State and Municipal Disadvantaged Business Programs – An Alternative to the Disparity Study Approach

1. Disparity Studies. Federal constitutional law limits the ability of municipalities and other governmental entities to create affirmative procurement programs benefitting disadvantaged business enterprises (DBEs) and designed to remedy past discrimination.

(a) See City of Richmond v. J.A. Croson Co., 488 U.S. 469,109 S.Ct. 706,102 L.Ed.2d 854 (U.S. Sup. Ct. 1989), and its progeny.

(b) To address the constitutional issues, governmental entities often undertake disparity studies that seek to quantify the impact of discrimination on past contracting opportunities.

(i) The disparity-study approach seeks to identify a market-wide pattern of past discrimination.

(ii) Unfortunately, the cost of such studies is often beyond the resources municipalities can allocate.

(iii) Moreover, the studies themselves are highly technical and susceptible to challenges, and on occasion create delay, litigation expenses, political criticism, and uncertainty.

(c) Disparity studies do have utility.

(i) Such studies confirm what is conventional wisdom, are easy to understand, and are actively promoted by the relevant consultant community.

(1) Construction contractors, service providers and commodity vendors develop relationships with majority-owned subcontractors, subconsultants and suppliers and often do not willingly depart from those relationships.

(2) Rectifying past discrimination has altruistic appeal that is easy to grasp.

(3) The consultants engaged in this work dominate the conversation when the subject turns to fashioning disadvantaged business programs.

(ii) Also, larger programs have a certain “economy of scale” that provides justification for use of disparity studies.

(1) A recent Pennsylvania study costing in the low seven-figures addressed the impact on disadvantaged business enterprises in the context of state construction and services contracting worth several billion dollars in annual spend. Clearly, an economy of scale was present there.

(2) Unfortunately, the study required several years to complete and was not implemented until 2021, the last year of an eight-year gubernatorial administration.

a. The fate of the program probably awaits the outcome of an election this fall.

b. In years past, programs created by one administration were effectively dismantled by the administration that followed.

2. Pennsylvania Programs. An earlier Pennsylvania state-level program, promulgated in 1990, and more recently programs adopted in Pennsylvania at the municipal level, have taken a different approach, one that does not require a disparity study, and is quicker and less expensive to implement.

(a) The 1990 state-level program first focused on construction contracts, and thereafter included service contracting for professional and nonprofessional services.

(b) Legal support for the state-level program (and for that matter municipal programs) was found in the Pennsylvania state law requirement that all governmental entities (both state and municipal) review the "contractor responsibility" of bidders and proposers before making awards.

(i) Typically, such reviews encompass examination of financial strength, bonding capacity, operational capability, and integrity.

(1) See Reading Blue Mt. & N. R.R. v. Seda-Cog Joint Rail Auth. & Bd., 235 A.3d 438, 452 (Pa. Cmwlth. 2020) (citing cases and defining responsibility as "financial responsibility, . . . integrity, efficiency, industry, experience, promptness, and ability to successfully carry out the particular undertaking") (emphasis added).

(2) It would seem self-evident that an entity that demonstrates discrimination in the solicitation and selection of subcontractors lacks integrity.

(ii) Similar requirements are operative in many if not all of the other states. A random search of five states disclosed "responsible contractor" requirements or the equivalent in all five:

(1) California: Cal. Pub. Cont. Code §20162 ("lowest responsible bidder");

(2) Delaware: 29 Del.C. §6962(c)(prequalification process may be required);

(3) Illinois: 50 ILCS 500/20-10(g) (award to "lowest responsible . . . bidder");

(4) New York: New York Town Law §122 ("lowest responsible bidder"); and

(5) Texas: Local Government Code § 271.027 ("lowest responsible bidder").

(c) Pennsylvania's 1990 program required the review of whether prospective construction contractors had discriminated in the selection of subcontractors and subconsultants in preparing their bids or proposals.

(i) A bidder or proposer that discriminated against DBEs in the process of selecting its subs would be denied the award on the basis of the contractor-responsibility requirement.

(1) Challenges to the program as written and as applied were rejected by a federal court:

a. Associated Pennsylvania Constructors v. Jannetta, 738 F.Supp. 891 1990 WL 81335 (M.D. Pa.) (facial challenge to constitutionality of state policy); and

b. First Capital Insulation, Inc. v. Jannetta, 768 F.Supp. 121 1991 WL 135939 (M.D. Pa.) (challenging the constitutionality of state policy as applied).

(2) The key distinction between this program and the disparity-study approach is that the focus in the contractor-responsibility program is on current discrimination, obviously a disqualifying event, and not on establishing a market-wide pattern of discrimination in the past.

(ii) In order to avoid unnecessary administrative reviews, and in all frankness to encourage majority contractors to use DBEs, minimum participation levels (MPLs) expressed in percentages of the construction bid were adopted at tailored levels on a project-by-project basis.

(1) The MPLs were set in each project on the basis of a variety of factors, including DBE availability for that project (current and potential) and the program's overall goals.

(2) Majority-contractor bidders which met the MPLs were in effect given a "safe harbor" and presumed to have been responsible in the solicitation of subcontractor bids.

(3) The bids of majority contractors that did not meet the MPLs on the project were reviewed, and the majority contractors that were found to have discriminated were disqualified.

a. Over the course of several years, the state rejected hundreds of bidders, and the program achieved state-wide disadvantaged business enterprise participation at about 10%.

(d) Thereafter, Pennsylvania extended its policy of encouraging the use of DBEs to services.

(i) Professional and nonprofessional services were covered.

(ii) Service contracts were graded using a system of point allocations set for technical competence and cost, to which the level of DBE participation was an added consideration.

(1) Specifically, points of up to 20% of the total were available to be allocated for DBE participation, with the actual point allocation given to each proposer being normalized, with the highest level of participation given for example the full 20% and remaining proposers were given fewer points on a proportional basis.

a. To illustrate, a proposer with the highest level of DBE participation at 8% of the bid price would receive 20% of the points, and a proposer that had three-quarters of the highest participation level (6%) would receive 15% of the points.

b. In effect, this system provided incentives to secure DBE participation. See, e.g., First Health Group Corp. v. National Prescription Adm'rs, Inc., 155 F.Supp. 194 (M.D. Pa. 2001) (successful vendor received an allocation of 10% of total points).

(2) The system's use was particularly significant from an economic perspective in the context of the state's $2 billion in annual information technology (IT) acquisitions.

(iii) This approach remained in effect for over two decades without challenge.

3. Municipal Adoption of the MPL Program for Construction. The MPL model for assessing contractor responsibility has been adopted in a handful of local jurisdictions in Pennsylvania, without challenges, and with results varying from 9% to 26% of contract value in DBE participation.

(a) The Harrisburg City School District implemented a MPL requirement for a $200 million dollar construction renovation program and achieved about 26% minority and women business enterprise participation.

(i) This extraordinary result was a function of a combination of unique factors in the marketplace for the DBE subcontracting services and should not be seen as a benchmark for MPL programs but rather as what can in certain very favorable circumstances be achieved.

(ii) Great care was taken there to insure that selected DBEs did not function as "pass-through" entities – a potentially fraudulent practice that defeats the purpose of building real DBE capacity.

(b) The Harrisburg Authority achieved about 9% in DBE participation for its low seven-figure and six-figure water and sewer projects over a number of years.

(c) The successor entity, Capital Region Water, has in a more recent period achieved about 10% for projects of about the same size.

(d) These local and regional results compare favorably to the previously mentioned MPL program operated by Pennsylvania.

4. Creating a Contractor-Responsibility/MPL Construction Program for Municipalities.

(a) Municipalities can create a disadvantaged business enterprise (DBE) program for construction using the minimum participation level (MPL) approach to assess contractor responsibility prospectively.

(b) The state or local law governing the municipality and the municipality solicitation documents must of course explicitly or implicitly require that bidders and proposers on public contracts be responsible in a relevant manner, i.e. the law must prohibit the award of a public contract to an entity which has engaged in discriminatory activity.

(i) There are numerous examples of how discrimination can occur, including:

(1) Providing bidding or proposal documentation unequally;

(2) Giving majority subs longer periods of time to respond than that given to DBEs;

(3) Soliciting DBEs indiscriminately through mass emails and the like, without regard to the relevant scope of work;

(4) Ignoring available information on DBEs that are able to perform;

(5) Imposing unnecessary requirements; and

(6) Restricting sub solicitations to a pre-existing group.

(ii) There may be no fully developed law supporting the application of the responsibility requirement in this context – indeed there was none in Pennsylvania before the Jannetta cases cited *supra*.

(c) There must be the adequate resources provided, including additional personnel to administer the program.

(d) The temptation to set arbitrary, across-the-board percentages for participation goals must be resisted.

(i) Goals that are not project-specific will breed disrespect for the program among the construction contractors.

(ii) Setting unrealistic goals will encourage the use of pass-throughs and other evasions and will not be as effective in creating capacity in the DBE communities.

(iii) Unrealistic goals will require an excessive amount of administrative time in performing reviews of responsibility.

(e) In drafting the program, there are key questions must be addressed:

(i) What is the legal basis for the program and for the ability of the municipality to disqualify bidders that discriminate against DBEs? This will clearly vary, state to state.

(ii) What identifiable disadvantaged groups will be included in the program? Besides the obvious inclusion of race and gender, other categories less in number can be established separately, or grouped in a combined MPL.

(iii) Will the municipality rely on certification of true ownership and control of the DBE by third-party certifying entities, or instead will it endeavor to undertake the certification process using its own personnel? Self-administration of certification applications is a labor-intensive but more reliable process.

(iv) Will the municipality reach out to majority-owned contractors in advance of the issuance of solicitations to provide program information? Outreach greatly improves results.

(v) How will the municipality assist the DBE communities in their efforts to be certified, to market their construction services, equipment, products and supplies, and to comply with program requirements? Public contracting can be somewhat intimidating to all small businesses.

(vi) What forms will be developed to provide ease of administration by the municipality, the construction contractors, and their DBE subs? Forms are essential.

(vii) Will the residency of DBE employees be woven into the contractor-responsibility/MPL program in some fashion? This is very hard to do, but is almost always requested.

(viii) Will the municipality maintain a list of potential DBE subs? Lists can be helpful, but contractors should be required to look beyond the known and listed DBEs.

(ix) Will there be a threshold for the application of the program to exclude smaller-value contracts? Smaller projects have the same administrative requirements, but obviously deliver less in terms of results.

(x) How will the MPLs be set and what factors will be included? Tailoring the MPLs to the specific project is difficult but with experience will become easier and more reliable.

(xi) To what degree will non-stocking suppliers be given MPL credit? Inclusion of non-stocking distributors has the potential to create pass-throughs and should only be allowed if customary in a particular market and then perhaps at less than 100%.

(xii) How will the MPL credit be determined for a DBE that qualifies in more than one category? The program may be drawn so as to allow credit in one category.

(xiii) For DBEs providing labor, what will be the requirement for self-performance? For example, self-performance may be set at 75%.

(xiv) What credit will be given to joint ventures that include a DBE partner? The points may be adjusted to reflect the DBE partner's true ownership interest.

(xv) For bidders not meeting the MPLs, what will be the mechanism for reviewing documents and information to determine responsibility? Here, judgment and careful review of the jurisdiction's procurement law is probably in order.

(xvi) What standard will apply to a bidder's disqualification? The administrative standard will usually apply.

(xvii) To what extent will bidders be permitted to supplement their initial submissions? Again, this will require judgment and careful review of the jurisdiction's procurement law.

(xviii) How will a contractor's commitments to its subs be memorialized? The commitments should become contractually binding.

(xix) What routine reporting will be required of the contractor and its subs? Large projects should require monthly reporting.

(xx) What document retention requirements will apply to the contractors? This need not be onerous, as these matters are usually handled in a relatively compressed period of time.

(xxi) What mechanisms for monitoring will be in place to guard against pass-throughs, where self-performance standards are not being met? Careful, on-the-ground monitoring is mandatory.

(xxii) What enforcement mechanisms will be employed for contractors departing from DBE commitments? The municipality must decide, generally or on a case-by-case basis, how deeply to be involved in contractor/DBE subcontractor disputes.

5. <u>Creating a Municipal Services Program that Includes DBEs.</u>

(a) Happily, the process for creating a services program is more direct, less complex and less likely to be challenged.

(b) The Pennsylvania program in effect for over two decades until 2021 was based upon the allocation of request-for-proposal (RFP) solicitation points among competing vendors.

(c) The legal basis for this program was never challenged.

(i) There was no disparity study conducted.

(ii) The conventional wisdom was accepted: DBEs were not participating in state services contracting to a satisfactory degree.

(iii) Vendors competed without protest for the points allocated to DBE participation.

(iv) The protests and challenges that were asserted by the vendor community, especially in connection with information technology (IT) solicitations, dealt instead with the application of general solicitation requirements, including:

(1) Whether the apparent winning proposal met all of the RFP's mandatory requirements;

(2) Whether the allocation of submittal points among technical, cost and DBE was proper;

(3) Whether the scoring of the points for those allocations was flawed; and

(4) Whether the composition of the proposal evaluation team was appropriate.

(v) The program was successful in encouraging the formation and development of DBE businesses providing services on state contracts.

(1) The principal compliance problem was in ferreting out woman-owned businesses that were not truly owned and controlled by female ownership.

(d) In drafting a services program, there are key questions that must be addressed, many of which parallel those that need to be answered in connection with a construction MPL/contractor-responsibility program:

(i) What is the legal basis for the services program and for the ability of the municipality to provide solicitation points for DBE participation?

(ii) What identifiable disadvantaged groups will be included in the services program? The identification of groups will usually follow those designated in the construction program.

(iii) Should the program incorporate small businesses and not just DBEs? This can be strategically advantageous.

(iv) Will the municipality rely on certification of true ownership and control of the DBE by third-party certifying entities, or instead will it endeavor to undertake the certification process using its own personnel? Self-administration of certification applications is a labor-intensive but more reliable process.

(v) Will the municipality reach out to vendors in advance of the issuance of RFP solicitations to provide program information? This helps with "buy-in."

(vi) How will the municipality assist the DBE communities in their efforts to be certified, to market their services, and to comply with program requirements? Depending on resources, this could be helpful in building participation.

(vii) What forms will be developed to provide ease of administration by the municipality, the service providers, and their DBE subs? This is probably not critical in the services context; requirements can be addressed in the texts of the proposals.

(viii) How will the DBE points (e.g., 20% of the total) be allocated and will the points be normalized? The 20% is more of a "yardstick" to be used in apportioning points, than a mandate. In many solicitations, proposers will only be able to include DBE allocations in the low single digits.

(ix) To what extent will proposers be permitted to supplement their initial submissions? This is usually inherent in the RFP process and can be permitted if administrative resources are sufficient.

(x) How will a vendor's commitments to its subs be memorialized? Again, the commitments should become contractual.

(xi) What routine reporting will be required of the vendor and its subs, and how will those reports be reconciled as to the time periods covered? Reports from the vendor and the sub must be harmonized as the latter is a check on the former.

(xii) What document retention requirements will apply to the vendors? Again, this need not be onerous.

(xiii) What mechanisms for monitoring will be in place to guard against entities whose ownership and control is not in the hands of a qualifying individual or individuals? Some degree of intrusion into the vendor/sub relationship is required.

(xiv) What enforcement mechanisms will be employed for vendors departing from DBE commitments? ? The municipality must decide how deeply to be involved in disputes.

6. <u>Private Entity Collaboration.</u>

(a) A largely untapped avenue for building DBE capacity in the municipality and the surrounding region is a program of collaboration between the municipality and regional for-profit and nonprofit businesses.

(b) This envisions a process of enlisting the businesses that have a diversity supplier program in reporting their successes and a process of recruiting businesses in creating such a program and joining in the effort.

(c) The program would be voluntary, but in our present circumstances the case for collaborating would seem to be compelling, especially with respect to the larger, more established institutions.

(d) The mechanism for this collaboration can be as simple as a letter or memorandum of understanding.

7. Conclusion. Municipalities have options for incorporating disadvantaged business enterprises into public contracting. The contractor-responsibility/MPL model can be considered in the construction context, and the RFP model with allocations for DBE participation can be used for services. Private entity collaboration is a largely untapped avenue for leveraging the buying power of cooperating private and nonprofit entities within a municipality's jurisdiction and region.

William W. Warren, Jr., Esq.
Saul Ewing Arnstein & Lehr LLP
2 North Second Street, Suite 700
Harrisburg, PA 17101
(717) 238-7698
william.warren@saul.com

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