

Department of Legislative Services
 Maryland General Assembly
 2022 Session

FISCAL AND POLICY NOTE
 Third Reader - Revised

House Bill 389

(Delegate Wilson)

Health and Government Operations

Budget and Taxation

Procurement - Minority Business Enterprises - Revisions

This bill establishes the position of Minority Business Enterprise (MBE) Ombudsman within the Governor’s Office of Small, Minority, and Women Business Affairs (GOSBA); expands accountability, transparency, and training requirements for the MBE program; codifies an existing set-aside program for small businesses; and requires a follow-up report to assess implementation of the bill’s provisions. **The bill takes effect July 1, 2022.**

Fiscal Summary

State Effect: General fund expenditures increase by \$308,600 beginning in FY 2023 for staffing. Out-year costs reflect annualization, ongoing operating expenses, and inflation. General fund expenditures for the Board of Public Works (BPW) and for the Office of the Attorney General (OAG), and reimbursable revenues (and potentially expenditures) for the Office of Administrative Hearings (OAH), may increase, but a reliable estimate is not feasible, as discussed below. Additional requirements likely have an operational effect on State agencies and GOSBA but otherwise can be carried out with existing resources.

| (in dollars) | FY 2023 | FY 2024 | FY 2025 | FY 2026 | FY 2027 |
|----------------|-------------|-------------|-------------|-------------|-------------|
| ReimB. Rev. | \$0 | \$0 | - | - | - |
| GF Expenditure | \$308,600 | \$368,400 | \$378,500 | \$388,200 | \$398,300 |
| Net Effect | (\$308,600) | (\$368,400) | (\$378,500) | (\$388,200) | (\$398,300) |

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Minority Business Enterprise Ombudsman

The MBE Ombudsman is appointed by the Special Secretary for GOSBA, who must, in accordance with the State budget, allocate staff and resources to the ombudsman to fulfill his or her duties. The ombudsman must (1) assist procurement officers in attempts to resolve disputes between MBEs and prime contractors, including disputes over contract scope and payments; (2) serve as a resource to MBE liaisons, procurement officers in units of State government, prime contractors, and MBEs in resolving disputes on relevant contracts; and (3) conduct trainings for procurement officers on enforcement of the requirements of the MBE program, including the assessment of liquidated damages. In resolving disputes, the ombudsman may:

- compel prime contractors and MBEs to provide documentation related to contract performance and payments; and
- assist the procurement officer who manages a contract in ordering any relevant payments to be made in conjunction with a dispute resolution.

In general, the MBE Ombudsman may not disclose information received during a dispute resolution without the written consent of the party that provided the information. However, the ombudsman may disclose information to GOSBA's assistant Attorney General.

By December 1, 2023, the ombudsman must report to the Senate Budget and Taxation Committee and the House Health and Government Operations Committee on his or her activities, including whether the number of staff allocated to the office is adequate.

Reporting Requirements and Transparency

Annually, each State agency must report to GOSBA the results of each compliance assessment required to be conducted under current law for each contract that is completed in that year. The report must include specified information, including the total dollar value of payments under the contract and the total dollar value of payments to each subcontractor.

Each solicitation for bids or proposals that includes an expected degree of MBE participation must include a summary of the factors used to determine the MBE participation goal, including subcontracting opportunities identified for the project, any applicable industry codes linked to those opportunities, and the number of certified MBEs identified for those opportunities.

Agencies must annually report to GOSBA their contract awards and payments by industry type, and, if applicable, GOSBA must annually summarize data reported by agencies by industry type.

Vendor Accountability

GOSBA and the Office of State Procurement, in consultation with specified entities, must adopt by regulation criteria used to determine that a prime contractor, in the absence of mitigating factors, has persistently failed to meet MBE participation goals on their contracts. The criteria must include the results of compliance assessments submitted by State agencies. GOSBA must refer prime contractors identified under the criteria to OAG for debarment for up to three years under procedures specified in current law.

The bill expands the requirement that prime contractors pay undisputed amounts to their subcontractors within 10 days to include all contractors, not just construction contractors. It also expands State agencies' authority to withhold progress payments from prime contractors that do not pay their subcontractors undisputed amounts in a timely fashion to include all prime contractors, not just those working on construction contracts.

By June 1, 2024, GOSBA must study the use of liquidated damages to enforce the requirements of the MBE program. GOSBA must report its findings and recommendations to the Senate Budget and Taxation Committee and the House Health and Government Operations Committee.

Small Business Set Asides

The bill codifies Executive Order 01.01.2021.01, which generally requires State procurements with a value between \$50,000 and \$500,000 to be automatically set aside for small businesses by designation to the Small Business Reserve (SBR) program. The set-aside requirement does not apply to (1) purchases from preferred providers; (2) specified procurements involving federal dollars; (3) procurement of human, social, cultural, or educational services; or (4) term and master contracts. GOSBA may waive this requirement when it is not practicable to reserve a procurement for small businesses.

The bill requires that standards for the SBR program allow a business that qualifies as a small business under State law and meets other specified criteria to register to participate in SBR without the need to file any additional paperwork.

Follow-up Report

By December 1, 2024, the Department of Legislative Services (DLS) must report to the Senate Budget and Taxation Committee and the House Health and Government Operations

Committee on the status of the recommendations included in the DLS December 2021, evaluation of the MBE program, including an assessment of (1) the effectiveness of changes implemented in response to the recommendations; (2) whether DLS reaffirms any recommendations that were not implemented or only partially implemented; and (3) any updated findings and recommendations related to the MBE program.

Current Law: For an overview of the State’s MBE program, please see the **Appendix – Minority Business Enterprise Program**.

Special Secretary for Small, Minority, and Women Business Affairs

Among other responsibilities, the Special Secretary is charged with, as authorized by the Governor, providing help to minority persons, small businesses, and veteran-owned small businesses and the communities in which they live, work, and employ others. Specific duties include, among others, (1) promoting, coordinating, and participating in plans, programs, and operations of State government that promote or otherwise affect the establishment, preservation, and strengthening of MBEs and (2) establishing a mentoring program in which larger and established MBEs can mentor start-up and small MBEs.

Minority Business Enterprise Contract Participation Goals

Each agency must evaluate each contract to determine the appropriate MBE participation goal for the contract based on (1) potential subcontract opportunities; (2) the availability of certified MBEs to perform those tasks; and (3) existing guidelines put forth by GOSBA. Agencies may not use quotas or any goal-setting process that relies solely on the State’s MBE goal. Each solicitation document must include the expected degree of MBE participation based on the agency’s determination.

Minority Business Enterprise Reporting

Each year, State agencies are required to report to GOSBA specified data regarding their contract *awards*, including the percentage of those awards being made to certified MBEs. There is no requirement to report actual contract *payments*. GOSBA, in its annual report, provides a summary of the value of each agency’s total contract awards and awards to MBEs. It also reports, on its own authority, data on total payments to MBEs but not as a percentage of total contract payments.

Statute requires that program regulations require State agencies to verify and maintain data concerning payments received by MBEs, including a requirement that, upon completion of a project, the agency compare the total dollar value actually received by MBEs with the amount of contract dollars initially awarded, and provide an explanation of any discrepancy.

Liquidated Damages

Each contract with an MBE participation goal must include a liquidated damages provision that applies if the contractor fails to comply in good faith with the provisions of the MBE program. However, a unit may not apply liquidated damages for an indefinite delivery or indefinite performance contract under specified circumstances.

Payment of Construction Subcontractors

For construction contracts only, a contractor must pay a subcontractor an undisputed amount to which the subcontractor is entitled within 10 days of receiving a progress or final payment from the State. Statute establishes a process for subcontractors to appeal to an agency if payments are not made timely. Following a mediation process, if a State agency determines that the contractor continues to be delinquent, the agency must withhold payments to the contractor until the subcontractor is paid and may order that work be suspended. There are no similar provisions for contracts that are not construction contracts.

Small Business Reserve and Set Asides

SBR requires that each State agency, to the extent practicable, structure its procurement procedures to award at least 15% of the total value of contracts to small businesses. An agency may count a contract awarded to a small business toward the 15% goal only if the contract was designated (set aside) as an SBR procurement. Small businesses self-certify based on business size standards in statute.

Executive Order 01.01.2021.01, signed by the Governor in January 2021, generally requires State procurements with a value between \$50,000 and \$500,000 to be automatically set aside for small businesses by designation to SBR, as described above.

Debarment

Under State procurement law, a person must be debarred from entering into a contract with any public body in the State if the person has been convicted for bribery or other related crimes committed in the process of seeking a contract with a public body. Statute specifies numerous other grounds for which a person may be debarred from contracting with any public body or, in some cases, only with the State, generally related to criminal convictions for specified crimes. Debarment proceedings are held before BPW following procedures outlined in statute.

State Expenditures:

Minority Business Enterprise Ombudsman

The bill requires the creation of the position of MBE Ombudsman within GOSBA to help resolve disputes between MBEs and prime contractors and to serve as a resource for agency procurement staff and MBE liaisons carrying out similar functions. It further requires the Special Secretary to allocate sufficient staff and resources to the ombudsman, consistent with the State budget, to carry out his or her duties, including conducting training on the assessment of liquidated damages. Given the volume of contracting that involves MBE participation, and the extent to which disputes regarding payment and contract scope arise, as described in the DLS evaluation, the ombudsman requires additional staff to fulfill his or her duties.

Therefore, general fund expenditures increase by \$308,593 in fiscal 2023, which accounts for a 90-day start-up delay from the bill’s July 1, 2022 effective date. This estimate reflects the cost of hiring an ombudsman and three compliance officers to assist in monitoring contract compliance, resolving disputes, and assisting State agencies with similar tasks. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

| | |
|---|------------------|
| Positions | 4.0 |
| Salaries and Fringe Benefits | \$270,971 |
| Operating Expenses | <u>37,622</u> |
| Total FY 2023 State Expenditures | \$308,593 |

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses.

Minority Business Enterprise Reporting and Accountability

Current law already requires agencies to conduct MBE compliance assessments at the conclusion of a contract. The bill requires agencies to provide the results of those assessments to GOSBA and further requires GOSBA to summarize the results of the assessments annually. It is anticipated that the results of the assessments can be provided to GOSBA in the aggregate, similar to how agencies currently provide data on MBE contract awards to GOSBA, and that GOSBA can report the results in the aggregate, by agency, as it currently does with MBE contract awards. Thus, the reporting requirements likely can be carried out with existing resources but may have an operational effect on agencies and GOSBA.

The bill requires GOSBA and the Department of General Services (DGS) to develop criteria in regulation for identifying vendors that persistently fail to meet MBE contract goals. GOSBA and DGS can develop the regulations with existing resources.

Under current law, OAG must conduct an investigation when a person is referred to the office for possible debarment. If OAG determines that grounds for debarment exist, it notifies BPW, and BPW notifies the subject of the debarment action. The subject may request a hearing, which must be conducted in accordance with the Administrative Procedures Act. Historically, BPW has referred such proceedings to OAH for adjudication. OAG is also responsible for presenting evidence in debarment proceedings.

It is not known how many vendors will be referred to OAG for investigation for persistently failing to meet MBE contract goals. Any such referrals are not expected to occur before fiscal 2025 due to the time necessary to develop the relevant criteria and for a vendor to establish a track record of failing to meet contract goals. If the number of referrals is limited, OAG can likely manage the investigatory and adjudicatory responsibilities with existing resources. If the number is large, OAG likely requires additional staff to manage the caseload, but a reliable estimate is not feasible. General fund expenditures for BPW also increase on a per-case basis to the extent it refers hearings to OAH; reimbursable revenues (and potentially expenditures) for OAH increase commensurately. As the number of hearings is dependent on the number of referrals from OAG and the number of persons who request a contested case hearing, a reliable estimate is not feasible.

Additional requirements in the bill either codify existing requirements (the SBR set-aside requirement) or can otherwise be carried out with existing resources (such as the DLS follow-up study).

Small Business Effect: The creation of the position of MBE Ombudsman gives MBEs, many of which are small businesses, a single point of contact to help them resolve disputes and/or answer questions about the MBE program. Accountability provisions in the bill encourage prime contractors to honor their commitments to MBEs under State contracts. Codifying the executive order for small business set asides makes permanent a program that helps MBEs (and other small businesses) secure prime contracts with the State.

Additional Information

Prior Introductions: None.

Designated Cross File: SB 487 (Senator Griffith, *et al.*) - Budget and Taxation.

Information Source(s): Governor's Office of Small, Minority, and Women Business Affairs; Department of Budget and Management; Department of General Services; Board of Public Works; Maryland Department of Transportation; University System of Maryland; Department of Legislative Services

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Appendix – Minority Business Enterprise Program

The State’s Minority Business Enterprise (MBE) program requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the Governor’s Office of Small, Minority, and Women Business Affairs (GOSBA), in consultation with the Secretary of Transportation and the Attorney General. In a year in which there is a delay in establishing the overall goal, the previous year’s goal applies. The Special Secretary is also required to establish biennial guidelines for State procurement units to consider in deciding whether to establish subgoals for different minority groups recognized in statute. In a year in which there is a delay in issuing the guidelines, the previous year’s guidelines apply. The Maryland Department of Transportation (MDOT) is the State’s MBE certification agency.

In August 2013, GOSBA announced a new statewide goal of 29% MBE participation that applied to fiscal 2014 and 2015; as no new goal has been established, the 29% goal remains in effect for fiscal 2022. GOSBA issued subgoal guidelines in July 2011 and then updated them effective August 2020, as summarized in **Exhibit 1**. The guidelines state that subgoals may be used only when the overall MBE goal for a contract is greater than or equal to the sum of all recommended subgoals for the appropriate industry, plus two. MBE prime contractors may count their own work for up to 50% of a contract’s MBE goal and up to 100% of any contract subgoal. Their full participation counts toward the State’s 29% goal.

Exhibit 1 Subgoal Guidelines for Minority Business Enterprise Participation

| | <u>Construction</u> | <u>Architectural/ Engineering</u> | <u>Maintenance</u> | <u>Information Technology</u> | <u>Services</u> | <u>Supplies/ Equipment</u> |
|------------------|---------------------|---------------------------------------|--------------------|-----------------------------------|-----------------|--------------------------------|
| African American | 8% | 7% | 9% | 10% | - | 6% |
| Hispanic | - | - | 3% | - | 2% | 2% |
| Asian | - | - | 2% | - | 3% | - |
| Women | 11% | 10% | - | 10% | 10% | 8% |
| Total | 19% | 17% | 14% | 20% | 15% | 16% |
| Total +2 | 21% | 19% | 16% | 22% | 17% | 18% |

Source: Governor’s Office of Small, Minority, and Women Business Affairs

There are no penalties for agencies that fail to reach the statewide target. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

History and Rationale of the Minority Business Enterprise Program

In 1989, the U.S. Supreme Court held in the *City of Richmond v. J.A. Croson Co.* that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. In addition, the ruling held that an MBE program must demonstrate clear evidence that the program is narrowly tailored to address actual disparities in the marketplace for the jurisdiction that operates the program. As a result, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting.

The disparity study completed in 2017 serves as the basis for the most recent reauthorization of the MBE program. It found continued and ongoing disparities in the overall annual wages, business earnings, and rates of business formation between nonminority males and minorities and women in Maryland. For instance, average annual wages for African Americans (both men and women) were 37% lower than for comparable nonminority males; average annual wages for nonminority women were 33% lower than for comparable nonminority males. It also found continued disparities in the use of MBEs by the State compared to their availability in the marketplace to perform work in designated categories of work. For instance, African American-owned construction businesses were paid 5.1% of State construction contract dollars, but they made up 10.3% of the construction sector in the relevant State marketplace. Nonminority women-owned construction businesses were paid 7.5% of State construction contract dollars but made up 13.7% of the construction sector. According to the analysis, these differences were large and statistically significant.

The MBE program is scheduled to terminate July 1, 2022; Chapter 340 of 2017, which reauthorized the program for the eighth time since its inception, required a new disparity study to be completed by September 2021 to inform the subsequent reauthorization process. However, MDOT has requested an extension to September 2023 due to delays in procuring a consultant to conduct the study. The program may be reauthorized in its current form pending the completion of the study. **Exhibit 2** provides MBE participation rates for major Executive Branch agencies based on contract awards made during fiscal 2020, the most recent year for which data is available.

Exhibit 2
Minority Business Enterprise Participation Rates, by Agency
Fiscal 2020

| <u>Cabinet Agency</u> | <u>% Participation</u> |
|---|-------------------------------|
| Aging | 0.6% |
| Agriculture | 7.2% |
| Budget and Management | 0.8% |
| Commerce | 9.1% |
| Education | 3.7% |
| Environment | 9.0% |
| Executive Department | 1.4% |
| General Services | 16.5% |
| Health | 10.5% |
| Higher Education Commission | 1.1% |
| Housing and Community Development | 20.9% |
| Human Services | 7.2% |
| Information Technology | 3.7% |
| Juvenile Services | 5.6% |
| Labor | 6.0% |
| Military | 3.3% |
| Natural Resources | 2.5% |
| Planning | 6.6% |
| State Police | 24.0% |
| Public Safety and Correctional Services | 11.3% |
| Transportation – Aviation Administration | 25.0% |
| Transportation – Motor Vehicle Administration | 38.6% |
| Transportation – Office of the Secretary | 22.0% |
| Transportation – Port Administration | 14.3% |
| Transportation – State Highway Administration | 18.4% |
| Transportation – Transit Administration | 17.0% |
| Transportation – Transportation Authority | 20.3% |
| Statewide Total¹ | 14.1% |

¹ Includes the University System of Maryland, Morgan State University, St. Mary's College of Maryland, and non-Cabinet agencies.

Source: Governor's Office of Small, Minority, and Women Business Affairs

Requirements for Minority Business Enterprise Certification

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and
- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. An MBE owned by a woman who is also a member of an ethnic or racial minority group may be certified as being owned by both a woman and by a member of a racial or ethnic minority, but for the purpose of participating on a contract as an MBE, it can only be counted as one or the other.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of his or her membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of \$1.5 million, adjusted annually for inflation, is not considered economically disadvantaged. The inflation-adjusted limit for calendar 2022 is \$1,847,024.