

## US DOT Updates its Rules Regarding the Disadvantaged Business Enterprise Program

On April 9, 2024, The U.S. Department of Transportation (DOT) announced numerous revisions to its in-place rules for administering its Disadvantaged Business Enterprise (DBE) Program. The new rule follows a Notice of Proposed Rulemaking published on July 21, 2022. The DBE Program was established to ensure that businesses owned by socially and economically disadvantaged persons were provided with an equal opportunity to participate in federally assisted projects. The DBE program, while created by the DOT, is operated at the state level, typically through a state's department of transportation or highway administration, and provides rules for the bidding and hiring on projects in which federal grant monies are provided. In effect, if the state takes and uses federal funds on a given project, it agrees to, among other things, hire socially and economically disadvantaged businesses, including DBEs, Minority Business Enterprises, Woman-owned Business Enterprises, and other like-owned companies.

The new rule defines a DBE as follows: "Disadvantaged Business Enterprise or DBE means a for-profit small business concern— (1) That is at least 51% owned by one or more individuals who are both socially and economically disadvantaged; and (2) Whose management and daily business operations are controlled by one or more of the socially and economically disadvantaged individuals who own it."

### An Overview of Changes Made

In publishing this Rulemaking, DOT highlighted the following changes: "updates personal net worth and program size thresholds for inflation; modernizes rules for counting of material suppliers; formalizes COVID-19 flexibilities; adds new program elements to foster greater usage of DBEs and ACDBEs with concurrent, proactive monitoring and oversight; updates certification provisions with less prescriptive rules that give certifiers flexibility when determining eligibility; and makes technical corrections that have led to substantive misinterpretations of the rules by recipients, program applicants, and participants."<sup>1</sup> The Final Rule becomes effective on May 9, 2024. Government contractors of all sizes should make themselves familiar with these changes in order to ensure compliance with these rules, whether they are doing so for their own DBE Program qualification or for potential subcontractors or partners.

### Major Specific Alterations to the DOT DBE Program

The Rulemaking and its changes are quite broad; however, the following highlights some of the more important changes.

#### Personal Net Worth of DBE Owners

Under the previous regulations, the personal net worth of DBE owners was capped at \$1.32 million, which was the applicable cap since 2011. However, the new personal net worth cap for DBE owners will be \$2.047 million, excluding retirement assets from the calculation. Additionally, the new rule removes state marital laws and community property rules from the equation. DBE owners should keep this change in mind when making personal finance decisions moving forward so that they may continue to qualify for and participate in the DBE Program as their net worth grows.

#### Modernizes Rules for Counting Material Suppliers

Under the prior rule, distributors or wholesalers/resellers were counted at 60% of the value of their goods sold towards small business participation. The new rule updates how DOT counts



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participation by DBE material suppliers and further clarifies some terminology, including the terms “distributor” and “manufacturer.” The term “distributor” is defined in the rule as a new subset of DBE suppliers. Distributors are permitted to drop-ship supplies from manufacturers provided that the firm has a distributorship agreement or assumes all responsibility for the materials after point of origin, allowing a 40% credit for the materials cost. The definition of a “manufacturer” is now updated such that a DBE that makes only minor modifications to existing materials is not a manufacturer for DBE goal attainment purposes. What constitutes a “minor modification” is vague and will likely result in court actions to seek guidance on these terms and the interpretation thereof.

Under the new rule, prime contractors must establish pre-award procedures to determine whether a DBE supplier they submit as a “distributor” or “regular dealer” has demonstrated the ability to perform as such during the contract.

For regular dealers, prime contractors may count 60% of materials costs toward the DBE goal, while they may count 40% of the materials costs toward the DBE goal for distributors. The former is a carry-over from the prior regime, but the latter is a new category and consideration for contractors. For a DBE firm to qualify as a regular dealer, it must maintain inventory and own or lease and operate the distribution equipment for the products it is selling. For DBE manufacturers, the rule of 100% counting of materials costs by prime contractors towards DBE goals is unchanged.

#### **Adds a DBE Performance Plan requirement for Design-Build Projects**

The new rule requires prime contractors responding to a Request for Proposal on a design-build procurement to submit an open-ended DBE Performance Plan (DPP) with its proposal. In general, these DPPs are required to detail the types of work the prime will solicit DBEs to perform and a projected timeframe in which actual subcontracts will come to fruition. Recipients are to monitor the prime’s adherence to the DPP throughout the life of the contract to evaluate good faith efforts, and parties may agree to make written revisions to the DPP throughout the life of the project. As with other programs, the contractor must make good faith efforts to reach the DBE/small business participation goals and document its efforts towards that effort. The DPP intends to “force” the contractor to think upfront about DBE participation and provide the agency/owner with a first glimpse at the plan and how it will be achieved.

#### **Strengthens Prompt Payment Requirements and Monitoring**

Recipients now are required to included proactive monitoring and oversight mechanisms to ensure that prime contractors are complying with retainage and Recipients must now include proactive monitoring and oversight mechanisms to ensure that prime contractors comply with retainage and subcontractor prompt payment requirements. This comes as a result of what the DOT perceived as being a failure of the prior system in which subcontractors would simply complain when they were not being paid.

The new rule also requires monitoring in the following areas by recipients of DOT funds:

1. A Commercially Useful Function (CUF) review is necessary for every DBE that performs for credit toward a recipient’s overall goal and a contract goal – the CUF was a requirement from the prior program that each small business must provide something that is commercially useful for the project and not merely be a pass-through entity,
2. Race-neutral compliance guidelines for reviewing DBEs, and
3. Recipients must keep an accounting of each contractor’s progress in attaining a contract goal through progress payments to the committed DBEs. This running tally requirement permits recipients to intervene if they observe a prime contractor falling short of a contract goal.

#### **Changes to the Certification Process and Admission Requirements**

The new rule also requires a potential DBE firm to have operations in the type of business it seeks to perform prior to applying for certification – in effect, it cannot be a new business or new to a given business line. DOT is making this change in the hopes of preventing certifiers from evaluating

firms that have no ability to bid (and, in effect, helps meet the CUF requirement). The new rule also reduces the time a certifier can extend a certification review from 60 to 30 days, allowing quicker certification decisions.

As for eligibility, the new rule clarifies that ownership investment includes purchases, capital infusions, additional investments after initial ownership, and gifts. It also permits only one tier of ownership above a subsidiary DBE. Additionally, the control requirements have been altered such that the disadvantaged owners are required to “run the show,” be the firm’s ultimate decision maker, have present control, including control of the board of directors, have an overall understanding of the operations of the firm to make managerial decisions and be at the head of the company’s chain of command. The disadvantaged majority owner also must have decision-making power, and the firm must prove its independent viability, separate from and apart from any relationship with another entity.

In other words, as with many Small Business Administration Programs, the owners must have day-to-day and long-term control and management over the company and not merely be a strawman.

The process for certification of a DBE has also become more individualized as a result of this new rule in that it provides less prescriptive rules so that certifiers may more accurately make individualized determinations of social and economic disadvantage. Additionally, applicants have greater discretion regarding what evidence to provide.

Business size also plays a role in both certification and maintaining one’s certification as a DBE. A DBE firm may not qualify as a DBE if it exceeds the program’s gross receipts cap, computed on a cash basis, and averaged over the preceding five years. The rule sets this annual cap at \$30.40 million, but it will be adjusted for inflation on a yearly basis under the new rule.

Another aspect of certification within the new rule is interstate certification. The new rule dictates that a DBE is to obtain certification in what is known as its Jurisdiction of Original Certification (JOC), which is typically where its principal place of business is located. Once it is certified in its JOC, it can apply for DBE certification in another state by simply sending a short cover letter with a signed Declaration of Eligibility. This will allow for DBEs to perform work in multiple states, obtain DBE benefits, and help prime contractors/recipients to meet DBE goals without the need to go through the full application process in each separate state, greatly streamlining the process and, perhaps most critically, giving the DBE a consistent review process, as under the current regime, each state certifies (with some reciprocity depending upon the state) and there is an inherent level of subjectivity, such that one state could certify a company as a DBE while another might not. This variation is now pushed to the side.

## Conclusion

Government contractors should review the new rulemaking in order to understand the new monitoring, eligibility, and certification requirements of these new DBE rules.

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1 U.S. Department of Transportation, DBE and ACDBE Final Rule: 49 CFR parts 23 and 26, April 9, 2024, <https://www.transportation.gov/DBEFinalRule>.

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