

DBE Participation: Dos + Don'ts

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DBE Participation Requirements

Federal, State, + Local Regulations Require DBE Participation on Public Projects.

Since the 1980s, projects funded by the federal government have come with mandatory DBE participation requirements. Similar DBE participation requirements have also been enacted at the state and local level.

1. Purpose/Goals.

DBE programs were designed to increase the participation of minority and women-owned businesses ("DBEs") in industries in which they have been historically underrepresented and discriminated against. By imposing quotas or minimum percentage participation requirements on projects funded by the government, the hope is to provide socially and economically disadvantaged individuals a means to start their own business and to grow and prosper.

2. Certification.

Certification of DBEs is typically done at the local or regional level. Because requirements vary from jurisdiction to jurisdiction, it is difficult to make any general observations. However, the following criteria are widely-used:

- i. At least 51 percent of the business is "owned and controlled" by a socially and economically disadvantaged individual or individuals.
- ii. The socially and economically disadvantaged owner must "control" the company's daily management and operations.
- iii. The company must be an independent business whose viability does not depend on its relationships with other firms.
- iv. The company must employ its own workforce and equipment necessary to perform its work.
- v. The company must be able to meet its financial obligations.

Businesses owned and controlled by minorities or women are presumed to meet the socially and economically disadvantaged criterion. Minority groups are defined as U.S. citizens who are:

Asian; Black; Hispanic; Native American; Asian-Indians whose origins are from India, Pakistan and Bangladesh; and Asian-Pacific citizens whose origins are from Japan, China, Indonesia, Malaysia, Taiwan, Korea, Vietnam, Laos, Cambodia, the Philippines, Thailand, Samoa and Guam.

"DBEs" actually come in a variety of forms:

- i. Minority Business Enterprises (MBEs) – assists minority businesses in obtaining state government contracts.
- ii. Women's Business Enterprises (WBEs) – assists women-owned businesses.
- iii. Disadvantaged Business Enterprises (DBEs) – assists businesses owned by economically and socially disadvantaged individuals, and typically smaller businesses with a revenue cap.

Definitions and qualifications for each category vary depending on jurisdiction.



DBE Participation: Dos + Don'ts

3. Minimum Participation Requirements.

To increase participation of DBEs in government-funded projects, the federal government and local and state entities created minimum DBE participation requirements. The U.S. Department of Transportation (DOT), which serves as a model for many state and local agencies, requires that at least 10 percent of federal funds authorized for highway and transit programs must be awarded to DBE contractors. States have aimed for much higher participation goals.

Ohio has a 15 percent goal for Minority Business Enterprises (MBEs). Ohio's DBE goal is 8.9 percent. By contrast, the State of New York has a 30 percent minimum participation requirement on applicable contracts. The City of New York has a 37 percent requirement.

4. Good Faith Effort.

Contractors working on government-funded projects with minimum DBE requirements must make "good faith" efforts to meet DBE goals. One of the foremost criticisms of DBE programs is that many (if not all) programs leave the term "good faith" undefined. Good faith generally requires commercially reasonable business practices and *actual* effort on the part of the construction company to meet minimum participation goals.

5. Commercially Useful Function.

Once retained for a construction project, federal, state, and local regulations require DBEs to perform a "commercially useful function." A "commercially useful function" is often defined by the applicable regulation. DOT regulations explain a DBE performs a "commercially useful function" "when [the DBE] is responsible for execution of the work of the contract and is carrying out its responsibilities by actually performing, managing, and supervising the work involved."

For material suppliers, DOT regulations explain the supplier must be responsible "for negotiating price, determining quality and quantity, ordering the material, and installing (where applicable) and paying for the material itself."

DOT regulations specifically provide that a DBE does not perform a "commercially useful function" "if its role is limited to that of an extra participant in a transaction, contract or project through which funds are passed in order to obtain the appearance of DBE participation."

The DBE must have the labor, equipment, financial resources and expertise to perform the work itself. The DBE must perform work with its own active workforce and have an active role in negotiating price and ordering materials. "Pass-through" DBEs are not allowed and companies and persons involved in such arrangements can be subject to serious financial and criminal penalties (see below).

6. DBE Credit for Material Suppliers.

Claiming credit for DBE material suppliers is a bit more complicated and requires an evaluation of the material supplier's business and their actual participation in the project.

a. "Regular Dealer"

A contractor who retains a "regular dealer" material supplier can earn DBE credit equal to **60 percent** of the value of the materials supplied to a project. A "regular dealer" is a business that engages as its principal business, and under its own name, in the purchase, sale or lease of products of the same general character as those involved in the contract for which DBE credit is sought. "Regular dealers" must maintain a store, warehouse, or other establishment where materials are bought, stocked, sold or leased to the public in the regular course of business.

b. "Broker"

If the DBE material supplier instead serves in the limited role of "broker," the DBE credit is **reduced to the amount of the fee or commission** the DBE broker receives for its work. DBE credit cannot be claimed for the value of materials supplied if the DBE merely acted as a broker.

DBE Participation: Dos + Don'ts

Recent Enforcement Efforts

Contractors + Material Suppliers Have Been Under Increased Scrutiny.

While DBE Participation requirements have existed now for over three decades, enforcement efforts have lagged behind. No more. The federal government along with state and local enforcement authorities have begun to crack-down on fraud and abuse in DBE practices. Fraud and abuse is thought to be widespread, pervasive, and has gone on for many years.

1. Enforcement Mechanisms.

a. False Claims Act

U.S. attorneys can bring criminal claims for alleged DBE fraud claims under the federal False Claims Act. This federal law imposes liability on persons and companies who defraud the federal government.

b. False Claims Act "whistleblower" provision

The False Claims Act also allows private citizens, including employees and former employees, to file suit on behalf of the government. Individuals have a strong financial incentive to file such claims because they are entitled to recover 15 to 30 percent of the government's funds in addition to being reimbursed for attorneys' fees. As of 2012, over 70 percent of all Federal Claims Act lawsuits were initiated by whistleblowers.

c. Similar State Action.

State law provides similar mechanisms for punishing fraud on the government. State criminal law may also apply.

2. Common Schemes.

a. The "pass-through."

The most common form of DBE fraud involves using a certified DBE as a "pass-through." In the prototypical "pass-through" scheme, the certified DBE is retained by a general contractor as a subcontractor, so that the project appears to satisfy minimum DBE participation requirements. But the DBE does not actually perform work or services on the project. Instead, the DBE "fronts" for the general contractor. The general contractor performs the work itself. The DBE firm obtains a "cut" or a fee in exchange for its complicity.

In some cases, invoicing may be done through the DBE to establish the appearance that the DBE actually performed work when, in reality, most of the money actually migrated to a non-DBE. Another example is where a general contractor claims to use a DBE to perform work or provide materials when instead a non-DBE is actually used.

b. False Representations.

Contractors, subcontractors, and material suppliers that falsely certify pay applications or invoices can be subject to substantial financial penalties and even criminal prosecution.

3. Fraudulent Practices Can Lead to Substantial Financial and Criminal Penalties.

Persons who commit DBE fraud are subject to potential civil and criminal penalties, prison terms, debarment from federal contracting work, restitution and forfeiture. Courts have meted out financial penalties amounting to millions of dollars.

4. Who's in Trouble?

a. Active Involvement

Anyone who actively participates in the fraud can be subject to severe financial repercussions and even criminal prosecution.

DBE Participation: Dos + Don'ts

b. Cannot be “Willfully Blind”

A contractor, subcontractor, and/or material supplier cannot be “willfully blind” to fraudulent schemes. Even non-DBEs can be prosecuted for willful blindness if evidence shows the non-DBE intentionally avoided learning the truth and deliberately chose to be ignorant of the facts surrounding a transaction.

Contractors and suppliers must be diligent in avoiding any participation in fraudulent DBE schemes, intentional or otherwise.

5. A Few Example Cases.

Material Suppliers:

a. Lafarge North America Inc.

Lafarge manufactures construction materials across the country and has locations throughout North America. In August 2012, Lafarge agreed to pay **\$950,000** to the U.S. Government without admitting liability for its alleged involvement in DBE fraud. Lafarge was charged with fraudulently obtaining subcontracts between June 2001 and March 2006 on eight highway construction projects in the Buffalo area that were to go to DBEs.

b. Rayford Enterprises Inc. d/b/a Rayford Concrete Products, Buffalo

A certified DBE construction company, Rayford obtained subcontracts on several Federal Highway Administration projects. Rayford represented that it was a DBE manufacturer of concrete but in reality it did not have a concrete batching plant or other equipment and machinery needed to manufacture concrete. Ultimately, the owner of Rayford plead guilty to mail fraud and **forfeited \$1.8 million.**

Contractor/Sub-Contractors:

a. Zohrab B. Marashlian, President of Perini Corporation's Civil Division

In March 2011, Mr. Marashlian was convicted after a four-week criminal trial of fraud and conspiracy to launder money for his involvement in a DBE “front” scheme. Mr. Marashlian faced up to 12 years in prison and \$34.5 million in fines before taking his own life two days before sentencing. As President, Mr. Marashlian was charged with defrauding government contracting agencies by falsely representing in proposals and other documents that DBE subcontractors would perform commercially useful functions on public works contracts. Instead, Perini allegedly used non-DBE subcontractors to complete the work. Mr. Marashlian and others arranged financing and laundered payments through “front” companies.

b. C.W. Matthews, Georgia

One of Georgia's largest roadbuilders agreed to pay a **\$1 million fine** in a settlement with the U.S. Federal Highway Administration. The agency concluded that from 2007 to 2010, C.W. Matthews had filed “false and misleading” reports related to a certified DBE trucking firm, when in-fact a non-DBE had completed the work.

c. Skanska USA Civil Northeast Inc., Whitestone, N.Y

In March 2011, Skanska USA agreed to pay **\$19.6 million** to settle a federal investigation into DBE fraud in connection with projects as prolific as the new World Trade Center transportation hub and a terminal project at John F. Kennedy International Airport. Skanska retained Environmental Energy Associates LLC (EEA), a certified DBE, but who did not have the labor, equipment or finances to actually perform the work. According to formal charges brought against Skanska USA, the company mostly self-performed the work that had been subcontracted to EEA. Skanska USA employees were placed on EEA's certified payrolls allegedly to create the appearance that EEA had done commercially useful work.

d. Moretrench American Corp., Rockaway, N.J.

Moretrench admitted to being involved in DBE fraud and was forced to pay over **\$3 million.** A geotechnical construction and engineering services company, Moretrench also retained EEA as a subcontractor on the World Trade Center transportation hub project. However, Moretrench used EEA as a shell company and actually hired pump operators, supervised the job site, and assembled biweekly payrolls itself. Moretrench also included its own employees on EEA's payroll. In turn, EEA received a markup on the payrolls as compensation for the use of its DBE certification.

DBE Participation: Dos + Don'ts

- e. RMD Holdings Ltd., Chesterfield, Mich., d/b/a Nationwide Fence and Supply Co.
RMD holdings agreed to pay **\$1.75 million** to settle allegations that it violated DBE requirements on federally funded projects in Kentucky, Indiana, Illinois, Georgia, and New York. On the LaGuardia Airport Central Terminal building project, RMD holdings hired a subcontractor to install structural steel. That subcontractor then hired RMD Holdings as a sub-subcontractor. RMD Holdings represented that it would use a DBE material supplier on the project. While RMD Holdings certified in its invoices that it had used MS Construction, a certified DBE, to supply materials, RMD Holdings knew that MS had not actually supplied the steel. In exchange for its complicity, MS Construction received a percentage amount for the use of its certification.
- f. Stephen Roeschley, Core Construction Services of Illinois
Stephen Roeschley plead guilty to fraud charges in May 2014 for using his DBE, BJB Enterprises, as a front on the Illinois Capital restoration project in Springfield. **Roeschley was convicted of a felony and was sentenced to 30 months of probation and ordered to pay \$800,000 in restitution.** While Roeschley represented that he would employ BJB Enterprises to satisfy the DBE minimum participation requirement, BJB Enterprises in fact did not do any work or supply any materials on the project.
- g. James McHugh Construction Co., Chicago, Illinois
James McHugh agreed in May 2014 to pay a **\$12 million settlement** arising out of DBE fraud. The case was brought by a project manager of a subcontractor on the Project. The project manager received **more than \$2 million** for his role in the litigation.

Dos + Don'ts of DBE Contract Procurement

Dos:

1. Do – Document Your Good Faith Efforts.

You should always document the efforts you make to obtain commitments from DBE participants. Even if you do not ultimately reach your goal, you should always document that you have made a good faith effort to do so.

The U.S. Department of Transportation has explained that “a one-size-fits-all checklist is neither desirable nor possible” in determining whether a contractor has met its good faith requirement. Instead, what constitutes a showing of good faith in a particular procurement requires a fact-specific judgment that your company must make. Because enforcement efforts have re-doubled in recent years, it may be prudent to err on the safe side. Short answer: make a conscious effort to obtain your DBE goal and always document your efforts.

Some states provide detailed documents that must be completed. But whether you work in one of these states or not, you should always have proof that you acted in good faith.

2. Do – Place DBEs on Solicitation Lists.

Contractors must make DBEs aware of contracting opportunities to “the fullest extent practicable through outreach and recruitment.” You should place DBEs on regular solicitation lists and you should solicit DBEs whenever potential opportunities arise. Advertisements should remain open for a minimum of 30 calendar days before the bid or proposal closing date.

3. Do – Remain Competitive in the DBE Procurement Market.

Take steps to make sure your company is competitive in the DBE procurement market. Track-records of other bidders can often be important and it is very likely that your company will be assessed against your competition regarding your ability to obtain DBE contracts. If other bidders have been able to obtain the DBE goal, but your company has not, that could count against a showing of good faith effort.

DBE Participation: Dos + Don'ts

4. **Do – Maintain Relationships with Reputable DBEs.** ✓

By maintaining good relationships with reputable DBE firms, you can minimize risk associated with contracting work to inexperienced DBE firms.

5. **Do – Find Replacement DBEs.** ✓

Always make an effort to replace DBEs that have dropped out of the project with other DBEs. While you are not required to replace DBEs that have fallen-away with other DBEs, you *are* required to make a good faith effort. You must attempt to replace fallen-away DBEs to ensure your company meets your overall contract goal for DBE participation.

6. **Do – Use Government Resources.** ✓

Government resources exist to help contractors find DBEs to work on their projects. Take advantage of services offered by the SBA, the Minority Business Development Agency, and the Department of Commerce to your advantage. Following ODOT DBE guidelines, even if not legally applicable to your job, may provide insulation from liability.

7. **Do – Make Reasonable Inquiries.** ✓

Make reasonable inquiries to ensure a DBE you are involved with is not a mere “pass-through” but is actually performing a commercially useful function on the project. Contractors, subcontractors, and material suppliers that are “willfully ignorant” can be prosecuted to the same extent as those companies that act intentionally to defraud the government. Ignorance is often not an excuse.

8. **Do – Maintain Monitoring and Enforcement Programs.** ✓

Particularly if you run a large operation, maintaining compliance programs that include adequate oversight and enforcement programs may be necessary to ensure compliance with DBE procurement laws. While these programs may add to project costs, the expense can save your company millions of dollars and help you avoid criminal prosecution.

9. **Do – Cooperate with Enforcement Officials.** ✓

You should comply with enforcement officials and set forth proof of good faith efforts made. A lack of cooperation will only hurt.

Don'ts:

1. **Don't – Never “Market” Your DBE Certification.** ✗

Even minor involvement in pass-through DBE schemes can end in enormous financial penalties, including potential debarment from future contracting work, and even criminal consequences. A small profit is not worth the *huge* risk.

2. **Don't – Reject Reasonable Price Offers.** ✗

If you do not meet your DBE participation goal and yet rejected a DBE offer that was within a reasonable range of the offer accepted (1 to 10 percent) that could establish a lack of good faith. You should carefully consider “reasonable price” offers made by DBE firms.

3. **Don't – Use “Time and Material” or “Cost Plus” Unless Reputation is Established.** ✗

Using “time and material” or “cost plus” contracts with DBE subcontractors can be a risky endeavor. Unless the DBE can demonstrate a history of performing and managing its own work, this type of contracting is fertile ground for “front” companies. Be on the look-out for companies with little more than an office and a handful of clerical employees to run a payroll, purchase materials, or pay project invoices. Companies that offer “payroll” services for a fee should also be scrutinized. Use of such firms will likely draw the attention of government investigators. Use these firms only after assuring yourself the company performs a commercially useful function.

4. **Don't – Terminate for Convenience and Self-Perform.** ✗

Do not terminate for convenience and then self-perform the work. Doing so without the DBE's consent can constitute a lack of good faith.

DBE Participation: Dos + Don'ts

5. **Don't – Bury Your Head in the Sand.** 

As ignorance is not an excuse, do not ignore warning signs that a DBE is not really performing a commercially useful function.




6. **Don't put Your Employees on the DBE's Payroll.** 

Companies that have placed their own employees on the payroll of the DBE to get work done have not fared well.

Stay Informed



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