

The Disadvantaged Business Enterprise Program

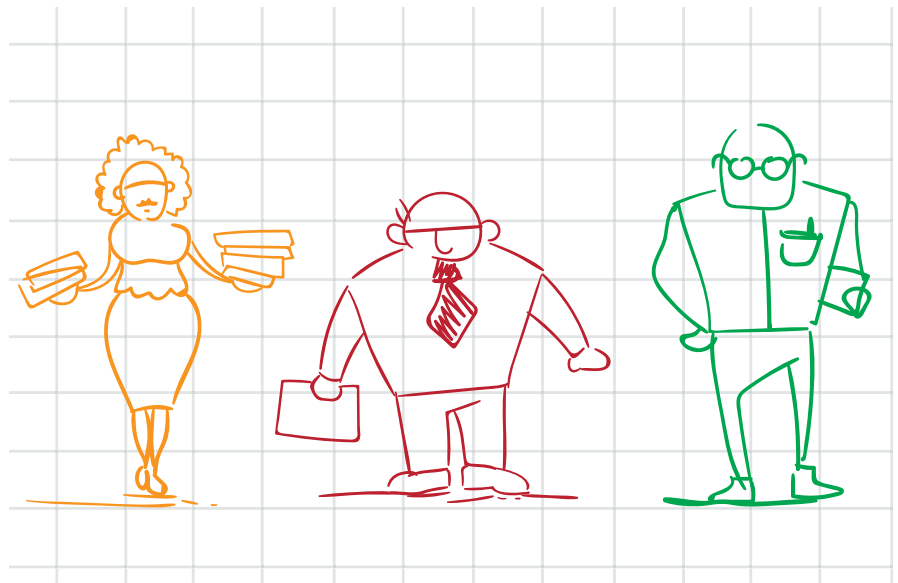
Everything you need to know about qualifying, applying, contracts & stipulations

BY VERNON HOWERTON

One of the most discussed and misunderstood arenas of the construction industry is the disadvantaged business enterprises (DBE) program. For those who already participate in the program or wish to own and operate a certified DBE, it is critical to know the history and rules of the system.

Conceived in the 1980s, the DBE program was originally a 10% set-aside (quota) for participation by minority- and woman-owned businesses in federally funded, transportation-related construction projects. The program was intended as a means to remedy past discrimination against women and minorities in the construction industry.

Under the old program, a contractor bidding a \$10 million highway project needed to demonstrate \$1 million of DBE participation for their bid to be considered responsive. But President Clinton and the Supreme Court changed the game in the late 1990s after *Adarand Constructors*, a guardrail contractor, submitted the lowest subcontract bid for guardrail on a Colorado highway construction project, but a higher bid was submitted by a DBE subcontractor. The prime took the high bid over the low to meet its quota for DBE participation. *Adarand* sued and ultimately won in the Supreme Court. In *Adarand Constructors Inc. v. Peña*, 515 U.S. 200



(1995), the court found the program unconstitutional as then implemented.

The United States Department of Transportation (USDOT) then amended the DBE program under the auspices of “mend, not end,” thereby creating the precursor to the current DBE regulations.

QUALIFYING AS A DBE

Most DBE programs, though implemented by the states via “uniform certification programs,” are based on the USDOT’s DBE regulations. They can be found in 49 CFR Part 26 at ecfr.gov. To qualify as a DBE, the firm must be at least

51% “owned” and “controlled” by one or more “socially” and “economically” disadvantaged individuals.

OWNERSHIP & CONTROL

Ownership and control must be real and substantial. Typically, the disadvantaged owner must hold the highest position in the company—president or chief executive officer—and have the ability to control the day-to-day affairs of the business. As a result, generally, the company’s bylaws or agreements cannot provide for supermajority voting on issues, such as borrowing money, purchasing equipment,

signing leases and the like.

The disadvantaged owner of 51% of a business cannot and should not agree to a requirement for a 60% majority vote to take certain actions where the 51% ownership is the basis for the DBE certification. On the other hand, if two women each own 30% of a business and each is considered socially and economically disadvantaged, it is acceptable to have a 60% majority requirement for certain transactions.

SOCIAL & ECONOMIC DISADVANTAGE

Women and minorities are rebuttably presumed to be socially disadvantaged. Economic disadvantage is generally based on the owner's net worth, exclusive of the owner's interest in their primary residence and the value of their interest in the firm that is seeking certification. And the certifying authority must determine disadvantaged status based on the "totality of the circumstances."

SMALL BUSINESS

To be certified as a DBE, the firm must also be "small," based on either its number of employees or total sales in its primary area of business. Size standards are set and published by the Small Business Administration (SBA) based on the North American Industry Classification System (NAICS) code for the firm's primary area of business.

When the same individuals own or have the ability to control multiple firms, the firms are considered "affiliates," and the total employees/sales are aggregated for purposes of the size determination. Firms that have grown too large to be certified as a DBE can still be certified as woman- or minority-owned.

KEEP IN MIND

When creating a company that is intended to be certified as a DBE, there are numerous other considerations. For

example, the disadvantaged owner must acquire their interest for its value to count (e.g., a husband cannot gift his wife or superintendent 51% of a business, then have it certified). Even where the disadvantaged owner's interest is acquired in exchange for lending their "expertise" to the business, the owner must have a significant financial investment.

In community property states, care must be taken to not acquire the disadvantaged owner's interest in the business with community property. However, a spouse can legally disclaim any interest in the business as community property.

A DBE firm must be independent and not disproportionately dependent on another non-DBE firm. In other words, a heavy highway contractor bidding on public work cannot set up captive DBE subcontractors.

Project DBE goals are no longer considered quotas. Rather, when a project has a DBE "goal," prime contractors bidding on the work must make "good faith efforts" to attain it. If the low bidder can demonstrate good faith efforts through records of advertising, solicitation of DBE bids, outreach and other means listed in the regulations, the project can still be awarded, even where the low bidder did not achieve the DBE participation goal.

Although there is some wiggle room for awarding authorities, prime contractors are no longer required to award a subcontract to a DBE firm just to meet the goal, if the DBE firm's quote is unreasonably high in comparison to other bidders' quotes.

DBE contractors are still required to perform a "commercially useful function." This means the DBE firm must contribute value to the project (i.e., you can't just award a \$1 million contract to a DBE who does nothing except be counted as a subcontractor.)

DEEP INTO THE DETAILS

People who break the rules can go to jail or be fined when they are caught. Anyone

who does not believe this should visit the USDOT Office of the Inspector General website (oig.dot.gov) and type "DBE" into the search bar. You will find pages of press releases concerning indictments, prosecutions and fines.

As recently as Feb. 6, 2019, the U.S. Department of Justice (DOJ) announced a settlement related to DBE fraud. "Contractor A," as we'll call them, had graduated from the SBA's 8(a) DBE program and used Contractor B, an allegedly related 8(a) DBE firm, to pursue business. According to the press release, Contractor B used Contractor A's "bonding, office space, employees, contractors, software, computers and vehicles." And Contractor A made high-level decisions and managed the day-to-day operations of Contractor B.

The DOJ alleged Contractor B lacked "control" of its own operations, and the arrangement was intended to defraud the government. The two contractors agreed to pay the government \$3.6 million to settle the case.

DBE fraudsters may also find they are subject to suspension or debarment from bidding and receiving new work from governmental entities, as well as subject to civil penalties under the False Claims Act or similar state laws. A good rule of thumb is not to do anything that will potentially put you in jail or ruin your existing business.

Bottom line: Seek legal counsel from an experienced attorney and trust them if they simply say, "No, don't apply." **CBO**

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