



MEMORANDUM

TO: ARTBA CONTRACTORS AND AFFILIATED CHAPTERS

**FR: RICH JULIANO, SENIOR VICE PRESIDENT FOR STRATEGIC INITIATIVES AND
MANAGING DIRECTOR, CONTRACTORS DIVISION**

RE: USDOT DBE RULEMAKING

DATE: OCTOBER 23, 2012 – REVISED OCTOBER 26, 2012

Background

The U.S. Department of Transportation (USDOT or “the Department”) September 6 published a notice of proposed rulemaking related to several aspects of the Disadvantaged Business Enterprise (DBE) program (Docket No. OST-2012-0147). Compliance with the DBE program is required in federal-aid highway, transit and airport construction contracts. ARTBA will be submitting comments on these proposed revisions, which are due ~~November 5~~ December 24, and welcomes the input of members and chapters to assist the ARTBA DBE Committee in drafting these views.

This process is very important to ARTBA contractor-members because it could dramatically change the way state and local departments of transportation implement the DBE program in certain respects. ARTBA highly recommends that you read this document in its entirety to familiarize yourself with the many program revisions USDOT is proposing. In turn, we would greatly appreciate your feedback in the coming days as described above.

Recent DBE Rulemaking Activities

In the recent past, the Department proposed and implemented rule revisions for the DBE program through an April 2009 advance notice of proposed rulemaking, a May 2010 notice of proposed rulemaking, and a final rule effective February 28, 2011. ARTBA submitted detailed comments in both 2009 and 2010, and has maintained an ongoing dialogue with USDOT officials about the program through meetings and other contacts.

In the current notice, the Department first recaps “important policy changes” incorporated in the 2011 revisions to the DBE rules. They included:

- requiring greater accountability for state/local transportation agencies with respect to meeting overall DBE program goals;
- adjusting for inflation the personal net worth cap applicable to owners of DBE firms to \$1.32 million;

- requiring greater monitoring of contracts by state/local transportation agencies (known as “recipients” or “recipient agencies” in the rulemaking and this summary, because they receive federal funds);
- adding a small business element to state/local DBE programs; and
- facilitating interstate certification of DBE firms.

USDOT then asserts a contrast by characterizing the issues in the current rulemaking as being “more technical... program improvements.” It also notes that Congress reauthorized the DBE program in the new federal surface transportation law, the Moving Ahead for Program in the 21st Century Act (MAP-21), on a “status quo” basis and without any “significant substantive changes” to the DBE program.

Content of the Current “Notice of Proposed Rulemaking”

The following is a summary of the issues raised in the current rulemaking. Not every detail is included in this overview, so if you need complete information about any particular matter, please consult the complete text at <https://www.federalregister.gov/articles/2012/09/06/2012-21231/disadvantaged-business-enterprise-program-implementation-modifications> or contact the ARTBA staff and we will be happy to provide further material for your review.

The notice of proposed rulemaking includes specific revisions to the DBE program being proposed by the Department, as well as matters on which USDOT is soliciting public comment to develop future proposals. (The latter are generally posed as open questions for response.) ARTBA and other public commenters are free to address any of these issues in their written submissions to the Department. Section numbers in this summary refer to the corresponding sections in 49 CFR Part 26 (within the *Code of Federal Regulations*).

“Other Provisions” of the DBE Program

While this part appears at the end of the notice of proposed rulemaking, it includes several provisions that will likely be of particular interest to ARTBA members, so it appears in this summary first.

Objectives of the DBE program (§26.1): The Department would add language emphasizing the purpose of the program is to promote the use of all types of DBE firms, not just those in construction.

Definitions – key terms (§26.5): USDOT proposes adding eight (8) new definitions of key terms used in the DBE rule. The revisions would also modify the existing definition of “socially and economically disadvantaged individual” to align with that of the U.S. Small Business Administration (SBA). There is also clarification that being born in a particular country is not sole evidence that an individual is disadvantaged. The Department also seeks comment on broadening the definition of “immediate family” as it relates to DBE rules on transfer of ownership.

Agency recordkeeping and reports (§26.11): The Department proposes revised recordkeeping requirements for recipient agencies and new reports, as authorized in MAP-21, to be submitted to USDOT by Unified Certification Programs (UCPs) regarding the percentage of small businesses controlled by various categories of disadvantaged individuals.

Subrecipient agencies and DBE programs (§26.21): The revised rule would clarify that subrecipient agencies (such as a local DOT receiving federal-aid highway funds through a state DOT) must comply with the recipient agency’s DBE program.

Goal-setting by recipient agencies (§26.45): The two-step process for setting overall (program) DBE goals would change as follows:

- 1.) Determining relative availability of DBE firms in the transportation contracting market
 - The recipient agency could continue to use a bidders list for this purpose, but data must include the past three years rather than just the past year as is the case under the current rule, and incorporate both successful and unsuccessful bidders.
 - NOTE: The Department also seeks comment on whether the rule should go further and simply prohibit the use of bidders lists for this purpose.
 - The recipient agency could no longer use lists of prequalified contractors or plan holders as a means of determining availability of DBEs in the market.
 - USDOT also seeks comment as to whether it should prohibit the recipient agency from exclusively using lists of bidders, subcontractors or plan holders to identify ready, willing and able firms in this process.

- 2.) Considering other available evidence of discrimination or its effects, and considering appropriate adjustment to the goal
 - The revised rule would state that downward adjustments to the overall goal must be “clearly warranted by the evidence.”
 - The relevant USDOT agency reviewing the state goal may disapprove it if the recipient agency “employ[s] practices that serve no purpose other than to drive down the overall goal...”
 - The Department believes that lower levels of past DBE utilization do not necessarily equate to the market’s DBE capacity, but instead could relate to “the continuing effects of discrimination,” the recipient agency’s failure “to implement a robust program,” or other non-compliance.
 - USDOT will evaluate program goals in the context of the guidance (“Tips on Goal Setting”) published by its Office of Small & Disadvantaged Business Utilization.

The revised rule would allow a project’s DBE goal to be a percentage of either the entire project’s value or its federal share.

The Department would eliminate the requirement that recipient agencies utilize a public comment period in its goal-setting process. However, on-line posting and “consultation” with outside stakeholder groups (described as “scheduled, direct [and] interactive”) would be required before submitting the goal to USDOT.

Overall goals for transit vehicle manufacturers (§26.49): While this section is likely less relevant to ARTBA members, it is included to provide full context and for possible contacts with the affected industry.

Because of “confusion” and “irregularities” in the DBE program as applied to transit vehicle manufacturers (TVMs) by the Federal Transit Administration (FTA) and its recipient transit agencies, the Department proposes to “clarify” DBE requirements in this area. These revisions would include the requirements that:

- All contracting opportunities made available to non-DBEs by TVMs must also be made available to DBEs, and must be included in goal-setting methodology;
- Overly-prescriptive contract specifications for transit vehicle procurement should be avoided, as they can eliminate opportunities for DBEs and restrict competition;
- The TVM’s DBE goal should be calculated based on the total value of contracts available to firms outside of the manufacturer itself;
- TVMs must continuously report their contracting activity using the relevant DBE program form;
- TVMs are subject to all applicable provisions of the DBE regulation and responsible for their implementation.

The Department also seeks comment on whether/how TVMs can be encouraged to make more parts of their manufacturing processes available to DBEs and other small businesses.

Race-neutral DBE participation (§26.51): The revised rule would no longer allow race neutral DBE participation to help meet the overall DBE goal when a prime contractor awards a subcontract to a DBE firm but did not consider its DBE status in making the award. The Department states that is “impossible” for recipient agencies to determine if the prime contractor was using a “strict low bid system” in such a circumstance. Also, USDOT contends the revision will harmonize this section with other portions of the DBE regulations which state the prime contractor “should not reject a DBE quote over a non-DBE quote if the price difference is not unreasonable.”

Good faith efforts under contract goals (§26.53 and Appendix A): USDOT believes that showing of adequate good faith efforts by a bidder is “necessarily a fact-specific judgment recipients must make.” The DBE rule spells out factors for this assessment, but the Department does not believe in a “template or checklist approach, or some quantitative formula” for recipients to use.

The Department notes its concern over an “unfortunate trend in which, in procurements that otherwise use a traditional low-bid procurement mechanism, [recipient agencies] sometimes give apparent successful bidder a period of several days or weeks after bid opening to submit DBE information...” USDOT believes this potentially facilitates bid-shopping. Accordingly, the revised rule would eliminate the distinction between “responsiveness” (in which bidders submit DBE information with the bid) and “responsibility” (in which the apparent successful bidder submits this information at a later time as established by the agency), allowing only the former.

The new requirements for prime contractor-bidders in this area would include the following:

- Bidders would have to ensure that their submitted DBEs are certified under the North American Industrial Classification System (NAICS) code for the type of work to be performed under the contract.
- Bidders would have to submit all information about DBEs that have been engaged for the project with their original submission. (A possible exception would be under a negotiated procurement.)
- In a good faith effort submission, the bidder “would have to provide copies of each DBE and non-DBE subcontractor quote it had received, in situations where [the bidder] picked a non-DBE firm to do work that a DBE had sought. This information will help the recipient determine whether there is validity to any claims by a [bidder] that a DBE was rejected because its quote was unreasonably high.”
- Recipient agencies would have two options for bidders’ submissions of good faith efforts documentation:
 - 1.) All bidders who do not meet the contract goal would need to submit good faith efforts documentation with their original bids; or
 - 2.) An apparent successful bidder not meeting the contract goal would need to submit documentation within one day of being notified by the agency. However, no information on post-bid good faith efforts could be included.

NOTE: The Department seeks comment on whether the second scenario could be lengthened, with three days as a possibility.
- “A promise to use DBEs after contract award is not considered to be responsive to the contract solicitation or to constitute good faith efforts.”
- Unless the prime contractor receives prior written consent from the recipient agency to replace a DBE subcontractor good cause, the prime contractor would not be entitled to payment for work or materials that had been contracted with that DBE.

Under the revised rule, when a prime contractor seeks DBE participation in place of the original DBE (and has received the agency’s prior written consent as described above):

- The prime contractor would need to provide documentation of solicitations to certified DBEs, efforts to negotiate with DBEs, project information provided to the DBEs, reasons why an agreement could not be reached with a DBE (if applicable), and the prime contractor’s seeking assistance from the recipient agency in identifying other DBEs.
- The recipient agency would require the prime contractor to submit all of the above information within seven (7) days of the agency’s request.
- Failure of the prime contractor to meet these requirements would be a material breach of the contract and could result in termination or other remedies, such as withholding progress payments, default, sanctions, liquidated damages and/or disqualification from future bidding.
- The prime contractor would be required to provide copies to the recipient agency of all subcontracts (first and lower tier) for DBEs.

USDOT also seeks comment on whether some of the provisions described above should also apply when DBEs are working on contracts that do not have a contract goal.

Finally, the rule's Appendix A describes possible actions by a bidder/prime contractor that a recipient agency could consider favorably when assessing good faith efforts. (However, as noted previously, Appendix A does not constitute a "checklist.") Under the proposed revisions, a bidder/prime contractor would be well advised to, among other actions:

- conduct "market research" to identify and solicit available DBEs through various contacts and events (and going beyond "*pro forma* mailings" to DBEs);
- solicit DBEs as early in the procurement process as possible;
- establish "flexible timeframes and delivery schedules in a manner that encourages and facilitates DBE participation;" and/or
- break out contract tasks into smaller, "economically feasible units."

Under the revised Appendix A, good faith effort would not be achieved if:

- the bidder/prime contractor rejects the DBE's quote simply because it was not the lowest received (although this does not extend to "unreasonable" quotes); and/or
- the prime contractor is unable to find a replacement DBE at the original DBE's price.

Moreover, in assessing a bidder's good faith effort, the recipient agency would be required to review the other bidders' performance in meeting the contract goal while comparing it to that of the successful bidder who could not do so. (If other bidders met the goal, then the recipient could be less likely to find good faith effort in the successful bidder's actions.) Also, the agency must contact the DBEs listed on the bidder's solicitation documents to verify that they were actually contacted by the successful bidder. A final, notable point: the relevant USDOT agency may review and change the recipient agency's good faith effort determination if it so chooses.

Counting DBE participation toward goals (§26.55): This section addresses two issues relating to a DBE's commercially useful function and counting towards DBE credit:

- **DBE trucking services:** A DBE firm that uses its own employees as drivers, but leases trucks from a non-DBE truck leasing company, could receive full credit for its trucking services. However, the DBE firm will not receive credit if it leases trucks from the prime contractor. Also, "potentially improper relationships" between DBE and non-DBE firms would still be subject to scrutiny.
- **"Regular dealer" vs. "transaction expediter/broker":** This distinction is significant because DBE firms in the former category may count 60 percent of their materials or supplies towards the DBE goal, while those in the latter category may not. USDOT proposes that recipient agencies make these counting decisions "on a contract-by-contract basis, not a generic basis." The notice of proposed rulemaking also references a USDOT guidance on this issue from December 9, 2011.

Moreover, the Department "wants to open a discussion of the regular dealer concept itself" and whether this "middleman" role has become obsolete in contemporary commerce. It expresses concern that "too-generous credit for supplies provided by a

DBE middleman or transaction expediter” would result in less of a demand for DBEs who provide other services like construction.

Ethics and conflicts of interest (§26.109): USDOT seeks comments on whether it should add provisions “empowering DBE [program] officials to resist inappropriate pressures” from government officials relating to their decision-making on matters such as certification.

Revisions to DBE Program-Related Forms

Personal Net Worth (PNW) Form: The Department is proposing revisions to the Personal Net Worth form and instruction sheet used by the principals at DBE firms. Recipient agencies would use this revised form as a minimum basis for acquiring information from a DBE firm, but would be encouraged to request additional information if necessary. Moreover, the recipient agency may still determine that the person is not “economically disadvantaged” – and therefore not eligible for the DBE program – if he/she “demonstrates an ability to accumulate substantial wealth, has unlimited growth potential, or has not experienced or has not had to overcome impediments to obtaining access to financing, markets, and resources,... even if the individual’s PNW is less than \$1.32 million[,]” which is the cap for eligibility.

The Department also seeks comment on whether it should adopt a “bright-line” approach for eligibility, perhaps relating to a DBE applicant’s adjusted gross income. USDOT also intends to include in the PNW calculation assets recently transferred by the applicant to the company or relatives, with some exceptions, although the Department seeks comment on this issue as well. Finally, the Department seeks comment on requiring the spouse of a DBE applicant to submit a PNW form during the process, and whether or not his/her “access to credit and capital” should be considered in the application process.

Application Form: The Department is proposing a revised DBE certification application, replacing a form used since 2003. It is noted that in the revised 2011 DBE rules, USDOT sought to facilitate interstate certification and reciprocity for DBEs. The new form would require information from applicants to assist in this objective while also preserving the integrity of the DBE program and its certification process.

DBE Commitments/Awards and Payment Reporting Form: The Department is proposing revisions to the form that recipient agencies must use to track DBE activity within their program.

Revisions to DBE Certification Provisions

Business size (§26.65): The Department proposes an inflationary adjustment to the annual gross receipts cap for DBE firms from \$22.41 million to \$23.98 million.

Ownership (§26.69): USDOT reiterates that for a firm to be eligible for the DBE program, ownership must involve a disadvantaged individual who has made a contribution of capital to acquire ownership in the firm. Moreover, that contribution must be “real, substantial, and continuing, going beyond pro forma ownership of the firm.”

Accordingly, the Department proposes greater scrutiny by recipient agencies in this area. It proposes a prohibition on non-disadvantaged parties' (an individual or company) having a prior or superior right to the DBE firm's profits, compared to that of the disadvantaged owners of the DBE firm. The proposed rule would also require applicants "to submit additional proof to substantiate both the sufficiency of their [capital] contribution and the circumstances of any funding streams to the firm since its inception." Finally, the Department seeks comments on how to treat marital property in certain contexts.

Control (§26.71): In an effort to ensure that disadvantaged owners actually control the operations of a DBE firm, USDOT proposes a presumption against certification in certain contexts. These include scenarios when a non-disadvantaged individual is involved in the firm's affairs and is the former employer of the DBE owner. There is also to be heightened scrutiny when a non-disadvantaged individual transfers ownership of the firm to a disadvantaged individual, but the former person remains involved in the firm's operations.

Other certification rules (§26.73): USDOT proposes prohibiting recipient agencies' using prequalification as a criterion for DBE certification. However, an agency may still require prequalification in order for DBE firms to receive certain sorts of contracts.

Certification procedures (§26.83): The Department proposes to enhance the process by which recipient agencies make DBE certifications. This would include interviewing key employees of the firm on-site, analyzing the firm's stock ownership, obtain information on the work the firm has done in various categories of the North American Industrial Classification System (NAICS) code, obtain at least three years (where possible) of tax returns from the firm and its owners, and request clarification or more information from the applicant during the certification process.

Non-expiration of certification (§26.83): The notice of proposed rulemaking emphasizes that DBE certifications do not expire, but recipient agencies should review the certifications periodically. The Department proposes that DBE firms submit additional documents with their annual affidavits of no change, including PNW statements and tax returns.

Certification denial (§26.86): A firm denied DBE certification would not have to wait longer than 12 months to reapply, although the recipient agency could establish a shorter time frame.

Decertification (§26.87): The Department proposes to revise and expand the grounds on which a recipient agency can decertify a DBE firm, "in the interest of program integrity." The agency would be able to decertify a DBE firm when it determines:

- The agency's own previous certification was erroneous;
- The DBE firm engages in a pattern that "attempts to subvert the intent or requirements of the DBE program," such as repeatedly seeking DBE credit for activities not involving a commercially useful function; and/or
- The DBE firm has failed to cooperate in providing timely documents and disclosures.

It is noted that under existing rules, the agency can decertify a firm for concealing or providing misrepresentative or false information, or when the disadvantaged owner's relationship with the firm changes.

The Department also seeks comment on whether a DBE firm's suspension or debarment should automatically result in decertification.

Suspension of certification (§26.88): Recipient agencies would be required to suspend a firm from DBE eligibility if the disadvantaged owner dies or is incarcerated. The agency could also suspend the firm if ownership changes, in which case the agency needs to evaluate DBE eligibility under the new ownership.

Certification appeals (§26.89): USDOT proposes clarification in the documents required from a firm that has been denied DBE certification and is appealing the decision.

USDOT “Regulatory Analyses and Notices”

The federal regulatory process requires the Department to describe and classify its rulemaking in a number of technical ways.

To this end, USDOT states that the proposed DBE rule revision does not constitute a “significant regulatory action” and consists of “administrative changes to improve program implementation” rather than “significant policy-level initiatives.” USDOT contends, among other points, that the proposal does not create significant cost burdens, affect the economy adversely, materially alter the impact of grants or user fees, or raise novel legal or policy issues. Moreover, the proposal states that the new rule would be “a streamlining of the provisions for implementing an existing program,” and thus would actually “result in significant savings to state and local governments” due to the lessening of DBE fraud. The Department also contends that the changes would have “little to no economic impact on program participants” and there would be “no substantial compliance cost imposed on state and local agencies...”

However, any objective reading of this proposal's extensive content would likely lead to a different conclusion, given the major changes in program implementation that may result.

USDOT also describes the proposal as a product of “stakeholder meetings and written comment” going back to 2007, in which state and local officials and agencies provided input. While ARTBA and other industry groups also participated in these activities, that previous industry input is not referenced.

ARTBA Comments

ARTBA welcomes feedback from its contractor members and affiliated chapters as we prepare comments for submission to USDOT in ~~November~~ December. Individual companies and chapters are also encouraged to submit their own written comments to the Department. For more information, questions or suggestions, please contact Rich Juliano at 202-289-4434 x. 206 or rjuliano@artba.org. Thank you for your attention to and assistance with this matter.