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Using Your "Disadvantaged Business" to Your Advantage

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If your business provides goods/services to governmental agencies, construction or other projects that have some sort of governmental financing (e.g., loans from state, county or municipal bodies), or is part of a supply chain for contractors that fall into such categories, you may qualify for the disadvantaged business enterprise program (DBE), which may help you or your customers win more contracts.

DBE was initially a federal program designed to ensure that federal funds allocated for certain highway construction projects were used to foster equal competition amongst firms in a nondiscriminatory manner. However, in recent years DBE's use has been expanded by other governmental entities using its standards to achieve the same goals (fostering equal competition in a nondiscriminatory manner) in their procurement and construction projects. This means that DBE is no longer just for road builders.

1. **Disadvantaged Business Enterprises.**

   DBE entities are for-profit, small businesses, that (1) are majority-owned and controlled by individuals that are deemed socially and economically disadvantaged; (2) are existing businesses that meet the size standards (based on average annual revenue) promulgated by the Small Business Administration; and (3) are independent businesses.

   A. Ownership and Control.

   Women, Black Americans, Hispanic Americans, and other similar minority groups that are citizens of the United States (or lawfully permitted permanent residents) are presumed to be socially and economically disadvantaged individuals under the first requirement. While these classes of individuals are presumed to be socially disadvantaged, to meet the definition of an economically disadvantaged group, an individual owner of a firm may not have a personal net worth of more than $1.32 million (excluding the individual's ownership interest in the business and equity in his or her primary residence). For example, if your business is owned and controlled by a woman, but that woman's net worth is $1.5 million (not including the value of her home or the value of her ownership in the business), the business will not qualify for DBE status because she will not qualify as a socially and economically disadvantaged individual.

The qualifying owner must enjoy the customary incidents of ownership, including the profits, losses, and liabilities of the business. If a disadvantaged individual owning at least 51% of the small business has an arrangement with a non-disadvantaged individual such that the non-disadvantaged individual receives, or has a right to receive, more profits or bears the burden of more losses than the disadvantaged owner, the business may not qualify for DBE certification.

Any contributions of capital or expertise in exchange for ownership must be real and substantial and should be for “adequate consideration.” Ownership of a business may be presumed to not be held by a socially and economically disadvantaged individual if a non-disadvantaged individual gifts or transfers ownership interests to a disadvantaged individual. without adequate consideration. This presumption may be rebutted by showing the gift or transfer was made for reasons other than obtaining DBE certification and the disadvantaged person actually controls the operations of the firm.

It is important to note that DBE certifying bodies are cognizant of “fronts” that are devised to reap the benefits of DBE certification. Gifting equity interests from non-disadvantaged individuals to disadvantaged individuals, transfers between husband and wife, and using marital assets to acquire ownership interests in a business are highly scrutinized by certifying bodies.

Ownership by disadvantaged individuals alone is not sufficient for a business to qualify as DBE. The business must also by **controlled** by the disadvantaged individuals. The disadvantaged owner must have the power to direct or cause to direct the management of the firm and must have the power to make day-to-day and long-term decisions.[1] If the business is a corporation, the disadvantaged owner must also hold the highest officer position in the company and must be able to control the company’s board of directors.[2]

Like with the ownership aspect of a business, a major consideration of whether a disadvantaged individual controls the business depends on the experience and expertise the disadvantaged owner has in the industry. A disadvantaged owner “must have the ability to intelligently and critically evaluate information presented by other participants in the firm’s activities and to use this information to make independent decisions concerning the firm’s daily operations, management, and policymaking.” Technical expertise is necessary to obtain DBE status. Expertise that is limited to office management and bookkeeping functions will not pass muster.

B. “Small Businesses”.

A business (including its affiliates), must also be a “small business.” The Small

Business Administration (SBA) defines the standards for whether a business is considered “small.” These standards are expressed in dollar amounts based on average annual gross receipts. The maximum annual receipts a small business is able to receive to obtain DBE certification is determined by the type of work the business primarily conducts. The average annual gross receipts is the <u>average annual gross receipts collected by the business in the most recent three (3) year period.</u> Therefore, if the SBA guidelines require your average annual receipts to be $15 million or less, your business may exceed the $15 million threshold for any one year so long as the average for the most recent three (3) year period does not exceed $15 million. For example, if a small business has $20 million in receipts in the most current year, $15 million in receipts the year before, and $10 million or less two years prior, the small business would likely not lose its DBE certification. If however, the small business exceeded $45 million in the most recent three year period, the business would no longer be considered a small business and would likely lose its DBE certification.

C. Independent Businesses.

The component of being an “independent business” is often overlooked, but is an important one and can be a significant hurdle to obtaining DBE status. If a business meets all of the other requirements set forth in this article, but has only one or two customers for which it derives most of its revenue, the business may not qualify as an independent business, and therefore, not qualify as DBE. Having only one or two primary customers leads to the presumption that the business is simply a “front” by a larger, non-qualifying business, to gain access to DBE benefits. It is important that businesses attempting to qualify as DBE have enough of a client base to prove that the business is independently controlled, and is not beholden to some other business to the extent that the owner does not actually exercise control over the business. A good example of this is a subcontractor that works with a single general contractor. If that subcontractor does not have any other clients, the question arises whether the subcontractor can truly exist separate from the contractor. If the answer is that it cannot, then the business is not truly independent and the owner does not have the requisite control required under the DBE program.

2. **Certification Process.**

   Although the DBE program utilizes federal standards and (at some levels) is subject to federal oversight, the program is administered at the state level. The certification process starts with an application, which requires the submission of numerous supporting documents. The certification process can take as little as 90 days to complete if everything is in order. However, it is important to have the business’ corporate structure reviewed to be sure that it will meet the requirements. This includes reviewing how the business was started, its management structure, its finances and its customer and vendor lists.

3. **Benefits of DBE.**

The benefits to being certified as DBE are primarily in the priority of contracting. Many construction projects that use governmental money will have a requirement that a designated percentage of the total contract values awarded are awarded to DBE businesses. This allows DBE businesses that may not be able to compete on price with larger operations to win contracts on projects that such businesses may not traditionally be able to win on price alone. In addition to the financial benefit that such contracts provide, they also give DBE businesses contacts within their respective industries that may lead to additional work.

Aside from the construction industry, the federal government (and many state governments) set aside a certain amount of their annual procurement requirements to be awarded only to small businesses. Being certified as DBE can help ensure access to those contracts.

Recent high profile projects in southeastern Wisconsin provide real world examples of projects or companies which DBE-certified businesses may have an advantage. The Northwestern Mutual building, the Milwaukee Bucks arena and the surrounding redevelopment of the "Deer District," as well as the recently announced Foxconn development, all have or are likely to have requirements that a certain percentage of all contracts related to those projects go to DBE-certified companies. Further, as a high-end manufacturer, Foxconn may very well have clients that will require or request that Foxconn utilize DBE-certified businesses in its supply chain.

4. **Conclusion**

While there are a number of benefits to being certified as DBE, there are numerous restrictions in addition to those discussed above. If possible, business owners should consult with their attorney early in the business formation stages and discuss whether DBE certification is a potential goal of the business. If the business is already formed, but the business owner feels that DBE certification will help them, the business owners should speak with their attorney to determine what steps need to be made in order to achieve DBE status.

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[1]49 C.F.R. §26.71(d).
[2]49 C.F.R. §26.71(d)(1)-(2).

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