

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
CPC TRANSPORTATION COMPANY, LLC,) OTA NO. 19064866
)
APPELLANT.)
)
_____)

TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Wednesday, July 22, 2020

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken at
12900 Park Plaza Dr., Suite 300, Cerritos,
California, 90703, commencing at 10:06 a.m.
and concluding at 10:35 a.m. on Wednesday,
July 22, 2020, reported by Ernalyn M. Alonzo,
Hearing Reporter, in and for the State of
California.

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APPEARANCES:

Panel Lead: ALJ KEITH LONG

Panel Members: ALJ ANDREW KWEE
ALJ JOSHUA LAMBERT

For the Appellant: TYLER ORMISTON
JOHN LYON

For the Respondent: STATE OF CALIFORNIA
DEPARTMENT OF TAX AND
FEE ADMINISTRATION
By: JARRETT NOBLE
STEPHEN SMITH
JASON PARKER

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-9 were received at page 6.)
(Department's Exhibits A-G were received at page 6.)

OPENING STATEMENT

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CLOSING STATEMENT

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| By Mr. Lyon | 22 |

1 Cerritos, California; Wednesday, July 22, 2020

2 10:06 a.m.

3

4 JUDGE LONG: We are now going on the record.

5 This is the appeal of CPC Transportation Company,

6 LLC, OTA Case Number 19064866. The date is Wednesday

7 July 22nd, 2020. The time is approximately 10:06. This

8 appeal was intended to be heard in Cerritos, California.

9 I am lead Administrative Law Judge Keith Long.

10 And with me today is Judge Josh Lambert and

11 Judge Andrew Kwee. We'll be hearing the matter this

12 morning. I am the lead ALJ, meaning I'll be conducting

13 the proceedings, but my co-panelists and I are equal

14 participants, and we will all be reviewing the evidence,

15 asking questions, and reaching a determination in this

16 case.

17 Parties, please state and spell your names and

18 who you represent for the record. We'll start with the

19 Appellant, Mr. Lyon.

20 Mr. Lyon, you were muted when you started

21 talking.

22 MR. LYON: You can hear me now? Okay. Thank

23 you. This is John Lyon. I'm representing the Appellant

24 CPC Transportation Company.

25 JUDGE LONG: Thank you.

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And CDTFA.

MR. NOBLE: This is Jarrett Noble representing CDTFA.

MR. SMITH: My name is Steven Smith also representing CDTFA.

MR. PARKER: And Jason parker with CDTFA.

JUDGE LONG: At issue today is whether Appellant is entitled to a refund of use tax paid on vehicles transferred from its parent company.

Taxpayer submitted Exhibits 1 through 9, which are admitted into evidence without objections.

(Appellant's Exhibits 1-9 were received in evidence by the Administrative Law Judge.)

CDTFA has submitted Exhibits A through G, which are admitted into evidence with no objections.

(Department's Exhibits A-G were received in evidence by the Administrative Law Judge.)

Mr. Lyon will begin with the Appellant's opening statement. You have five minutes. You will begin when you're ready.

MR. LYON: Very good. Thank you, Judge Long.

OPENING STATEMENT

MR. LYON: As an introduction, as you stated, at issue today is the transfer of vehicles from the

1 Appellant's parent, company Calportland Company, to
2 Appellant in 2009. The tax at issue was originally
3 assessed under audit, and the refund claim was filed.

4 Appellant and I believe that CDTFA has a
5 misinterpreted guidance to hold that a transfer from a
6 parent to a subsidiary is taxable in the same manner as
7 transfers between wholly owned subsidiaries. Appellant
8 further believes that there is no indication that any
9 consideration was paid or received under what we believe
10 the appropriate standard proof should be as the
11 reasonableness standard of proof.

12 I would like to briefly just describe what each
13 of the exhibits contain. Exhibit 1 is a balance sheet of
14 CPC Transportation, the Appellant, as of 2009. And
15 overall, the company of which CPC Transportation is a
16 subsidiary, overall, the company operates on a
17 consolidated basis with the accounting entries between
18 entities made through intercompany control account.

19 But during the course of the audit, this balance
20 sheet was created for the Appellant on a standalone basis.
21 As you can see that the components of it consists
22 primarily of assets, non-current receivables, current
23 liabilities, and stockholder's equity.

24 Exhibit 2 is a trial balance for the Appellant
25 for 2009, which provides the detail entries that roll into

1 the balance sheet. And you can see on Exhibit 2 that the
2 primary components are assets, which is primarily auto and
3 truck equipment, which are the vehicles at issue,
4 primarily; current liabilities, which is primarily AP
5 voucher entries; and then noncurrent assets, which is
6 largely consisting of the intercompany control account.

7 Exhibit 3 in turn, provides the detail of the
8 intercompany control account. You can see that on the
9 credit side of the transactions you have primarily auto
10 and truck equipment, which is the transfer at issue;
11 assets under construction; payroll; and diesel fuel. On
12 the debit side you have freight revenue. This entity
13 provides freight services for the parent.

14 Exhibit 4 is a journal entry of the asset
15 transfer in 2009, which is hitting the auto and truck
16 equipment account and the transfer of the cost of
17 \$1,672,000. And with depreciation, that's a net book
18 value of the transfer of \$1,093,793, which is the amount
19 that was the basis of the assessment.

20 Exhibit 5 is a -- images of the DMV titles and
21 registrations of all the vehicles that were transferred.
22 As you can see by scanning through the various pages, that
23 there was no lien holder and, thus, no debt was
24 transferred with these vehicles.

25 Exhibit 6 is a declaration under perjury if the

1 Chief Accounting Officer, Matthew Hisson, who states
2 that, "With respect to these vehicle transfers, no debt
3 was assumed, no intercompany payable was created, no
4 additional ownership interest was given, and rather, the
5 vehicles were contributions to capital."

6 Exhibit 7 is simply the Audit Manual, which you
7 should be familiar with. This Audit Manual section is
8 referenced in the supplemental decision and states that,
9 "Property transferred to an existing LLC for which no
10 additional membership interest is given is not subject to
11 tax, even if that interest is increased in value."

12 Exhibit 8 is a section of the Audit Manual. It
13 simply describes that a reasonableness standard should be
14 used in questions of judging whether or not a
15 certificate -- a resale certificate was taken in good
16 faith.

17 Exhibit 9 is an annotation that provides that
18 consideration consist of assumption of any of the parent's
19 liabilities and intercompany debt, the cancellation of
20 indebtedness, or the parent's receipt of additional shares
21 in the subsidiary.

22 Now, to briefly provide an analysis summary of
23 our position. We believe -- Appellant believes that as
24 shown by these exhibits that there is no evidence of any
25 consideration having been paid on the transfer between the

1 parent and the Appellant. However, the CDTFA has
2 characterized any entries to the intercompany control
3 account between parent and subsidiary as consideration.

4 And to overcome this characterization, the CDTFA
5 is requiring Appellant to prove a negative in an area
6 where there is no expressed guidance with respect to what
7 documentation must be provided to make this and to show
8 this. Therefore, the sole issue is whether the CDTFA has
9 erred in concluding that a transfer of assets from parent
10 to subsidiary is taxable where there is no consideration
11 paid or received.

12 Rather, the available evidence shows that there
13 are no existing liabilities assumed, no new debt was
14 created, and no additional ownership interest was received
15 by parent. Specifically, footnote for the supplemental
16 decision references the -- that there is -- or it concurs
17 that with the Audit Manual section is saying that no
18 additional membership or other consideration is given,
19 even where the value of existing membership is enhanced,
20 it is not subject to tax.

21 Page 10 of the supplemental decision confirms
22 that no additional ownership interest was received. And
23 also that the 2009 trial balance does not show any direct
24 liabilities as resulting from the vehicle transfer.
25 However, there are, quote, unquote, "Other expenses and

1 accounts cleared through the Intercompany Account.

2 However, when you scan through the intercompany
3 control account detail, which we provided as Exhibit 3,
4 all comparably-size transactions that could possibly be
5 related to the transfer of the vehicles include payroll,
6 freight revenue and diesel fuel. And none of these appear
7 to be related to the transfer in any way.

8 JUDGE LONG: Mr. Lyon.

9 MR. LYON: Yes, sir.

10 JUDGE LYON: I don't want to interrupt, but it
11 has been five minutes. Can you just take the next two
12 minutes or so to wrap up?

13 MR. LYON: Yes. I think -- I'm sorry. About two
14 minutes is about it. Thank you.

15 JUDGE LONG: Okay.

16 MR. LYON: Another way to cite the issue would
17 be, is it appropriate to treat any entries to an
18 intercompany control account between parent and subsidiary
19 as consideration, even when all such entries are clearly
20 not related to the transfer and, thus, not indicative of
21 there being any consideration.

22 The CDTFAs -- well, excuse me. The supplemental
23 decision references the Paine versus State Board of
24 Equalization decision as applying -- as requiring that the
25 firm -- that we affirmatively prove no consideration was

1 paid. However, that case dealt with the providing of
2 exemption certificates, which are clearly laid out in
3 Regulation 1667 and Audit Manual 0409.05. There are no
4 such established requirements for a transfer such as this.
5 And we, thereof, feel that a reasonableness standard
6 should apply in evaluating the evidence.

7 In summary, contrary to the CDTFA's, we believe
8 that a transfer from a parent to a subsidiary is not
9 comparable transfers between subsidiaries simply because
10 the parent has an ownership interest in the subsidiary.
11 And accordingly, a transfer such as this simply increases
12 the value of its existing investment, which is expressly
13 excluded from the definition of a consideration under
14 Exhibit A.

15 And that is the end of our statement.

16 JUDGE LONG: Thank you. I'm going to turn it
17 over to my panel members to ask any questions they may
18 have.

19 Judge Kwee, do you have any questions?

20 JUDGE KWEE: Yeah. I guess I do have one
21 question. There seems to be a lot of focus on the
22 annotations and what they say about transfers between a
23 parent and a subsidiary or sister corporations. But from
24 understanding we do have some court cases that discuss
25 this issue.

1 For example, there is the Mapo, Inc., versus the
2 State Board of Equalization. And there's Macrodyne
3 Investments [sic] versus the State Board of Equalization.
4 And I think those stands for the general rule that you
5 have to treat different entities as separate legal
6 entities.

7 Then there are some circumstances that the court
8 has carved where you would allow transfers between a
9 parent and a subsidiary to basically qualifies as
10 nontaxable, and then there's factors that you look at.
11 For example, the length of time the corporation has
12 existed, if there's a separate business, the formalities
13 if they're observed, if there's, basically, how distinct
14 they are.

15 And I'm just wondering if basically the rules set
16 forth Mapo, Inc., versus State Board of Equalization, and
17 if that's something that's been considered, and if those
18 factors specifically have been considered as applicable in
19 this case, or if that's distinguishable from this case or
20 if the parties have a position on that?

21 MR. LYON: I'm not familiar with that case, I'm
22 afraid, and I'll get back to you on that.

23 JUDGE KWEE: Okay. And I did have one
24 clarification question. Is the -- is the taxpayer a --
25 100 percent owned by the parent, or is there a different,

1 then, 100 percent ownership?

2 MR. LYON: I believe they're 100 percent owned.
3 But, Tyler, could you confirm please.

4 MR. ORMISTON: Yes, they are 100 percent.

5 JUDGE KWEE: Okay. And just one other question
6 before I turn it back to lead judge. So is there any
7 dispute or contention that the parent transferred all or
8 substantially all of the assets to the subsidiary? Or is
9 it conceded that this did not qualify basically a transfer
10 of all or substantially all the assets of the corporation
11 to the subsidiary?

12 MR. LYON: No, Judge Kwee. It's not
13 substantially all the assets. There was a limited number
14 of vehicles, and it was not the entire assets of the
15 parent.

16 JUDGE KWEE: Okay. Thank you. I will ask that
17 question of CDTFA after their presentation if they don't
18 incorporate it into their presentation. But at this point
19 I'll return the questioning to the lead judge.

20 JUDGE LONG: Judge Lambert, do you have any
21 questions? Judge Lambert, you're muted.

22 JUDGE LAMBERT: I have no questions. Thank you.

23 JUDGE LONG: Okay. I did have one question.
24 Regarding the transfers of the vehicles -- I'm sorry. Can
25 everyone mute their microphones, please. There's a lot of

1 feedback. Thank you.

2 Regarding the transfer of the vehicles, I know
3 that we have the titles and also the balance sheets in the
4 exhibits. Was there just no paperwork for the actual
5 transfer from the parent to the subsidiary? Did they not
6 record it anywhere? I mean, is there not -- is there no
7 understanding or contract, Mr. Lyon?

8 MR. LYON: I don't believe so.

9 Tyler, could you help me with that answer?

10 MR. ORMISTON: Correct. There -- there is none.
11 If it was a sale -- if it was a true sale, there would
12 have been. There would have been an invoice and such.
13 This was just a capital contribution. And let me point
14 out that it was brought up that the intercompany accounts,
15 and that's what -- that was considered by the State as
16 consideration. That's the only way that you can do it on
17 SAP, which is our accounting system.

18 There's no other way that we would be able to do
19 it. Plus you would do it as a sale, which it was not. So
20 the only way is the intercompany, which eliminated out
21 when you have 100 percent -- 100 percent ownership in the
22 SAP accounting system. It's just the way it is.

23 JUDGE LONG: Okay. Thank you. I don't have any
24 further questions. I will turn it over to CDTFA for their
25 presentation.

1 CDTF, you have 10 minutes. Go ahead.

2 OPENING STATEMENT

3 MR. NOBLE: There is no dispute that Appellant is
4 a single member LLC that commenced operation on or about
5 April 4, 2008, and that Appellant is wholly owned by
6 Calportland Company, and that Calportland Company also
7 wholly owns another corporation called Calportland
8 Construction.

9 There is also no dispute that on
10 December 31st, 2008. Calportland Construction transferred
11 vehicles to Appellant with a total value after
12 depreciation of \$3,023,945, and that June 30, 2009,
13 Calportland Company transferred vehicles to Appellant with
14 a total value after depreciation of \$1,093,793. The
15 transfer of these vehicles in California occurred in
16 California and Appellant did not remit use tax on these
17 transfers at the time of registration or on sales and use
18 tax returns.

19 JUDGE LONG: I'm sorry. There's a lot of
20 background noise.

21 MR. NOBLE: It's not coming from me.

22 JUDGE LONG: Is there -- it looks like we're all
23 muted now. So I think -- go ahead, Mr. Noble. If you
24 could take it back, like, 30 seconds, that would be good.

25 MR. NOBLE: Okay. No problem.

1 There's also no dispute that on
2 December 31st, 2008, Calportland Construction transferred
3 vehicles to Appellant with a total value of after
4 depression of \$3,023,945. And on June 30th, 2009,
5 Calportland Company transferred vehicles to Appellant,
6 total value after deprecation of \$1,093,793. The transfer
7 of these vehicles occurred in California and Appellant did
8 not remit use tax on these transfers at the time of
9 registration or on its sales and use tax returns.

10 Lastly, as stated before, there's no longer any
11 dispute the 2008 vehicle transfers from Calportland
12 Construction are subject to use tax. Under the sales and
13 use tax law, every person storing, using, or otherwise
14 consuming tangible personal property in the state is
15 liable for use tax. As relevant to this case, when
16 vehicle required to be registered under the Vehicle Code
17 is sold at retail by other than a licensed vehicle
18 retailer, the purchasers shall pay the use tax to the DMV.

19 The law provides that a sale and purchase
20 includes any transfer of title or possession of tangible
21 personal property for consideration. Civil code
22 Section 1605 states that consideration is any benefit
23 conferred or agree to be conferred upon the promiser by
24 any other person in which the promiser is lawfully
25 entitled or any prejudice suffered or agreed to be

1 suffered by such person.

2 There are several sales and use tax annotations
3 that address the application of tax the transfers of
4 tangible personal property between related entities and
5 what constitutes consideration. For example, Annotations
6 395.1258 and 495.0748 both provide that the recording of
7 debits and credits in the internal accounts of related
8 entities in relation to the transfer of property is
9 consideration. In such, transfers are subject to tax.

10 In addition, we note that the pending OTA
11 precedential opinion for the Martinez Steel petition for
12 rehearing, Citation 2020-OTA-74P, provides that
13 annotations are entitled to great weight when CDTFA is
14 construing a statute it is charged with administering.
15 And that statutory interpretation is longstanding.

16 According to Exhibits 3 and 4 to the appeals
17 decision and is attached as Exhibit A to the Department's
18 brief, the intercompany control account shows that
19 Appellant recorded the vehicle transfers from Calportland
20 Company as debits and credits. In addition, according to
21 Appellant's year end trial balance sheet attached as
22 Exhibit 5 to the decision, it appears that Appellant and
23 Calportland Company balanced revenue and expenses through
24 the intercompany control account.

25 These records establish that Appellant incurred

1 intercompany debt for the transfer of their vehicles and
2 owed corresponding intercompany credits to Calportland
3 Company. These debits and credits in the Appellant's
4 internal books are consideration within the meaning of the
5 law and, thus, claimant made purchases of vehicles subject
6 to use tax.

7 Furthermore, we note that Appellant has conceded
8 that the 2008 vehicle transfers from Calportland
9 Construction are subject to tax, and that the records for
10 those transfers are the same types of records remaining at
11 issue in this appeal. With respect to the Appellant's
12 assertion that the annotations are distinguishable from
13 the facts in this appeal because the transfers at issue
14 involve a parent and a subsidiary, rather than only
15 subsidiary companies, we note Annotation 495.0736.850,
16 which deals with transfers from a parent company to a
17 wholly owned subsidiary, states that sales and use tax
18 does not apply when there's no consideration involved in
19 the transfer, but does apply when there is, is relevant
20 here in intercompany debt.

21 As previously noted, the intercompany control
22 debits and credits for the transfers at issue, which is
23 consideration. With respect to Audit Manual
24 Section 1001.10 and annotation 395.0078, we note that they
25 provide the capital contributions to an existing LLC are

1 not subject to tax if no shares of stock, interest, or
2 other consideration is provided.

3 This type of transfer is not subject to tax, even
4 if the value of shares or interest held by the person
5 contributing the property is enhanced. Here there is no
6 evidence that the transfer of vehicles from Calportland
7 Company was solely paid in capital that resulted in its
8 ownership interest and Appellant being enhanced. Instead
9 the records establish that debits and credits were
10 recorded.

11 Lastly, Rules For Tax Appeal Regulation 35003(a)
12 states that except as otherwise specifically provided by
13 law, the applicable burden of proof is upon the taxpayer
14 to prove all issues of fact by a preponderance of the
15 evidence. Accordingly, Appellant's assertion that a
16 reasonable test should be applied to this appeal is
17 incorrect. For all of the aforementioned reasons,
18 Appellant is liable for use tax on the vehicle transfers
19 at issue.

20 Thank you.

21 JUDGE LONG: Thank you.

22 I'm going to turn it over to my fellow panelists
23 for questions. Judge Kwee, do you have any questions?

24 JUDGE KWEE: Yes. I had asked the taxpayer's
25 representative about the court cases dealing with

1 transfers from related entities, parents to subsidiaries,
2 the Mapo, Inc., versus State Board of Equalization, the
3 Macrodyne Industries versus State Board of Equalization,
4 and I believe there's another case, Beatrice Co., versus
5 State Board of Equalization.

6 And they set forth the default rule that
7 transfers of this nature, you have to respect the
8 corporate form, treat them separate legal entities.
9 Generally, it doesn't matter if there's 100 percent
10 ownership. But then there are certain circumstances where
11 you would basically disregard it, but those are very
12 limited circumstances.

13 And I'm wondering if that's something that's been
14 addressed or examined by CDTFA to determine if this is one
15 of those situations or the facts make clear that it's not
16 one of those situations one way or the other?

17 MR. NOBLE: Yeah. Mapo basically stands for the
18 general rule, the transfer between parents and
19 subsidiaries is a sale. They are very narrow exceptions
20 when those sales would be disregarded. When I hear what
21 the facts are in this case, the corporations have been
22 formed for a while.

23 They appear to be maintaining corporate
24 identities, and they appear to have independent business
25 purposes for the separate corporations. So we don't think

1 that the limited circumstances are exception to the
2 general rule described in Mapo as applicable in this
3 appeal.

4 JUDGE KWEE: Okay. Thank you.

5 So I'll turn it become back to Judge Long at this
6 point.

7 JUDGE LONG: Judge Lambert, do you have any
8 questions?

9 JUDGE LAMBERT: I have no questions. Thanks.

10 JUDGE LONG: I also do not have any questions.
11 So at this time we'll turn it back to Appellant for
12 rebuttal.

13 Mr. Lyon, you requested five minutes for
14 rebuttal. You may begin at any time.

15 MR. LYON: Thank you Judge Long.

16

17 CLOSING STATEMENT

18 MR. LYON: Two of the annotations that the CDTFA
19 referenced were 395.1258 and 495.0748. I would just like
20 to point that 495.0748 does relate to transfers between
21 wholly owned subsidiaries and not a parent to a
22 subsidiary. And that it states on the second page of the
23 annotation that the creation of intercompany debt is
24 consideration, which we don't have here. There's no
25 indication of it with the available evidence.

1 I would -- and with respect to annotation
2 395.1258, this also deals with transfers between different
3 operating corporations. It's not real clear, but it
4 appears to be between subsidiaries, not a parent to a
5 subsidiary because they're transferring TPP between
6 operating entities.

7 But the important thing that I'd like to point
8 out there is that on page 4 of the annotation, it states
9 in the third paragraph that there may in fact be an
10 explanation for the book entries made between the
11 entities. And the Department offered to review those and
12 see if those entries had an explanation and other than
13 being consideration.

14 So I would like to point this out that this
15 supports the idea that book entries by definition are
16 automatically are not necessarily consideration. It
17 depends on the nature of those entries. And I would just
18 point out again that in the balance sheet and the detail
19 trial balance accounts and the intercompany control
20 accounts, there's no indication of any transfers of the
21 comparable size that an intercompany debt was created.
22 All of the transactions that are of a comparable size are
23 unrelated revenue, payroll, and other entries. There's no
24 indication of a debt.

25 That's all I have in response. Thank you.

1 JUDGE LONG: Thank you, Mr. Lyon.

2 Judge Kwee, do you have any final questions?

3 JUDGE KWEE: No. I don't have any further
4 questions. Thank you.

5 JUDGE LONG: Judge Lambert, do you have any final
6 questions?

7 JUDGE LAMBERT: No. Thanks.

8 JUDGE LONG: Okay. Thank you. Thank you,
9 Mr. Lyon.

10 We now have Appellant's evidence and the
11 information that was provided today. Is there anything
12 else that you prepared or anything else you would like to
13 tell us before we include the case?

14 MR. LYON: Yes. Thank you, Judge Long. I would
15 just like to state as a conclusion that we believe there
16 is -- the nature of the entities that these assets
17 transferred between is significant simply because there's
18 already existing ownership interest by the parent in the
19 operating entity. And when a transfer of this type is
20 made, at the consolidated level it doesn't change
21 anything.

22 You're just transferring equity from one entity
23 to another. And it simply serves to increase the value of
24 the parent's ownership interest in the subsidiary, which I
25 think if that -- and if that is all that is occurring with

1 no additional shares and no other debt being created, a
2 simple increase in value of the existing ownership
3 interest is not consideration under various guidance that
4 are available.

5 JUDGE LONG: Thank you.

6 This concludes the hearing. The judges will meet
7 and decide the case based on the documents and testimony
8 presented and admitted as evidence today. We'll send both
9 parties our written decision no later than 100 days from
10 today.

11 Thank you for your participation. The case is
12 now submitted, and the record is closed. The hearing is
13 now adjourned. Thank you.

14 (Proceedings adjourned at 10:35 a.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 7th day of August, 2020.

ERNALYN M. ALONZO
HEARING REPORTER