes
14 that were owed.

15 Petitioner did not engage in any illegal
16 activities, nor did it fail to make its estimated tax
17 payments. The Appellant never falsified any documents.
18 The Appellants have sought to resolve the matter as
19 expediently and as cooperatively as possible. Therefore,
20 I argue that there is no indicia of fraud. Again, I go
21 back to page 115, negligence. At worst case scenario, I
22 believe this is a 10-percent case, not a 40-percent case.

23 Thank you.

24 ADMINISTRATIVE LAW JUDGE DANG: Thank you. Panel
25 members, any questions?

1 ADMINISTRATIVE LAW JUDGE GAST: No questions.

2 ADMINISTRATIVE LAW JUDGE CHENG: No questions.

3 ADMINISTRATIVE LAW JUDGE DANG: I have one brief
4 question for you, Mr. Davis. I wonder if you can give a
5 little bit more specific explanation as to how
6 Ms. McIntee's illness constitutes a reasonable cause?

7 MR. DAVIS: Yes, Your Honor.

8 ADMINISTRATIVE LAW JUDGE DANG: Maybe tie the
9 pieces together a little more.

10 MR. DAVIS: Terri suffers from a debilitating
11 condition, multiple sclerosis, which is affected by
12 stress. The disease causes Terri to experience a shutdown
13 in her ability to make rational decisions and to think
14 clearly. Thus, while under the stress of operating this
15 business in preparing tax returns, Terri had no proper
16 knowledge how to, which caused her to make significant
17 mistakes in preparation of payments to the Department.

18 I hope that answers your questions.

19 ADMINISTRATIVE LAW JUDGE DANG: Okay. Was there
20 a different return prepared prior to this liability period
21 issue?

22 MR. DAVIS: I believe there was, Your Honor. I
23 believe there was a certified public accountant. And as I
24 mentioned earlier, one of the reasons they used Terri was
25 because they couldn't afford the certified public

1 accountant.

2 ADMINISTRATIVE LAW JUDGE DANG: Was Terri
3 qualified to? What qualifications did she have to prepare
4 the corporation return?

5 MR. DAVIS: I'm not sure about her
6 qualifications, Your Honor, but I do know she's made some
7 mistakes. Mea culpa. I'm not here saying that. What I'm
8 here saying is it wasn't fraud. It was negligence. As
9 page 115 tells us, at the time of the event, at the time
10 of the audit.

11 ADMINISTRATIVE LAW JUDGE DANG: I'm curious as to
12 why she was selected if she was -- she had this illness.
13 And if the corporation wasn't certain of her capability to
14 file these returns, why was she selected to prepare the
15 returns?

16 MR. DAVIS: That I don't know, Your Honor. I
17 would be speculating.

18 ADMINISTRATIVE LAW JUDGE DANG: Okay. Thank you.
19 CDTFA, you may begin with your presentation.

20

21 OPENING STATEMENT

22 MR. LAMBERT: Thank you, Your Honor.

23 This audit period covers three years. It's for
24 the years 2010, 2011, and 2012. The taxpayer is required
25 to file quarterly returns for those periods, and they did

1 so. Waivers were obtained for the expiring period so that
2 when the notice of determination was issued, even if there
3 had not been a fraud penalty applied, that all periods
4 would have been open to the statute of limitations based
5 on those waivers.

6 MR. DAVIS: Your Honor, may I make an objection?
7 Since those waivers are not in evidence --

8 ADMINISTRATIVE LAW JUDGE DANG: I'm sorry. Could
9 you please speak up a bit?

10 MR. DAVIS: Yes. Might I interpose an objection?
11 He's referring to something that's not even in evidence.
12 The Court sustained my objection to that.

13 ADMINISTRATIVE LAW JUDGE DANG: Your objection is
14 sustained. If you could just continue without mentioning
15 the waivers at this time?

16 MR. LAMBERT: Okay. Well, the statute of
17 limitations is open for the period of time when the notice
18 of determination was issued. The -- well, I'll just step
19 back. Well, I'll go forward.

20 It was our understanding there was a different
21 agreement at the time of the prehearing conference, and
22 the Department feels that we followed what was said at the
23 prehearing conference. And so we were told to bring
24 something here that we -- that we had brought. So anyway
25 I'll move on.

1 A 40-percent penalty was applied in this
2 particular case under the requirements of 6597, which
3 is -- there's two items that you have to have, or two
4 criteria in order to apply the 40-percent penalty. The
5 first one is that the liability has to be at least \$1,000
6 per month.

7 And in this particular case, the taxpayer filed
8 quarterly. So in effect he would have to average over
9 \$3,000 for that quarterly period. If you refer to
10 page 145 of the exhibits -- and the exhibits that I'm
11 referring to are the combined exhibits, which are
12 different than the numbers that -- of our -- of the
13 Department's exhibits. But I'm going to go by combined
14 exhibits.

15 So 145 would be part of the -- the decision, and
16 it would be Exhibit 1, page 3. At the bottom there is a
17 chart. And what you'll see from that chart in Column E,
18 that the average unremitted tax per month meets the \$1,000
19 average per month for each quarter and audit period.

20 The second requirement of 6597 is that it has to
21 be over 5 percent in error. If you look at Column F, it
22 gives the percentage of error, and it averages 73 percent
23 for the audit period. Each particular quarter is above
24 5 percent. One thing that should be pointed out is when
25 the taxpayer originally filed the returns. There was a

1 substantial underreporting that they collected during the
2 audit period, \$252,000, and they only reported \$28,000.
3 And this is on page 58 of the exhibits.

4 It shows in effect the taxpayer reported just
5 over 11 percent of the sales tax that they collected from
6 their customers. Also a requirement of 6597 is that there
7 had to have been sales tax reimbursement collected from
8 the customers. And in this case, that is what happened.
9 The taxpayer had a point of sale system, and it showed
10 sales tax that was collected on all the sales -- all the
11 taxable sales that they had. And that's the figure that
12 was used for the audit period. So they had underreported
13 \$223,000 for the audit period.

14 What happened was the Department has a program
15 with DMV, and that they will provide us with information.
16 And before the start of this audit, taxpayer was sent some
17 billing for periods where it was noted that -- or DMV had
18 noted that the sales that were being reported by the
19 Appellant were understated, and they were billed the --
20 the Department billed the Appellant, and the sales for
21 that was \$481,000.

22 The Appellant has been given credit for that, and
23 that's reflected in the chart that is on -- on page 145.
24 So that has all been taken into account, what they filed
25 on the return plus the billing after a certain period of

1 time. The tax -- the audit that's at issue here is the
2 third audit.

3 So in the second audit, if you go to page 90 of
4 the exhibits, what this is for the second audit. It's a
5 transcript of the returns that were filed for that period.
6 If you take a look at -- it's about the middle of the
7 chart, and it'll say C -- I'm sorry -- SC STTA Tax Due,
8 and the total for that is \$343,000.

9 This is the -- that's the state local tax that
10 was collected for this period of time. If you go to the
11 next column, it's the local tax, then the transit tax.
12 Ultimately, the taxpayer reported \$452,000 in tax for the
13 second audit. And why this is important is if you take a
14 look at the quarterly tax that was being collected for
15 each one of these periods -- I'm sorry. I should say
16 reported for each one of these periods.

17 So the second quarter of '06 is \$44,770, and the
18 last quarter -- the first quarter of 2009 is \$58,596. And
19 what you'll notice is these are all five-figure tax per
20 quarter. Even though the taxpayer did underreport for
21 this period of time, the second audit, and they
22 underreported, I think essentially, because they didn't
23 report part sales and service sales of parts.

24 So what's important to this is to compare this to
25 what was reported in this audit, which is on page 50 of

1 the exhibits. And on page 50, what you'll see in
2 Column K -- and this is a transcript of the returns from
3 this audit period that the taxpayer filed. If you take a
4 look at the taxes being reported for each one of those
5 periods, the first period is \$4,130 and the last period is
6 \$2,098.

7 These are substantial differences from what was
8 reported just in the prior audit period. So the argument
9 that's being made is that the person that is preparing
10 these returns didn't understand how to do the returns.
11 And I think when you make these comparisons, a person
12 would notice that they were paying somewhere between 30,
13 to 50, to \$60,000, and now they are paying a couple of
14 thousand dollars for a quarter.

15 So what I'd also like to do is take a look at
16 page 60 for a minute. And these are our -- I'm sorry. It
17 is page 67 of our -- of the exhibits. And what you'll see
18 is that in March of 2007, a couple of years before the
19 audit period, Terri McIntee, which is the person that's
20 preparing the returns, is involved in the payment.
21 They're behind in payments. They're being contacted. So
22 they know the amounts of liability that is showing up that
23 they owe.

24 And they're just -- these aren't all the
25 transcripts from the notes. They're just some excerpts,

1 which basically show that Terri McIntee was aware of the
2 large liability from the earlier periods. If you go to
3 112, what that will show is that's the first quarter of
4 2009. And even though that's outside of this audit
5 period, what it shows is that the person who signed this
6 return is Terri McIntee. And the preparer is Mark
7 Englander who is the CPA. And the liability that's being
8 reported is on line 21, which is \$58,598 that is due for
9 that return.

10 If you go to Exhibit 114, it'll show on line 21
11 it's the same people that are signing this, \$31,177 that
12 is due. And then when you go to 116, you start seeing the
13 numbers drop off. On line 21 it's \$12,794. When you go
14 to the 4th quarter of '09, which is on Exhibit 118, it
15 shows \$8,478. And then if you refer back to the prior
16 transcript of returns, when the taxpayers reporting only a
17 couple of thousand dollars, there's a significant
18 difference.

19 Now, in this type of business they're selling
20 relatively large valued items, motorcycles. It's, you
21 would collect -- on any particular sale you would have a
22 substantial amount of sales tax that is collected. So to
23 think you would only owe \$2,000 would not be reasonable.
24 On page 120, this is the fourth audit. So I believe the
25 Appellant was referring to the fourth audit when they were

1 mentioning the negligence penalty.

2 The -- and what's important is the fourth audit
3 does not make -- there to be intent for the third audit
4 because you can't have that. Your intent has to be -- if
5 you're -- the intent for fraud has to be at the time that
6 you're filing the return. So even if you filed the return
7 and then you tried to cover it up afterwards, if your
8 intent was not to commit fraud when you filed that return,
9 there is none. There isn't any fraud.

10 So the intent is when you file the return that
11 you intend to underreport it. So in the fourth audit
12 what's important here is that you go to page 127 and under
13 Reporting Method, it says, "Terri McIntee, secretary,
14 prepared and filed all the sales tax returns."

15 So you essentially have underreported the same
16 amount in the fourth audit that you did in the third
17 audit. And if you believe that Terri McIntee was ill and
18 could not adequately prepare the returns, it doesn't
19 appear that the Appellant decided that when they allowed
20 her to continue filing the returns after the audit in
21 question here. So afterwards she continues under -- she
22 continues filing returns and under reporting, which I
23 believe goes back to the illness issue.

24 We don't believe that her illness affected her
25 from filing the returns. When you take a look at the

1 doctor's order, which is page 4 here, it just mentions
2 that she should be on -- she should be on a restricted
3 work schedule, that she should only be working 24 hours a
4 week. It doesn't say she shouldn't be working or that she
5 can't work. It says that she should be limited in the
6 work that she's conducting.

7 So I'll have Mr. Tucker address --

8 MR. TUCKER: Go ahead.

9 MR. LAMBERT: All right. So to go back over, the
10 requirements of 6597 have been met, the two criteria that
11 tax has been collected. There was a \$1,000 a month in
12 underreporting, and there was a 5 percent difference in
13 each one of those quarters and the requirements have been
14 met. We believe that there was clear and convincing
15 evidence, based on what I've gone over, that there was an
16 intent to underreport the tax.

17 And that concludes our presentation.

18 ADMINISTRATIVE LAW JUDGE DANG: Thank you.

19 Questions, panel members?

20 ADMINISTRATIVE LAW JUDGE CHENG: No.

21 ADMINISTRATIVE LAW JUDGE GAST: Just a quick
22 clarification. The fourth audit you are referring to is
23 after the one we're dealing with right now; right?

24 MR. LAMBERT: That is correct.

25 ADMINISTRATIVE LAW JUDGE GAST: Okay. So there

1 has been four audits?

2 MR. LAMBERT: There have been four audits to
3 date, and the one that's before you is the third audit.

4 ADMINISTRATIVE LAW JUDGE GAST: Okay.

5 ADMINISTRATIVE LAW JUDGE DANG: Okay. Thank you
6 everyone for your presentations and for coming today and
7 participating in this hearing. We're gonna go ahead and
8 following this hearing we're going to leave the record
9 open, and you'll receive additional briefing requests for
10 these audit waivers at that time. And I will discuss with
11 the panel members as well if we require any additional
12 information. So you will get that in a letter. Upon
13 receipt, you'll be provided with an opportunity to respond
14 to that.

15 MR. DAVIS: Thank you. Just for the record, I
16 would like to object to leaving the record open in order
17 to provide those documents.

18 ADMINISTRATIVE LAW JUDGE DANG: Your objection is
19 overruled.

20 Thank you, everyone. This hearing is now
21 adjourned.

22 (Proceedings adjourned at 2:23 p.m.)
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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 13th day of March, 2019.

ERNALYN M. ALONZO
HEARING REPORTER