American Road & Transportation Builders Association

Summary
U. S. Department of Transportation Rule Revisions
Disadvantaged Business Enterprise Program
April 2024

On April 9, the U.S. Department of Transportation (U.S. DOT) announced several revisions to the rule for administering the Disadvantaged Business Enterprise (DBE) program, in what was described as an effort to "significantly modernize" it. The revisions will take effect May 9. The Department is also maintaining a web page on the final rule changes.

The Department had published a Notice of Proposed Rulemaking (NPRM) on July 21, 2022, addressing more than 40 aspects of the DBE program (as applied to federal-aid highway and transit projects) and its companion, the Airport Concession Disadvantaged Business Enterprise (ACDBE) program.

About 400 entities submitted comments on the potential changes, including ARTBA, which did so on October 31, 2022. The narrative for the final rule references specific points made by ARTBA and numerous other commenters.

Ultimately, the new rule includes a number of notable revisions, although arguably not as wide-ranging as those made in past DBE rulemakings. It will be important for ARTBA members to work with federal, state and local officials, as well as industry partners, to become familiar with the changes as they take effect. ARTBA will assist in this effort.

Here is a summary of key provisions in the final rule, with emphasis on the issues ARTBA chose to address as priorities in its comments.

DBE Supplier Credit

In its 2022 proposal, U.S. DOT planned to impose a cap of 50 percent on the total allowable credit for a prime contractor's expenditures with DBE suppliers (manufacturers, regular dealers, distributors, and transaction facilitators) to meet a contract goal. U.S. DOT proposed this new policy to compel development of DBE subcontractors, which it preferred to a perceived excessive reliance on DBE suppliers to meet goals.

This was ARTBA's chief concern with the proposed rule revisions, with the association expressing strong opposition to this change in its comments and a meeting with the White House Office of Management and Budget. **Ultimately, U.S. DOT did not include this revision in the final rule**.

ARTBA argued that U.S. DOT had not provided data to justify this major change in policy. Also, it would limit state and local agencies' flexibility in meeting DBE goals, not automatically lead to development of DBE firms in underrepresented disciplines, disrupt the business plans of DBE firms working as regular dealers, result in more good faith effort waiver requests, and necessitate a downward adjustment of DBE goals. The Department noted some of these points in deciding to change direction.

Moreover, in its original NPRM, the Department cited an invitation-only "listening session" in 2018 as a basis for imposing the 50 percent cap. However, in choosing not to make this change, U.S. DOT acknowledged ARTBA's comment that relying on such closed-door, off-the-record feedback would constitute "rulemaking by anecdote." The Department also cited a comment from the Kentucky Association of Highway Contractors, ARTBA's affiliate, that its state transportation agency did not even maintain data on the participation of DBE suppliers compared with other DBE firms.

The final rule does include the following new or modified policies in this area:

- Prime contractors may continue counting 100 percent of the cost of materials or supplies obtained from a DBE **manufacturer**. However, the definition of manufacturer has been enhanced.

- Prime contractors may continue counting 60 percent of the cost of materials or supplies purchased from a DBE **regular dealer**. At the same time, the new rule expands requirements for a DBE firm to qualify as a regular dealer, along with additional oversight responsibilities for state and local agencies to determine the firm is performing a commercially useful function (CUF). Notably, the firm must maintain inventory, as well as own/lease and operate distribution equipment for the products it sells.

- Prime contractors may now count 40 percent of the cost of materials or supplies purchased from a DBE **distributor**, a new category requiring a "valid distributorship agreement" for particular products. A distributor does not maintain inventory or distribution equipment, but must demonstrate ownership of the items in question and assume all risk for loss or damage during transportation, including drop shipping arrangements.

- For DBE firms not fitting any of the above categories, only their "reasonable" fees and commissions, rather than the cost of materials and supplies, may be counted toward the goal.

- The project owner may only apply one of the above categories to a DBE firm on a contract-by-contract basis. ARTBA has continued to express concern that this

practice, which dates to 2014 DBE rule revisions, provides insufficient certainty for DBE firms and the prime contractors partnering with them.

Please refer to the end of this summary for a "redline" showing the current rule on DBE credits and the exact language of the impending revisions.

Requirements for a "Disadvantaged Business Enterprise"

The final rule requires would-be DBE firms to describe in detail within the Uniform Certification Application (UCA – with examples wherever possible – the type(s) of work they envision performing on federal-aid contracts for transportation projects. The UCA will not be considered complete if the applicant omits this information. U.S. DOT is seeking to lessen the burden on Unified Certification Programs, which can end up dealing with DBE firms uninterested in or unable to participate in transportation projects. ARTBA supports this objective of clarifying the overall capacity of the DBE community in a jurisdiction.

Reporting Requirements: Bidders Lists

State and local agencies will need to supplement existing reports they provide to U.S. DOT on contractors and subcontractors bidding their federal-aid projects, with which the Department will build a database to "analyze the representation of DBEs within the bidding process" and monitor the effectiveness of the program. The reportable information will now include race and gender information for the firm's majority owner, as well as the North American Industry Classification System (NAICS) code applicable to each scope of work the firm sought to perform in its bid.

While U.S. DOT referenced ARTBA's concern that this additional information collection would burden prime contractors (especially if they must gather it from their subs), they will in fact be required to submit these data points with their bids.

DBE Directories

ARTBA supported U.S. DOT's initial proposal to enhance DBE directories, many of which are notoriously out of date and cluttered with listings for irrelevant firms. The final rule requires state and local agencies to include additional information on these firms (including NAICS codes), keep it up to date, and post the directory in an on-line, searchable format.

The Department chose not to require information such as "resources, equipment, bonding, experience, or other qualifications of a firm to do particular sorts of work" for the DBE firms' listings, stating that prime contractors should be tasked with seeking it through their own due diligence. U.S. DOT also references the need for DBE firms to enhance their websites with these details, although ARTBA notes that in reality many of those companies do not maintain a significant on-line presence.

Monitoring Requirements

U.S. DOT will enhance state and local agencies' responsibilities for ensuring and tracking DBE compliance on projects. The Department contends inspectors and other personnel regularly assess and report on certain aspects of projects, so they should be trained to add monitoring of DBE participation to their responsibilities.

The new rule will also require monitoring on projects without a DBE goal. ARTBA had expressed concern about adding administrative costs for this purpose, as well as a resulting disincentive for prime contractors to retain DBE subcontractors on these projects.

Prompt Payment and Retainage

Having devoted particular attention to this topic in recent years, U.S. DOT plans to "strongly encourage [state and local agencies] to establish shorter time frames for [payments to] lower tier subcontractors, because these smaller businesses have more acute cash flow needs than their larger counterparts."

Procedures for Good Faith Efforts on Design-Build Contracts with DBE Goals

The final rule incorporates a DBE Open Ended Performance Plan (OEPP) that provides flexibilities for compliance on design-build projects. The Federal Highway Administration's current round of Every Day Counts (EDC-7) also features this innovation. ARTBA has endorsed this concept, suggesting that it be considered for design-bid-build projects as well.

Terminations

The Department reiterates the requirement for prime contractors to obtain written consent from their contracting agency before terminating a DBE for cause, eliminating any of their work items, or substituting another DBE firm. While ARTBA had emphasized the importance of a timely process in this regard, U.S. DOT does not specifically reference this issue in its narrative.

Business Size

A DBE firm must not exceed the program's gross receipts cap, computed on a cash basis, and averaged over the preceding five years. The current annual cap is $30.40 million, and will be adjusted yearly for inflation. The Department noted some comments calling for regional differences in size standards, but concluded that for a "national program – especially one in which interstate certification reciprocity will become a reality – a single national standard is appropriate."

Personal Net Worth

The personal net worth cap for DBE owners has remained at $1.32 million since 2011. The new rule will raise it to $2.047 million, with future adjustments planned every three years. Notably, retirement assets for these individuals will now be excluded from the calculation.

North American Industry Classification System (NAICS) Codes

In its comments, ARTBA encouraged U.S. DOT to facilitate a review of NAICS codes as utilized for transportation construction. Many remain overly broad and not useful for prime contractors seeking DBE partners for specific tasks. Several ARTBA members have also expressed concern over DBEs' exceeding the lower business size caps for specialty NAICS codes and thus being excluded from the program.

However, in its narrative, U.S. DOT states, "We continue to believe that the narrowest appropriate code should control for purposes of certification; doing otherwise would allow circumvention of the intent of small business size standards for firms."

Interstate Certification

Under the final rule, a firm must obtain DBE certification in its principal place of business, now known as the firm's "jurisdiction of original certification" (JOC). The JOC would normally be the state in which the firm maintains its principal place of business. Once a firm is certified in its JOC, it may apply for DBE certification in another state with a short cover letter and a signed Declaration of Eligibility (DOE).

U.S. DOT acknowledged ARTBA's comment that interstate certification should be implemented without distorting state DBE goals or undermining the accuracy of DBE directories, which could result from policies enabling multi-state certification even though the firm has minimal intention of actually working in additional jurisdictions.

Counting DBE Participation After Decertification

If a prime contractor has executed a subcontract with a DBE firm, and that firm loses its DBE certification, the prime may continue to use that sub and receive credit toward the DBE goal for its work. The Department agrees that "prime contractors should not bear the burden of finding a DBE replacement if the firm was certified at the time the subcontract was executed."

However, the prime must receive prior written consent from the project owner before extending or adding work to the subcontract after the firm has been notified of its decertification. U.S. DOT cites a perceived incentive under the previous rule for prime contractors "to give work to decertified firms that were already working for them, rather than find new eligible DBEs to do the work going forward."

Should a firm lose its DBE certification because of acquisition by or merger with a non-DBE firm, the owner and prime may not continue counting its performance toward the contract or overall DBE goals.

In its comments, ARTBA noted that the DBE firm was, by definition, a business entity independent of a prime contractor. Similarly, the prime should not bear an additional administrative burden (or the risk related to that eventuality) for the other firm's business decision. U.S. DOT disagrees, stating "we believe that the benefit to the DBE program of directing the prime contractor to seek DBE participation to make up the now-ineligible firm's contribution to the goal outweighs the costs to the prime contractor of doing so."

Legal Defensibility of the DBE Program

While the NPRM did not encompass this issue, some DBE program supporters raised concern in their comments over its continued viability given increasing legal challenges to similar government requirements. (Note that comments for this rulemaking were submitted in advance of the U.S. Supreme Court's decision in *Students for Fair Admissions v. Harvard* and other notable legal developments during 2023.)

In its response, the Department contended the DBE program and its rule have:

- met the constitutional "strict scrutiny" requirement for programs using racial classifications through "narrow tailoring,"
- survived numerous previous legal challenges,
- been repeatedly authorized by Congress to remedy discrimination,
- been based on statistical and anecdotal evidence of the persistence of discrimination (including disparity studies), and
- differed significantly from other government programs that may use race-based classifications in order to advance worthy, but conceptually distinct, objectives such as achieving diversity.

In addition, the rule revisions and U.S. DOT's narrative address policies relating to membership in groups presumed to be socially and economically disadvantaged, evidence and rebuttal of disadvantage, and individual determinations of disadvantage. These topics remain timely as courts incorporate them into evaluating constitutionality of certain government programs.

ARTBA Staff Contacts

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U.S. Department of Transportation
Disadvantaged Business Enterprise (DBE) Program Rule Revisions
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From 49 CFR §26.55: "How is DBE participation counted toward goals?"

(e) Count expenditures with DBEs for materials or supplies toward DBE goals as provided in the following:

(1) (i) If the materials or supplies are obtained from a DBE manufacturer, count 100 percent of the cost of the materials or supplies ~~toward DBE goals~~.

(ii) For purposes of this paragraph (e)(1), a manufacturer is a firm that owns (or leases) and operates ~~or maintains~~ a factory or establishment that produces, on the premises, the materials, supplies, articles, or equipment required under the contract and of the general character described by the specifications. Manufacturing includes blending or modifying raw materials or assembling components to create the product to meet contract specifications. When a DBE makes minor modifications to the materials, supplies, articles, or equipment, the DBE is not a manufacturer. Minor modifications are additional changes to a manufactured product that are small in scope and add minimal value to the final product.

(2) (i) If the materials or supplies are purchased from a DBE regular dealer, count 60 percent of the cost of the materials or supplies (including transportation costs)~~toward DBE goals~~.

(ii) For purposes of this section, a regular dealer is a firm that owns (or leases)~~,~~ and operates~~, or maintains~~ a store, warehouse, or other establishment in which the materials, supplies, articles or equipment of the general character described by the specifications and required under the contract are bought, kept in ~~stock~~sufficient quantities, and regularly sold or leased to the public in the usual course of business.

(iii) Items kept and regularly sold by the DBE are of the "general character" when they share the same material characteristics and application as the items specified by the contract.

(iv) You must establish a system to determine that a DBE regular dealer per paragraph (e)(2)(iv)(A) of this section, over a reasonable period of time, keeps sufficient quantities and regularly sells the items in question. This system must also ensure that a regular dealer of bulk items per (e)(2)(iv)(B) of this section owns/leases and operates distribution equipment for the products it sells. This

requirement may be administered through questionnaires, inventory records reviews, or other methods to determine whether each DBE supplier has the demonstrated capacity to perform a commercially useful function (CUF) as a regular dealer prior to its participation. The system you implement must be maintained and used to identify all DBE suppliers with capacity to be eligible for 60 percent credit, contingent upon the performance of a CUF. This requirement is a programmatic safeguard apart from that described in § 26.53(c)(1).

(A) To be a regular dealer, the firm must be an established~~, regular~~ business that engages, as its principal business and under its own name, in the purchase and sale or lease of the products in question. A DBE supplier performs a CUF as a regular dealer and receives credit for 60 percent of the cost of materials or supplies (including transportation cost) when all, or at least 51 percent of, the items under a purchase order or subcontract are provided from the DBE's inventory, and when necessary, any minor quantities delivered from and by other sources are of the general character as those provided from the DBE's inventory.

(B) A ~~person~~ DBE may be a regular dealer in such bulk items as petroleum products, steel, ~~cement~~concrete or concrete products, gravel, stone, or asphalt without owning, operating, or maintaining a place of business as provided in this paragraph (e)(2)(ii) if the ~~person~~ firm both owns and operates distribution equipment used to deliver ~~for~~ the products. Any supplementing of regular dealers' own distribution equipment shall be by a long-term operating lease ~~agreement~~ and not on an ad hoc or contract-by-contract basis.

(C) A DBE supplier of items that are not typically stocked due to their unique characteristics (e.g., limited shelf life or items ordered to specification) should be considered in the same manner as a regular dealer of bulk items per paragraph (e)(2)(iv)(B) of this section. If the DBE supplier of these items does not own or lease distribution equipment, as descried above, it is not a regular dealer.

(~~C~~D) Packagers, brokers, manufacturers' representatives, or other persons who arrange, facilitate or expedite transactions are not regular dealers within the meaning of ~~this~~ paragraph (e)(2) of this section.

(3) If the materials or supplies are purchased from a DBE distributor that neither maintains sufficient inventory nor uses its own distribution equipment for the products in question, count 40 percent of the cost of materials or supplies (including transportation costs). A DBE distributor is an established business that engages in the regular sale or lease of the items specified by the contract. A DBE distributor assumes

responsibility for the items it purchases once they leave the point of origin (e.g., a manufacturer's facility), making it liable for any loss or damage not covered by the carrier's insurance. A DBE distributor performs a CUF when it demonstrates ownership of the items in question and assumes all risk for loss or damage during transportation, evidenced by the terms of the purchase order or a bill of lading (BOL) from a third party, indicating Free on Board (FOB) at the point of origin or similar terms that transfer responsibility of the items in question to the DBE distributor. If these conditions are met, DBE distributors may receive 40 percent for drop-shipped items. Terms that transfer liability to the distributor at the delivery destination (e.g., FOB destination), or deliveries made or arranged by the manufacturer or another seller do not satisfy this requirement.

(~~3~~4) With respect to materials or supplies purchased from a DBE which is neither a manufacturer, ~~nor a~~ regular dealer, nor a distributor, count the entire amount of fees or commissions charged that you deem to be reasonable, including transportation charges for ~~assistance in~~ the ~~procurement~~ delivery of ~~the~~ materials ~~and~~ or supplies~~, or fees or transportation charges for the delivery of materials or supplies required on a job site, toward DBE goals, provided you determine the fees to be reasonable and not excessive as compared with fees customarily allowed for similar services~~. Do not count any portion of the cost of the materials and supplies themselves ~~toward DBE goals, however~~.

(~~4~~5) You must determine the amount of credit awarded to a firm for the provisions of materials and supplies (e.g., whether a firm is acting as a regular dealer, distributor or a transaction expediter) on a contract-by-contract basis.

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(h) Do not count the participation of a DBE subcontractor toward a contractor's final compliance with its DBE obligations on a contract until the contractor ~~amount being counted~~ has ~~actually been~~ paid ~~to~~ the DBE the amount being counted.