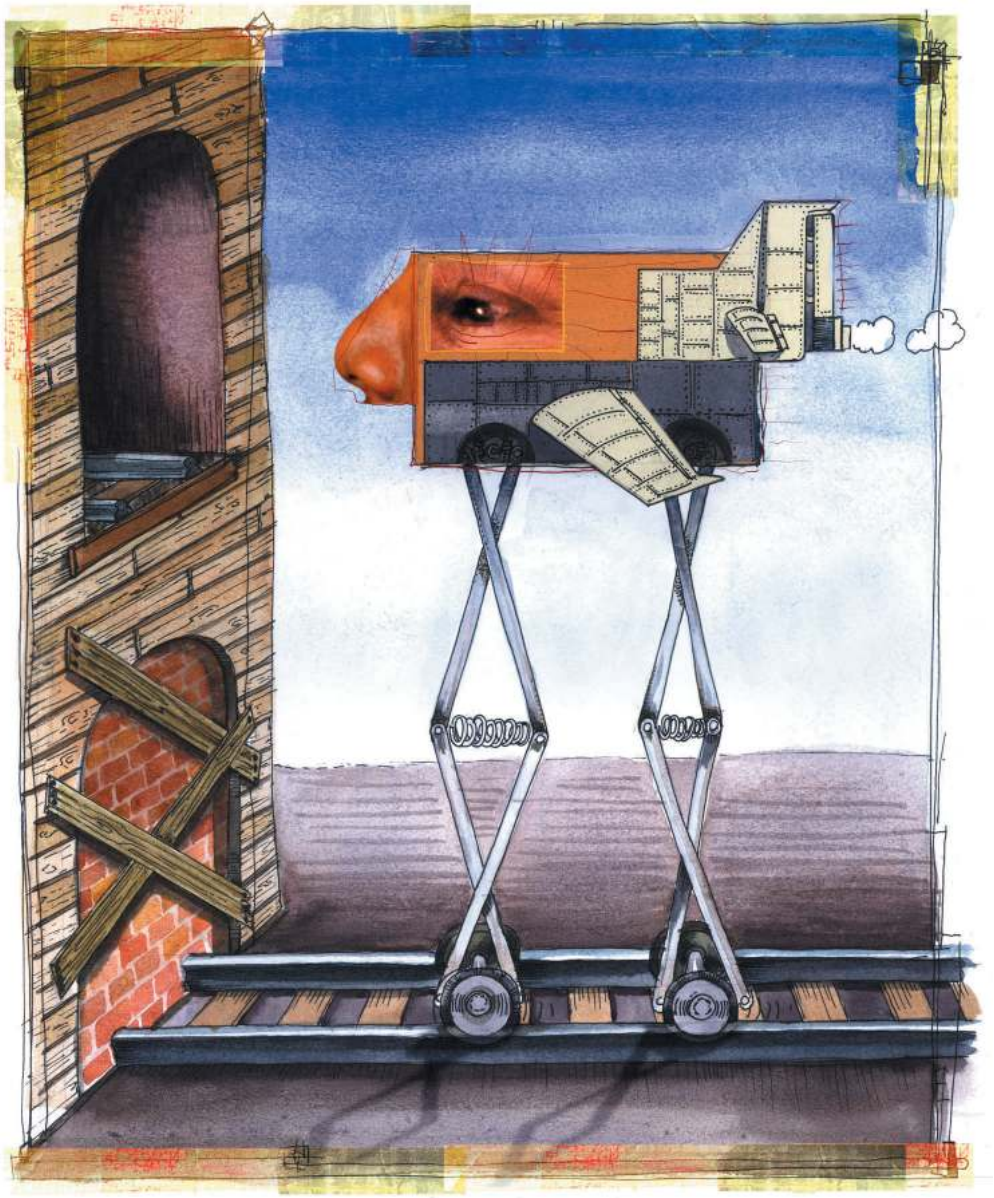
TRACKING regulations

Bid requirements often shut out the little guy, leaving opportunities for only the biggest of the small.

By Robert F. Nixon

In early 1999, the U.S. Department of Transportation (DoT) revised its disadvantaged business enterprise (DBE) program regulations by issuing 49 CFR Part 26. The creation of these new rules was no small feat. DoT officials had to consider such issues as discrimination against DBEs, fostering diversification, streamlining the certification process, meeting strict scrutiny and narrow tailoring standards, and redefining the way DBE goals are established.

Before the rules were even written, the DoT reviewed approximately 900 comments received by public and private industry representatives at all levels of business. As expected, there were supporters and opponents. As additional questions and concerns are raised about administering the new rules, the DoT continues to issue supplemental written guidance, which is available on the Internet.[1]



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[1]http://osdbu.dot.gov/index.html).

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It is generally agreed that the intent of the new DBE rules is a significant improvement over the old Part 23 rules, but there is disagreement about how to actually administer the DBE program. If the objective of the program is to maximize opportunities for minority and women owned businesses, then the persons responsible for making that happen need to take advantage of the flexibility within the rules.

My comments below address what I believe to be the strengths and improvements in the new rules as well as those areas that still need improvement or further clarification. I have substituted "transit property" for the DoT's term, "recipient."

Strengths and Improvements

Subcontracting

Primes Must "Walk the Talk"—Under the old DBE rules, prime contractors reported their DBE participation based upon contract dollar amounts to be awarded to DBE suppliers. However, changes were often made after the initial subcontract agreement was reached, and the amount actually paid to the DBE subcontractor was sometimes less than the award amount. Prime contractors weren't meeting their contractual obligations and DBEs were being short-changed. The new rules, which required prime contractors to report actual payments to DBEs, instead of the contract award amount, should keep everyone honest and accountable. The true value of any DBE program should always be measured by actual performance, not promises.

Prompt Payment—Transit properties now must establish a contract clause requiring primes to pay their DBE suppliers for satisfactory performance of contracts within a specific number of days after *each* payment is received from the transit property. Under the old rules, prime contractors would sometimes withhold payments to their DBE suppliers until the end of the contract or well beyond a reasonable amount of time.

Eligibility—Under the old rules, if a DBE exceeded the size standards *during* the performance of a contract, transit properties could arbitrarily decide not to allow the prime contractor to count those contract dollars toward the DBE goal for the *remaining* portion of the contract. Under the new rules, if a prime contractor has (in good faith) executed a subcontract with a DBE firm *before* a transit property has notified the DBE of its new ineligibility, the prime may continue to receive credit for that DBE firm's work.

There are two legitimate reasons for DBE ineligibility that are beyond the prime contractor's control after a DBE contract award: the DBE has exceeded the size/sales threshold after a contract award (which indicates the successful growth of a disadvantaged company), or there's a change in the ownership/management structure of the DBE firm.

Backsubbing and **Passthroughs**—Prior to the new rules, some prime contractors would manufacture or assemble significant portions of a component and then sell and ship them to a DBE for final assembly. In this practice, known as backsubbing, sometimes the DBE did little more than apply labels and repackage essentially the same items they received from the prime contractor, and then sold the "finished product" back to the prime contractor. The prime contractor would then count the entire "selling price" toward their DBE goal. Passthrough arrangements operate the same way, except the DBE is buying from another manufacturer instead of from the prime. Under the new rules, if a DBE subcontractor leases equipment or buys supplies from the prime contractor on its contract, these backsubbing costs do not count toward DBE goals. And, work that a DBE subcontracts to a non-DBE firm will also not count toward DBE goals. Prime contractors need to utilize DBEs that perform a legitimate *commercially useful function* based on acceptable industry standards.

Certification

Procedures—There are "fronts" and "frauds" who try to take advantage of the DBE certification program. If these fraudulent firms are certified as DBEs and subsequently win contracts, it will create a lose-lose situation in which the fraud receives a contract it's not really entitled to and a legitimate DBE loses an opportunity to increase revenue. DBE certifications based on paperwork *alone* are now prohibited. Transit properties must either perform an on-site visit to the offices of the DBE applicant or, in the case of an out-of-state applicant, require the applicant to secure certification in their home state. An on-site visit is the best way to verify that DBE applicants are truly owned and managed by minorities and women.

Under the old Part 23 rules, DBE fronts and frauds would follow the path of least resistance by applying only to those transit properties that didn't perform on-site visits. Perhaps, once we all agree on a

uniform certification process, the DoT will create a national reciprocity agreement.

Paperwork Reduction—Transit properties issue DBE certifications that are now valid for a period of at least three years. Under the old rules, DBEs had to reapply annually. To ensure that they remain eligible during this longer certification period, DBE owners must now annually submit a sworn affidavit affirming that there have been no changes in the firm's circumstances that would affect its ability to meet size, disadvantaged status, ownership, and control requirements.

Management and Control—Transit properties had been inconsistent when addressing this issue. The new rule states that DBE owners need not possess more expertise in every aspect of their business than their staff. They may now delegate some areas of management and daily operation of the firm to their staff, provided such delegations of authority are revocable, and that the DBE owner retains the power to hire and fire those staff members. Nor are DBE owners required to have experience or expertise in *every* critical area of the firm's operations, or to have greater experience or expertise in a given field than managers or key employees. DBE owners must have the ability to evaluate decisions made by those key staff members and be able to make independent decisions concerning the firm's management. Under the old rules, some transit properties would arbitrarily deny DBE certification if he or she was not an expert in every facet of the business, or if any management task was delegated to a non-minority staff member.

Processing Applications—Some transit properties had an informal policy of delaying application processing if the applicant was not listed on a bid/contract. Yet primes preferred DBEs that were certified prior to issuing a subcontract because if the new potential DBE applicant were denied certification, the subcontract value could be subtracted from the prime contractor's overall DBE credit amount, possibly causing the prime to fall short of the transit property's DBE goal. This placed the new DBE suppliers in an all-too-familiar position: "We can't get our certification application processed unless we're listed on a contract and we can't get a contract if we're not certified." Now, transit properties must make their DBE certification decisions within 90 days of receiving all of the required information (although a 60-day extension is permitted).

Areas Needing Improvement and/or Clarification

Increasing DBE Subcontracting Opportunities

Bid Requirements—Transit properties have a choice between handling bidder compliance with contract goals as a matter of *responsiveness* (committing to specific DBE subcontractors up front in their bid submittals) or *responsibility* (committing to a DBE contract goal, but selecting DBE suppliers after the transit property has awarded the contract to the prime contractor). Some transit properties prefer the responsiveness approach as a deterrent to bid-shopping while others believe the responsibility concept offers a more flexible and cost-effective approach.

DoT maintains that transit properties should continue to use their own discretion on this issue, however, my experience has shown that, on nearly all applicable DoT-assisted contract bid solicitations issued since the new DBE rules, transit properties have required prime contractors to abide by the responsiveness approach. In essence, this means guaranteeing all DBE subcontracts *up front* in their bid proposals through "DBE Letters of Intent."

Excerpts from Section 26.53 (b) reveal why transit properties so consistently utilize the responsiveness approach in their bid solicitations:

"In your solicitations for DoT-assisted contracts for which a contract goal has been established,…All bidders/offerors will be required to submit the following information to the recipient [transit property]…: (i)The names and addresses of DBE firms that will participate in the contract; (ii) A description of the work that each DBE will perform; (iii) The dollar amount of the participation of each DBE firm participating; (iv) Written documentation of the bidder/offeror's commitment to use a DBE subcontractor whose participation it submits to meet a contract goal; (v) Written confirmation from the DBE that it is participating in the contract as provided in the prime contractor's commitment;…"

Perhaps the reason the responsibility approach isn't utilized by transit properties is that this important option is buried 12 paragraphs later in Section 26.53 (e) which states:

"In a 'design-build' or 'turnkey' contracting situation, in which the recipient [transit property] lets a master contract to a [prime] contractor, who in turn lets subsequent sub-

contracts for the work of the project, a recipient *may* [emphasis added] establish a goal for the project. The master contractor then establishes contract (DBE) goals, as appropriate, for the subcontracts it lets. Recipients must maintain oversight of the master contractor's activities to ensure that they are conducted consistent with the requirements of this part."

This excerpt from the Preamble (or Background Information) section of the new rules offer a good argument relevant to the rail car industry:

"…In a sense, the master contractor stands in the shoes of the recipient [transit property]. On design-build contracts, the normal process for setting contract goals does not fit the contract award process well. At the time of the award of the master contract, neither the recipient nor the master contractor knows in detail what the project will look like or exactly what contracting opportunities there will be, let alone the identity of DBEs who may subsequently be involved. In these situations, the recipient may alter the normal process, setting a project goal to which the master contractor commits. Later, when the master contractor is letting subcontracts, it will set contract goals as appropriate, standing in the shoes of the recipient…"

Enforcing the Goal—Some transit properties prefer the responsiveness approach because some primes commit to using specific DBEs to meet their contractual goal but don't honor the commitment. The solution is simple. Transit properties should include in their contracts a financial penalty, equal to the DBE shortfall, that the prime contractor must pay the transit property. And, the transit property must enforce this policy.

If You're Not in The Bid, You're Out of The Contract—The responsiveness approach also limits opportunities for DBEs wishing to solicit prime contractor subcontracting bids for the years subsequent to a contract award. DBEs often do not contact primes until after the transit property awards the contract. Even if these newly-sourced DBEs offer a better bid value, prime contractors generally cannot award them a contract because they committed to other DBEs at the time of the original contract award.

Bid shopping—Transit properties often prefer the responsiveness approach because of "bid shopping." It is important to note the difference between bid shopping and competitive bidding. Bid shopping is when a prime contractor reveals the bid price of their potential DBE sub-contractors to competing DBE subcontractors and requests that they beat the original price. This kind of bid shopping (DBE or non-DBE) should *never* be allowed because it's unethical to reveal proprietary information.

However, allowing prime contractors to request competitive bids after the transit property has awarded the contract is not bid shopping, it's capitalism. Since most transit properties make awards to the lowest bidder, it would make sense that prime contractors (if so compelled) should be able to use the same system to select their subcontractors, DBE or not.

Although some DBEs argue that this competition *forces* them to submit bid prices that are too low to provide them a profit margin, any business owner (DBE or not) must understand what constitutes a sensible, profitable bid. This might also spur improvements in processes and end products. A DBE owner should be exposed to the same risks and rewards as any other entrepreneur.

Rules Written for Other Industries—The practice of guaranteeing contracts with DBE firms prior to a contract award has been advocated in other business sectors, especially construction. In a fixed-price construction bid, (when the design is substantially or totally defined and the contractor is dealing primarily with first-tier subcontractors whose scope of work can be determined based on that completed design), such a "lock-in" may make sense in order to assure achievement of a DBE goal. It's widely acknowledged that the rail car industry differs from construction in that most DBE subcontracting opportunities are defined months and even years *after* a contract award. Transit properties do not finalize many engineering designs until they have received and accepted the prime contractor's first prototype vehicle(s). A prime contractor's ability to increase DBE participation is best served when they're entrusted with the responsibility for awarding DBE contracts throughout the duration of their multiyear contracts.

For example, wire/cable assemblies are needed on a rail car remanufacturing project. How can a prime contractor or their potential major system supplier guarantee up-front specific DBE names, workscopes, and dollars on a multiyear contract when the DBE wire/cable assembly firm won't know the cost

of copper six months hence?

A Few Goliaths or Many Davids—When transit properties require prime contractors to abide by the responsiveness approach, the larger, well-established DBEs (who are capable of providing multiple subsystems) receive the lion's share of the DBE subcontracts, effectively shutting out many up-and-coming DBEs who really need the opportunities. When given the flexibility to select their DBE subcontractors throughout a contract's duration, primes can often double the number of DBE participants. The total DBE participation amount doesn't necessarily increase (although it often does), but many more small DBEs now get a piece of the pie.

Size Standards—Many prime contractor rail car bids are worth hundreds of millions of dollars, therefore, many of the major subsystems themselves are worth tens of millions of dollars. In order for companies to be able to realistically bid on these major subsystems, they must own millions of dollars worth of equipment. Businesses generally do not make such investments unless their sales are also in the $10 million or more range. If a DBE firm's sales are at that level, the firm exceeds the size standard (gross receipts) and loses its DBE eligibility. So, within the rail car industry, DBEs tend to cluster in those workscopes requiring lesser amounts of capital investment.

Second Tier—A prime contractor's ability to obtain second-tier DBE participation on the rail car major subsystems is limited by the amount they derive from non-DBE major system suppliers. If these non-DBE suppliers are single- or sole-source-listed by the transit property in the bid specification, the prime really has no control over those suppliers' second-tier DBE participation. Hence, many non-DBE major system suppliers offer minimal second-tier DBE participation, especially on a responsive approach contract. However, if there is more than one non-DBE supplier technically qualified by the transit property, the prime contractor should consider the potential subcontractor's second-tier DBE participation as an important sub-bid evaluative criterion.

Technical Qualification—Many transit properties require primes to subcontract only to those major subsystem suppliers that are *technically qualified* to meet the transit property's specific technical specifications (e.g., propulsion, auxiliary power, braking system, etc.). Generally, DBEs do not meet these major subsystem technical specifications. If they did, they would exceed the size standard and lose their DBE eligibility. And, these major systems equal approximately 80 percent to 85 percent of a prime contractor's total subcontractable value. Taking into account the limited DBE participation available on rail car major subsystems, prime contractors must maximize DBE participation through direct purchases from DBEs that provide supplies and services such as metal fabrication, electrical supplies and hardware, which are *not* within the major systems [the remaining 15 percent to 20 percent].

Change Orders—A prime contractor's procurement process is affected by provisions that encourage the use of second-tier DBE subcontractors, but that also require primes and their non-DBE major suppliers to obligate workscope and price to DBEs *before* the transit property's award date. That, in effect, means that prime contractors and their non-DBE major system suppliers have no ability to adjust scope or price to conform to post-award approvals of subsystem specifications nor the prime contractor's executed purchase order with DBE suppliers. This subverts the normal relationship between contractor and subcontractor and places everyone, including the DBE, at risk of realistic adjustments to workscope and price.

Prime contractors should be willing to contractually obligate themselves to an attainable DBE contract goal suggested by the transit property and should guarantee that level of DBE participation by certified DBE firms throughout the lifetime of the contract. The elimination of the requirement to obligate proposers to *specific* DBE firms for *specific* dollar amounts *prior* to contract award is in the best interest of *all* parties. DBEs participating in the bidding process throughout contract duration would be afforded the opportunity to compete and grow.

Reasonable Contract Goals—Within the rail car industry, a significant number of bids are for the remanufacturing [refurbishment] of existing vehicles. Since transit properties' DBE goal-setting guidelines are not restricted by the Federal Transit Administration on remanufacturing bids, transit properties use this opportunity to set DBE goal percentages that, in some cases, are technically and/or com-

mercially unattainable. Some transit properties set the same percentage DBE goal on every eligible bid, regardless of contract size or available workscopes.

The goal for a specific contract *should* depend upon various factors such as the type of work involved, the location of the work, and the availability of qualified DBEs. The same goal-setting methodologies established by the DoT for setting *overall* DBE goals should be used by transit properties in setting *individual* contract goals.

Many transit properties compare NAICS (formerly SIC) codes and their corresponding workscopes to the items needed to build their rail cars when establishing DBE contract goals. NAICS codes do not necessarily mean all DBEs within a certain NAICS code actually possess the capability to perform on a specific rail car contract. For example, there are several hundred DBE truckers and transportation suppliers located throughout the country. Included in this list are dump trucks, gravel haulers, and food delivery vehicles.

However, there are very few DBEs capable of transporting 85-foot carshells or over-dimensional components (e.g., locomotive truck assemblies containing traction motors, wheels, and axles). The only practical way for a transit property to accurately measure the number of capable DBE firms within certain codes on a specific rail car contract bid is to closely examine the bid specification and determine who is technically qualified to perform the work.

Working Together—Transit properties need to bring together their procurement, new bid contract management and DBE departments in order to agree on what is a reasonable, attainable DBE goal for each specific contract—and then put it in writing. Currently, many transit property DBE coordinators do not discuss with their own procurement departments what DBE goals they believe are attainable prior to their bid specification's release. It's time to build or strengthen this very important relationship.

Improving Administrative Procedures

Bidder's Lists—Prime contractors must now provide additional DBE program data to the transit properties by creating and maintaining a bidder's list, consisting of all firms bidding on or quoting subcontracts on DoT-assisted projects. For every potential subcontractor, prime contractors must include the following information: the firm's name and address, age, annual gross receipts, and status as a DBE or non-DBE. This is a cumbersome, difficult task to accomplish during the proposal stage due to time constraints, the number of firms involved (perhaps hundreds), and the reluctance of some potential subcontractors to share this data.

DBE Directories—My review of dozens of transit property DBE directories reveals no common format. Some directories sort alphabetically only by name, others only by workscope. Others are sorted numerically by NAICS codes. DoT should develop a user-friendly standard format for all transit properties.

DBE Certificates—When preparing DBE certification letters, transit properties should list the firm's NAICS codes, workscopes/areas of expertise, and DBE credit percentages (i.e., 100 percent, 60 percent, fees and commissions), especially for those DBEs capable of performing as both a manufacturer and a distributor. Failing to do so encourages prime contractors to misrepresent the legitimate workscope contributions of potential DBE suppliers. This would also help prevent brokers (who merely drop-ship their supplier's materials and never take title) from passing themselves off as distributors. Some, but by no means all, transit properties follow this format.

PNW Statements—Transit properties require DBE owners to submit a signed, notarized personal net worth (PNW) statement listing their assets and liabilities with appropriate supporting documentation. In determining net worth, owners exclude their ownership interest in the firm as well as the equity in their primary residence. If, after these exclusions, the DBE owner's PNW exceeds $750,000, their presumption of economic disadvantage is rebutted. It sounds simple enough. However, there's little consistency in how transit properties develop their PNW statements and interpret the financial data reported by DBE applicants. Many DBEs (and their accountants) find these forms to be both confusing and misleading.

Conclusion

The Department of Transportation's new rules are flexible enough for transit properties to work with prime contractors toward increasing DBE subcontracting opportunities. Transit properties should allow reliable prime contractors to develop their DBE participation program throughout their contract's duration,

thereby enabling more DBEs to succeed.

When you consider the transit industry's ultimate customer base (the riders), minorities and women represent a significant portion, and perhaps a majority, of the market. It stands to reason that minorities and women should also be part of the supplier base. ◆

On May 8, 2001, the U.S. Department of Transportation issued a notice of change to DBE Program Information. The Department is proposing revisions to the Department's regulations for its Disadvantaged Business Enterprise (DBE) program (49 CFR part 26). In its final DBE rule the Department reserved publication of a uniform reporting form and a uniform certification application form for a later date. This document proposes those forms. In addition, this document proposes implementation procedures for a Memorandum of Understanding (MOU) between DOT and the U.S. Small Business Administration (SBA). The MOU streamlines certification procedures for participation in SBA's 8(a) Business Development and Small Disadvantaged Business programs, and DOT's DBE program for small and disadvantaged businesses. Finally, this document proposes substantive changes to several provisions, including: personal net worth, retainage, the size standard, proof of ethnicity, confidentiality, proof of economic disadvantage, and DBE credit for trucking firms.

You can view the Federal Register Notice on the OSDBU web site:

Summary-*http://osdbuweb.dot.gov/business/DBE/nprmsum.html*

Full Notice-*http://osdbuweb.dot.gov/business/DBE/nprmmay8.html*

Full Notice (PDF)-*http://osdbuweb.dot.gov/business/DBE/DBE_NPRM.pdf*

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