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CONSTRUCTION LAW E-UPDATE

M/W/DBE UPDATE & NEW DEVELOPMENTS

JUNE 20, 2011

We continue to receive inquiries concerning two issues related to good-faith compliance.

Apparently, like many other requirements in this complex and rapidly evolving area of the law, contractors have received mixed answers from different sources and, therefore, are justifiably concerned.

We would like to provide some clarification on two issues that have repeatedly surfaced:

Issue #1: Whether the greater cost of utilizing a DBE is a good faith justification for not using the DBE where the goal is not met.

Short Answer: No.

This question is answered by the Federal Regulations as follows:

A bidder using good business judgment would consider a number of factors in negotiating with subcontractors, including DBE subcontractors, and would take a firm's price and capabilities as well as contract goals into consideration. However, the fact that there may be some additional costs involved in finding and using DBEs is not in itself sufficient reason for a bidder's failure to meet the contract DBE goal, as long as such costs are reasonable. Also, the ability or desire of a prime contractor to perform the work of a contract with its own organization does not relieve the bidder of the responsibility to make good faith efforts. Prime contractors are not, however, required to accept higher quotes from DBEs if the price difference is excessive or unreasonable.

Issue #2: Whether a second tier DBE can be counted towards goal fulfillment, notwithstanding the fact that the first tier subcontractor, with whom the prime contractor is actually in privity of contract, is not a DBE.

Short Answer: Yes.

This issue is not as easy to resolve. This has been a controversial issue and Federal agencies have not always been consistent in addressing it, with some clearly indicating that credit for second tier DBE subcontractors was not allowed.

However, we are now reasonably confident, (despite some lingering inconsistent responses from some Federal agencies), that a second tier DBE, if all is clearly disclosed in the applicable Utilization Plan, should be counted towards goal fulfillment.

The applicable Federal Regulation, 49 CFR 26.55(a)(3), states in less than clear fashion:

(3) When a DBE subcontracts part of the work of its contract to another firm, the value of the subcontracted work may be counted toward DBE goals only if the DBE's subcontractor

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is itself a DBE. Work that a DBE subcontracts to a non DBE firm does not count toward DBE goals.

Some federal regulators have taken the position that where the above regulation states initially, "When a DBE subcontracts part of the work," it means precisely what it says, namely, that only a DBE subcontractor of a subcontracting DBE would qualify.

However, despite this language, it now appears to be the interpretation of the USDOT, the lead Federal agency in this area that the second tier DBE subcontractor of a non-DBE first tier subcontractor will qualify. This interpretation also appears to be the one currently utilized locally by, for example, the Metropolitan Transit Authority.

Finally, notwithstanding the foregoing, with regard to M/WBE (rather than DBE) second-tier subcontracting here in New York State, DASNY has issued the following FAQ:

Is M/WBE second-tier subcontracting allowed?

Yes. Second-tier subcontracting is allowed; however, it is not encouraged to Prime contractors. DASNY would prefer a direct relationship between M/WBE its subcontractors and the Prime contractor. [sic] (Emphasis added)

Further, the New York State DOT has stated in its Contract Administration Manual, Section 94(II), entitled "Potential D/M/WBE Fraud", that "[t]he D/M/WBE program has significant potential for fraud." More significantly, at Section 94(II)(D), entitled "Commercially Useful Function", the NYSDOT has identified "D/M/WBE Subcontractors second-tier subcontracting" as a circumstance "that may potentially be fraud and may need to be further investigated." (Emphasis added)

Clearly, it remains to be the case that second tier D/M/WBE subcontracting is "controversial." When employing this practice be particularly circumspect.

New Developments - NYC'S New Initiatives

There have also been important new developments in this area. The City of New York has just (5/25/11) issued new initiatives intended to improve and expand the City's Local Law 129 (M/WBE) program. They are intended to establish programs and services to build capacity and eliminate market barriers to M/WBEs, streamline purchase processes to increase opportunities for M/WBEs and generally improve the procurement process to ensure compliance

1. Facilitating Smaller Company Participation.

To address the challenges smaller firms, such as M/WBE's face in competing in the City's procurement marketplace, the Department of Small Business Services ("SBS") has established new programs and expanded its existing services

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to address such competitive hurdles. Some of the programs/services include:

- Bid and proposal preparation support, including cost estimating guidance and bid document review;
- For the construction industry, a bond readiness program to help firms increase bonding capacity and obtain bonding;
- Joint venture workshops to assist M/WBEs understand the benefits/responsibilities of partnering with experienced firms, as well as networking opportunities for M/WBEs to meet businesses interested in partnering;
- Mobilization loan program that will provide short-term working capital for firms who are awarded City contracts; and
- Mentorship program, including classroom and on-the-job training.

2. Streamlining of Procurement.

The initiatives to streamline the procurement process to increase opportunities for M/WBEs include:

- Requiring all solicitations material on the City Record Online to centralize where M/WBEs look for opportunities;
- Increasing the bond threshold from $500,000 to $1 million, which is intended to help increase the pool of contractors who can compete for City construction contracts under $1 million and reduce the cost of bids.
- Reducing bonding requirements by requiring agencies to get approval before adding bonding requirements to a solicitation; and
- Streamlining invoice processing and expediting the payment process.

3. Efforts to Enhance Compliance.

Finally, in an attempt to generally improve the procurement process and compliance therewith, the City is proposing new ways to ensure that prime contractors are held accountable for and improve their M/WBE subcontractor utilization, tracking and compliance. Some of the ways in which the City intends to do so, include:

- Requiring all agency buyers to complete training covering the M/WBE program and the requirements of Local Law §129;
- Requiring agency officers to attend pre-bid meetings to inform bidders about M/WBE requirements and the Online directory;
- Requiring prime contractors to regularly certify that they are on track to meet their M/WBE subcontractor goals; requiring agencies to track all payments to subcontractors; and developing automated methods for tracking payments to subcontractors; and
- Adding language to contracts to set liquidated damages for prime contractors who do not make good faith effort to meet M/WBE subcontracting goals.

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Clearly, this last set of initiatives could be problematic. For example, liquidated damages should play no role in M/WBE oversight.

As we have previously noted, with the increased attention focused on D/M/WBE participation and goal compliance comes more pressure on prime contractors to meet those goals. Redouble your efforts at good faith compliance consistent with those we discussed. Create utilization plans that are reasonable and achievable. If you later believe you will not be able to meet the goals, be certain to proactively consult with the procuring agency as problems arise.