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BEFORE THE SUBCOMMITTEE ON TRANSPORTATION
OF THE COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS
UNITED STATES SENATE
REGARDING THE SECTION 105(f) PROGRAM OF THE
SURFACE TRANSPORTATION ASSISTANCE ACT OF 1982

NOVEMBER 19, 1985

Mr. Chairman and Members of the Subcommittee:

My name is Jim Marquez and I am General Counsel of the Department of Transportation. With me today is David Lukens, Special Assistant to the Administrator of the Federal Highway Administration (FHWA). On behalf of Secretary of Transportation Elizabeth Hanford Dole and Federal Highway Administrator Ray Barnhart, I would like to express to the Subcommittee our appreciation for your interest in our efforts to implement the Disadvantaged Business Enterprise (DBE) Program established pursuant to section 105(f) of the Surface Transportation Assistance Act (STAA) of 1982. The Department fully supports the purpose of this legislation, that is, ensuring that minorities and other socially and economically disadvantaged members of our society are afforded the opportunity to participate equally in contract opportunities resulting from our federally-assisted transportation programs.

In the letter of invitation to Secretary Dole, you indicated those issues you would like us to address.

Capacity of DBEs and WBEs

The capacity of DBEs and WBEs in the highway construction industry has never been determined with any degree of confidence. The FHWA has relied on the individual States to project capacity in relation to establishing or achieving State goals. The number of DBE firms certified in a particular State together with some estimate of the ability of those firms to undertake highway contracts or subcontracts should provide some indication of the goal a State should set in order to comply with program requirements. State highway departments are the entities that determine eligibility and enter into contractual relationships with the construction firms, and thus, are in a position to determine a firm's capacity. Individual States have set DBE goals ranging from 5.5% to 14% and WBE goals ranging from 0.5% to 5% over the past two years, and have generally achieved these goals. This may provide a rough measure of DBE capacity.

In many States, DBE and WBE firms are included on certification lists whether or not they actually do highway construction work. In many cases, firms active in other areas of construction apply for certification in the highway construction area and then, for one reason or another, do not compete for highway contracts or subcontracts. Many of the

certified firms are newly emerging companies, the capacities or abilities of which have not been determined through experience.

We view the DBE program as one that is intended to provide opportunities to develop capacity, as well as working with existing DBEs. Consequently, capacity is an ever changing phenomenon as new DBEs are established.

Earlier this year, the General Accounting Office (GAO) investigated the DBE program in six States -- Colorado, Florida, Illinois, New Hampshire, Maine, and North Dakota -- and reported that the data available indicated that capabilities exist among certified DBEs to perform 10 percent of the highway work needed by those States.

The capacity of DBEs to participate in needed highway construction is not present in every instance. Some States have experienced situations where capable DBE contractors are not available at the time contracts are let, or the availability of such contractors is affected by the location of the work and competing job opportunities. These conditions have been encountered in a number of States, and thus, were considerations in our approval of participation goals. In such situations we ask the States to fully document the problem and the good faith efforts in meeting their goals.

Participation and Development as Prime Contractors

Currently there are 466 DBEs and 205 WBEs which are bidding as prime contractors for highway construction work. It should be noted, however, that of these firms 170 DBEs and 74 WBEs are bidding in only four states which have very active set-aside programs.

Because participation in prime highway contracting involves large capital investments, complex financial arrangements, and technical expertise, DBE and WBE firms have, in most cases, entered into the industry through subcontracting. Subcontracting allows these firms to develop industry experience and skills without the financial burdens and risks associated with prime contracting.

While the number of DBEs and WBEs competing as prime contractors is relatively small, the FHWA has been involved in various efforts designed to encourage initiatives to increase the numbers and to remove barriers to DBE/WBE participation. We are funding supportive services contracts through the States which provide technical and financial assistance to these developing firms. I will briefly discuss these activities later in my testimony.

Effects of DBE Program on Non-DBE Specialty Contractors
and WBEs

The FHWA has received in past years considerable correspondence from non-DBE specialty contractors and other firms who complain that the DBE requirements are forcing them to lose business or are even driving them out of business. This correspondence alleges that non-DBE specialty contractors with lower bids than DBEs are denied the contract. It is difficult to judge fairly the weight which should be given to individual complaints of adverse impact, some of which may stem from disappointment at losing competition to new entrants into a formerly less open market, and to the overall effort of the STAA, which increased total contract dollar and opportunities by 50 percent for the entire industry. In most cases, specialty work is performed through subcontracts. This requires consideration of determinations made by prime contractors in entering into subcontracts. Non-DBE specialty contractors suggest that the 10% DBE provision impacts heavily in highway construction because such construction is not conducive to significant subcontracting opportunities. Thus, these complainants assert that about 90% of an average highway construction contract is done by the prime contractor leaving only 10% for subcontractors. As a result, they claim many non-DBE subcontractors are shut out from bidding opportunities.

Women-owned businesses if socially and economically disadvantaged can qualify on an individual basis under the statutory program. The statutory program left unchanged the existing DOT regulatory program requiring good faith effort for WBEs. We remain committed to the WBE program and we intend to continue encouraging the States to take affirmative, non-discriminatory steps to increase participation of WBEs in federally-assisted work.

DBE and WBE Certification Process

The Department regulations provide minimum standards which the States must follow in certifying DBE and WBE firms. The process must be compatible with their procurement and contract award procedures. We have distributed to the States guidelines on eligibility criteria, certification and verification procedures. We have been striving to provide for maximum uniformity. Consistent with the concept of a federally-assisted, State administered highway program, we do believe that the primary responsibility for certification remains with the States.

At our urging, the States have been focusing more attention to the certification and verification process. Manpower and other resources dedicated to this task have been greatly increased at the State level.

reading, planning, business management, accounting, and recordkeeping. These companies are often in need of bonding and financial assistance.

Initiatives undertaken by the Department should help address these needs. The FHWA is currently providing this type of assistance through the supportive services program. The STAA of 1982 authorized FHWA to finance supportive services programs to help "minority businesses . . . achieve proficiency to compete, on an equal basis, for contracts and subcontracts." Since this Administration came into office, FHWA has allocated a total of \$30.5 million for this program, including \$8.4 million for fiscal year 1985.

The supportive services program has helped DBEs understand the States' contract award processes, improved communications on contracting opportunities, provided technical assistance, and established "networks" among DBEs and sources of contracts. Many innovative approaches have been implemented, including workshops, seminars, one-on-one consulting, and assistance from State highway personnel.

The Department's Office of Small and Disadvantaged Business Utilization is also presently funding 14 Program Management Centers (PMCs), and one Native American Business Enterprise project. The PMCs are a national network of professional management consulting firms which are supported by the Department for the purpose of providing assistance to DBEs in pursuit of business opportunities with the Department

We believe that the screening programs undertaken by the states have been effective in preventing front firms from taking advantage of the program. There is abuse, and I doubt that we will ever eliminate all abuse any more than the IRS eliminates all cheating on taxes. But fronts are not taking over the program, and we believe that the vast bulk of the funds counted toward our DBE and WBE goals goes to legitimate firms.

In addition to screening and enforcement, another important way to prevent abuse is an emphasis on and a recognition of good faith efforts to afford equal contracting opportunities to DBEs. We continue to stress that this is not a quota program, and to emphasize the responsibility of the States to maintain competitive standards in administering the program and the obligation to accept good faith efforts in lieu of goal achievements. Consequently, a combination of close monitoring and enforcement to prevent and correct profiteering through pass through arrangements, and reasonable requirements focusing on opportunities and good faith efforts should go a long way toward reducing the incentive to create fraudulent DBEs and WBEs.

Financial and Technical Assistance to DBEs and WBEs

We have found that DBE and WBE firms, like most emerging companies, are in need of technical assistance in areas such as prequalification, estimating, bid preparation, plan

and its financial assistance recipients. The PMCs provide assistance by identifying DBEs, and performing outreach, marketing, referral, follow-up and technical assistance. Technical assistance consists of bid proposal development, cost estimating, loan packaging and assistance in obtaining bonding. This program, since its establishment in FY 1982, has consistently provided valuable assistance to DBEs involved in business opportunities resulting from the STAA of 1982.

As you know, DBEs historically have had difficulties in obtaining surety bonds and financial assistance. To assist DBEs in overcoming such barriers, in December of 1982, the Department created bonding and short-term loan programs with Fireman's Fund Insurance Companies and the Atlantic National Bank. These programs have been successful in providing DBEs with the bonding and financing needed to perform transportation-related projects.

Over the two and one half years ending June 30, 1985, 88 bond approvals were made. Final bonds have been issued to cover 33 contracts with bonded amounts nearly \$3.0 million. Other approvals include 37 bid bonds and 18 applications for bond readiness. Also, from December 1982 to October 1985, 64 short-term loan dispersals have been made for approximately \$7.2 million. These loans were made to DBEs at the current prime rate. This is a unique feature of the Department's

short-term loan program, since many other loan programs make loans available to DBEs only at interest rates above the prime.

Additional Costs Resulting from DBE Program

The allocation of resources at the State level to establish adequate certification and verification processes, as well as the steps taken to provide assistance to DBEs and develop innovative procedures, have entailed added costs. There have also been allegations that prime contractors have awarded subcontracts to DBEs in order to meet contract goals, even though the DBEs' quotes were higher than non-DBE competitors. This could have the effect of raising bid prices on contracts where DBE goals are included although it is far from certain that this has happened in any systematic way or that unreasonably high prices for work have resulted.

There is a problem in quantifying these additional costs. We do not have the data available which would permit us to arrive at exact figures or even accurate estimates.

Fronts and their Prevention

The Department continues to believe that effective enforcement of the DBE program's eligibility requirements is a key part of ensuring that the program will achieve its

purpose. Keeping ineligible "front" firms out of the program is essential to maintaining the program's integrity and credibility.

The first and most important part of this responsibility falls upon the State and local governments receiving financial assistance from the Department, who must screen applicants for DBE certification. This screening process has succeeded in preventing the participation of a substantial number of ineligible firms.

I have already discussed the aggressive actions taken by the States on certification and the resulting decrease of fraudulent firms benefitting from this program. A few figures will further illustrate this point. According to a survey conducted in June of this year, the States took certification actions on 6,084 firms during fiscal year 1984 and the first quarter of fiscal year 1985. In all, the States have denied DBE certifications to 906 applicants. This means about 15 percent of all firms that applied were denied certification.

We also require the States to review certified firms annually. The States conducted recertification reviews of 4,803 firms in fiscal year 1984 and the first quarter of fiscal year 1985, with 403 firms denied recertification -- or about 8 percent of those reviewed. In the same period, the States decertified 359 firms following reviews or investigations conducted outside the normal process.

The Department maintains a certification appeal process for firms that believe they had been wrongly denied certification or decertified by recipients. As of November 6, 1985, the Department's Office of Civil Rights has decided 499 of 554 appeals it has received. Of this number, only 40 (or about 8 percent) were decided in favor of the appellant firms. Insofar as the cases appealed to the Department are representative of recipient certification actions, this low percentage of reversals suggests that recipients' judgments that firms should not be certified are generally reliable.

The participation of ineligible firms in the DBE program is an abuse of the program, and could sometimes involve actual fraud as well. Consequently, the Inspector General's office is often called upon to independently investigate matters related to DBE certification.

In some cases, investigations have resulted in referrals for prosecution at the Federal or State level. In other cases, referrals have been made to the agency for possible debarment action. These actions have also provided assistance in the general administration of the programs.

States with Small Minority Populations

While on this subject, I would like to address another question posed by the Subcommittee concerning States with small minority populations and their ability to meet DBE requirements. To begin with, the Department's regulations

require only that a State set reasonable overall goals annually. If the goal is less than ten percent, the State is required to submit justification. Small minority population within a State has been accepted as a factor justifying a goal of less than ten percent, but not in and of itself. A State must also consider the availability of DBEs in neighboring States, and explain what efforts were taken to attract such firms. In some cases, genuine efforts to attract out-of-State contractors have not been fully successful. The principal reasons in such cases are that the out-of-State DBEs are already working at or near capacity or the site of the project is too inconvenient. Problems are also sometimes encountered when there are non-DBE firms available within the State to do the work. Four states have requested goals of less than 10% for FY 86. Three have been approved and one is pending.

Initiatives to Promote Participation
and Ensure Program Integrity

I would like to discuss other recent efforts that have been undertaken to facilitate DBE/WBE participation.

The FHWA is confident that our day-to-day monitoring and oversight of the DBE program provides significant guidance to the States which facilitates the administration of the program and leads to enhanced DBE participation. Recently, we issued policy guidance clarifying the concept of "good faith efforts"; and offering assistance in the administration of

contracts subject to section 105(f). On a periodic basis, the FHWA has issued advice to field offices providing examples of various innovative procedures and programs being used by States to increase opportunities for DBEs/WBES. Among these are the establishment of development credit funds with local banking institutions; increasing the minimum level of contract value for required bonding; elimination or modification of prequalification requirements; allowances for documented administrative costs by prime contractors subcontracting to DBEs; compensation for DBE training and technical assistance provided by prime contractors; and, the use of mobilization costs and quick payment provisions in DBE subcontracts.

In response to a specific question posed in the invitation letter as to whether assistance to DBES should be counted toward the 10 percent goal, the FHWA has adopted the policy of counting such assistance to DBES only to the extent that it involves a consulting contract with a DBE firm.

Bonding Demonstration Program

In addition to these initiatives, we were directed by Congress to undertake a bonding demonstration program, for which \$5,000,000 has now been appropriated to come out of FHWA general operating expenses. The States of New York, Pennsylvania, and Florida were selected as demonstration States at the suggestion of the House Appropriations Committee. Our plan is to combine technical assistance for

DBEs in those States, specifically in the bonding area, with an increased capacity for direct bonding of DBE highway contractors through augmentation of an existing program administered by the Department's Office of Small and Disadvantaged Business Utilization.

We expect the demonstration program to be operational in all three States by the beginning of 1986.

DBE and WBE Participation

In order to assist the Subcommittee in its understanding of the extent of this program, I would like to provide for the record a table of Federal-aid contract totals for fiscal years 1984 and 1985. You will note that complete data for fiscal year 1985 is not yet available, however, a table containing the first 9-month totals has been prepared. To supplement this information, I am also providing a table showing the contract values of all States and the portion of those figures going to DBEs and WBEs for the same periods.

This information reveals that during fiscal year 1984, the States obligated more than \$9.34 billion on federally-assisted contracts. Of that amount, \$1.2 billion was awarded to DBEs and \$0.3 billion to WBEs, as prime contracts or subcontractors. In other words, approximately 13 percent of our contracting dollar actually went to DBE firms, and 3 percent to WBEs. This pace has continued during the first 9 months of fiscal year 1985. The States have awarded contracts

amounting to about \$8.25 billion, of which nearly \$1.1 billion has gone to DBE firms, and \$0.24 billion to WBE firms. This represents a nationwide participation of over 13 percent for DBEs and of 2.86 percent for WBEs in the first three quarters of fiscal year 1985.

Study on Impacts of DBE Program

We have been concerned that we do not have a comprehensive analysis of the effects of the DBE program. Earlier this year, we awarded a contract for a study to identify and assess beneficial and adverse impacts of DBE participation requirements of the Federal-aid highway program. The scope of work for this study includes the identification of significant measures to determine the effects of the DBE program on the contracting community; the location of data sources useful in providing the measures; the collection of data and quantification of identified measures; and, analysis of the data in order to assess any positive and negative impacts of the DBE program.

The Abt Associates of Cambridge, Massachusetts was awarded the competitive contract on April 1, 1985, in the amount of \$186,895. This firm is scheduled to deliver its final report on the study on January 14, 1986.

The Abt Associates has conducted on-site visits in 9 States in order to obtain information on DBE program impacts from State and Federal highway personnel, DBE and non-DBE

firms, and supportive services agencies. The States were selected to illustrate program impacts under a variety of circumstances, including differences in program size and approach, minority population, and geographic location.

The contractor is presently attempting to gather additional information to complement existing data sources. At this time, we are unable to report conclusive findings resulting from the study.

Conclusion

The Department believes that our efforts and those of the States, as has been documented in the various congressional hearings on these programs, have fulfilled the intent of section 105(f) of the STAA of 1982 and opportunities for disadvantaged business have been enhanced significantly. We also recognize that we have been faced with many legitimate problems during the implementation of this program. We have been doing our utmost to overcome these problems. We will continue our efforts with the States to monitor the program and to address current and future problems.

This concludes my prepared statement. I will now answer any questions you may have.