

COMPLIANCE MATTERS

THE ROLE OF COMPLIANCE IN BUILDING A WORLD-CLASS DBE PROGRAM

Understanding DBE Programs

In an effort to stimulate economic development in their communities, many local government agencies have launched Disadvantaged Business Enterprise (DBE) programs modeled, in part, after the **U.S. Department of Transportation’s (DOT) DBE program**¹.

DBE programs were created to level the playing field and give all businesses, including **socially disadvantaged**² and **economically disadvantaged**³ businesses, an equal opportunity to bid and perform on construction, professional service, supply and other contract opportunities funded by Federal, state, and local taxpayer dollars.

DBE programs typically establish certification guidelines for qualifying as a DBE. For example, in order to be certified as a DBE for the DOT’s program, a business must be at least 51% owned, managed and controlled by a socially and economically disadvantaged individual or individuals. DBE programs also typically establish overall program goals for DBE participation, for example, 35% for construction projects and 25% for professional service projects. In many cases, however, DBE participation goals are established on a project by project basis, based on the number and availability of certified DBEs in a particular category. When a DBE participation goal is established on a project, the firm bidding on the project, the prime contractor, is usually required to submit a **DBE Compliance Plan**⁴ detailing how his or her firm will meet or exceed the DBE participation goal.

Whatever agreements on price and participation are made between the prime contractor and DBE firms, the DBE firms are required to perform a **Commercially Useful Function**⁵ on the project. For example, a DBE firm that is only certified as an electrical contractor cannot perform work as a plumbing contractor. In the example, the prime contractor would not be able to receive credit towards meeting the DBE goal for the electrical contractor’s plumbing scope of work.

After a prime contractor wins a bid and signs a contract, it is incumbent upon the government agency (project owner) to ensure that all of the conditions of the contract, including DBE program provisions, are met. Ensuring DBE program provisions are met is known as **DBE Compliance**.

DBE programs were created to level the playing field and give all businesses, including socially and economically disadvantaged businesses, an equal opportunity to bid and perform on contracts funded by Federal, state or local taxpayer dollars.

Compliance Matters

- Understanding DBE Programs
- What is DBE Compliance?
- DBE Fraud Tactics
- DBE Compliance “Red Flags”
- The Cost of DBE Non-Compliance
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History of the U.S. Department of Transportation's DBE Program

In 1983, Congress enacted the first Disadvantaged Business Enterprise (DBE) statutory provision. This provision required the Department to ensure that at least 10% of the funds authorized for the highway and transit Federal financial assistance programs be expended with DBEs. In 1987, Congress reauthorized and amended the statutory DBE program by including women to the groups presumed to be disadvantaged. Since 1987, DOT has established a single DBE goal for firms owned by women and minority group members.

DOT DBE regulations require recipients of DOT Federal financial assistance, namely, state and local transportation agencies, to establish goals for the participation of disadvantaged entrepreneurs and certify the eligibility of DBE firms to participate in their DOT-assisted contracts.

Each DOT-assisted state and local transportation agency is required to establish narrowly tailored DBE goals. Then these DOT-assisted agencies evaluate their DOT-assisted contracts throughout the year and establish contract-specific DBE subcontracting goals where these goals are needed to ensure nondiscrimination in Federally-assisted procurements.

The DOT's DBE program is the model or basis for many local DBE programs.

(Source: www.dot.gov)

What is DBE Compliance?

DBE compliance encompasses all of the functions within a DBE program that ensure bidders, prime contractors and subcontractors comply with all Federal, state and local laws and agency-specific policies, procedures and guidelines for DBE participation on procurement opportunities (front-end compliance) and contracts (back-end compliance).

If an agency does not have DBE compliance in place as a component of its DBE program, the DBE program will likely be highly susceptible to DBE fraud.

DBE Fraud Tactics

Question: Why do some motorists speed or disobey the rules of the road when they know that doing so can result in a ticket, a fine, or even worse, time in jail?

Answer: They do not believe they will get caught. They also believe that if they are caught, the cost of the ticket, fine or time in jail is worth the risk.

There is a similar, if not same, mindset with prime contractors and DBEs who commit DBE fraud. They are willing to engage in DBE fraud because they do not believe they will get caught or they believe the potential penalties are worth the risk. The following examples reveal just a few of the ways prime contractors and DBEs commit DBE fraud:

- A firm submits fraudulent documentation to become certified as a DBE, despite the fact that the firm is not owned, managed and controlled by a socially and economically disadvantaged individual.
- A DBE firm is selected by a prime contractor to perform work that the DBE firm is not certified, qualified or experienced to perform.
- A prime contractor includes the cost of equipment in a DBE's participation percentage, even though: 1.) The DBE is not certified as a supplier, 2.) The DBE is not qualified to install the equipment, or 3.) The equipment is not part of the DBE's scope of work.
- A DBE receives a payoff or commission to be listed as a subcontractor for work that the prime contractor or another non-DBE subcontractor actually performs.
- A prime contractor forms or hires someone to form a DBE company in order to have an "in-house" DBE subcontractor that the prime contractor actually manages and controls.
- A prime contractor lists a DBE as a part of the bid or DBE Compliance Plan, but substitutes the DBE with a non-DBE to perform the work when the project begins.

DBE Compliance “Red Flags”

The DOT’s Office of Inspector General (OIG)⁶ has identified ten (10) DBE fraud “red flags” in determining whether or not to investigate a DBE fraud case:

1. DBE owner lacking background, expertise or equipment to perform subcontract work
2. Employees shuttling back and forth between prime contractor and DBE-owned business payrolls
3. Business names on equipment and vehicles covered with paint or magnetic signs
4. Orders and payment for necessary supplies made by individuals not employed by DBE-owned business
5. Prime contractor facilitated purchase of DBE-owned business
6. DBE owner never present at job site
7. Prime contractor always uses the same DBE
8. Financial agreements between prime and DBE contractors
9. Joint bank accounts (Prime/DBE)
10. Absence of written contracts

It is highly likely that one or more of the DBE fraud tactics or DBE “red flags” mentioned is occurring regularly in DBE programs that lack effective DBE compliance.

The Cost of DBE Non-Compliance

The following legal cases from the DOT’s OIG, further demonstrate the extent to which some firms will go to commit DBE fraud.

Schuylkill Products Case: The Largest DBE Fraud Case in the Nation’s History

January 13, 2014- The U.S. Attorney’s Office for the Middle District of Pennsylvania announced that Dennis F. Campbell and Timothy G. Hubler were sentenced in connection with their roles in what the U.S. Department of Transportation has called the largest DBE fraud in the nation’s history. Romeo P. Cruz, the former owner of Marikina Construction Corporation, the DBE firm that operated as a front for SPI to gain lucrative DBE contracts, pleaded guilty to DBE fraud and tax fraud in the case in 2008 and 2009.

According to U.S. Attorney Peter J. Smith, the DBE fraud lasted for over 15 years and involved over \$136 million in government contracts in Pennsylvania alone. SPI, using Marikina as a front, operated in several other states in the Mid-Atlantic and New England regions. Although Marikina received the contracts on paper, all the work was really performed by SPI personnel, and SPI received all the profits. In exchange for letting SPI use its name and DBE status, Marikina was paid a small fixed-fee set by SPI.

Campbell, Schuylkill Products Inc.’s (SPI) former vice president in charge of Sales and Marketing, was sentenced to 24 months’ imprisonment, \$119 million in restitution to the USDOT, and two years’ supervised release. Hubler, SPI’s former vice president in charge of Field Operations, was sentenced to 33 months’ imprisonment, \$119 million in restitution to the USDOT, \$82,370 in restitution to the Internal Revenue Service, and two years’ supervised release.

**Global Marine Construction Supply Case:
Owner of NY-Based DBE Firm Sentenced for Her Role in DBE Fraud Scheme**

November 14, 2013- Yona Jimenez, a/k/a "Yona J. Bocchino", the president and owner of Global Marine Construction Supply (GMCS), was sentenced in United States District Court, White Plains, New York, to three years supervised release and a forfeiture of \$52,347. Jimenez was convicted for her role as a pass-through DBE purporting to provide structural steel on the Cross Westchester Expressway Project.

Between June 2006 and October 2009, the general contractor claimed that GMCS was awarded a \$6 million subcontract to supply structural steel to reconstruct bridges, although another company (a non-DBE) actually supplied the steel. The general contractor then claimed credit for the "services" provided by GMCS towards meeting its DBE goal. GMCS was paid approximately 1% of the subcontract value as a commission.

**Perini Corporation Case:
Former President of Perini Corp. Civil Division Convicted in \$19 Million DBE Fraud**

March 10, 2011- Following a four-week trial, a Federal jury in Brooklyn found Zohrab B. Marshlian, the former president of Perini Corp.'s Civil Division, an international construction services corporation, guilty of fraud and conspiracy to launder money. The charges arose out of Marshlian's false representations to New York government agencies that DBEs were performing work in connection with major public works contracts, when, in reality, Marshlian had non-DBEs subcontracted by Perini Corp. to do the work.

The government's evidence established that while Marshlian was President of Perini Corp. Civil Division, he and others used front companies to falsely certify that construction work was performed by DBEs. As a result, Marshlian fraudulently won public works contracts from the government and also gained \$14 million in salary and personal bonuses.

"This prosecution and verdict should send a message to all in the contracting industry that taxpayer dollars must be appropriated in a way to foster fair competition through the DBE programs," stated United States Attorney Loretta E. Lynch.

A 2013 U.S. Department of Transportation, Office of Inspector General report* estimated that in fiscal year 2009 alone, at least \$124 million in DBE funds distributed across 52 U.S. states and territories was wasted as a result of ineffective DBE compliance.

*DBE Program Audit Report
April 23, 2013
www.oig.dot.gov

Fighting DBE Fraud with DBE Compliance

It is clear to me, and hopefully to you by now, that DBE fraud is wide-spread and costly to taxpayers. In order to combat DBE fraud, an agency can implement some of the best-practice examples for DBE compliance described below.

DBE Fraud: A firm submits fraudulent documentation to become certified as a DBE.

DBE Compliance Strategies: 1.) Include language in your agency's certification policy stating that all certified firms are subject to random certification audits. If it is found that the business is no longer or has never been owned, managed and controlled by a socially and economically disadvantaged individual, the firm will immediately be de-certified and debarred from performing work for the agency. 2.) Conduct random certification audits.

DBE Fraud: A DBE firm is selected to perform work that it is not certified, qualified or experienced enough to perform.

DBE Compliance Strategies: 1.) Cross-reference the DBE firm's NAICS codes, under which the firm was certified to perform work, with the NAICS codes for the scope of work provided by the prime contractor in the DBE Compliance Plan. Verify if the DBE firm is certified to perform the scope of work listed in the DBE Compliance Plan. 2.) Review the DBE firm's professional licenses and certifications, and request client references from the DBE firm to determine if the firm is qualified and experienced enough to perform the scope of work described.

DBE Fraud: A prime contractor includes the cost of equipment and supplies as part of a DBE's participation percentage, even though they are not a part of the DBE's scope of work.

DBE Compliance Strategies: 1.) Review the DBE Compliance Plan to ensure any equipment and supply purchases credited towards a DBE's participation percentage are necessary for the DBE to perform the contracted scope of work. 2.) If the equipment and supply purchases are simply a "pass-through cost" to increase DBE participation, remove the totals and recalculate the prime contractor's overall DBE participation percentage on the project.

DBE Fraud: A DBE receives a commission or payoff to be listed as a subcontractor for work that the prime contractor or another subcontractor actually performs.

DBE Compliance Strategies: 1.) Review the monthly compliance reports to determine if there are any subcontractors, who were not part of the original bid or DBE Compliance Plan, that are receiving payments to uncover evidence of possible DBE substitutions. 2.) Conduct unscheduled job site and office visits to interview owners, workers, project managers and supervisors in an effort to uncover possible DBE payoff fraud.

DBE Fraud: A prime contractor helps, or hires, someone to form a DBE company in order to have a DBE "front company" that is actually controlled by the prime contractor.

DBE Compliance Strategy: Conduct unscheduled job site and office visits to interview owners, workers, project managers and supervisors in an effort to uncover possible DBE "front company" fraud.

DBE Fraud: A prime contractor lists a DBE as a part of the bid or DBE Compliance Plan, but hires a non-DBE to perform the work when the project begins.

DBE Compliance Strategy: Monitor DBE compliance reports and impose sanctions and fines on prime contractors that do not report DBE substitutions or that do not maintain DBE participation percentages agreed upon in the DBE Compliance Plan and contract.

The Importance of DBE Compliance

Sir Isaac Newton's *Third Law of Motion* teaches us:
For every action, there is an equal and opposite reaction.

In other words, as long as there are DBE programs, there will be individuals and firms that will try to defraud the system. That is why DBE compliance is so important. DBE compliance helps to mitigate the potential for DBE fraud because firms are less likely to attempt a DBE fraud scheme if they know they are being monitored on a regular basis. DBE compliance is also important because:

- DBE compliance informs the public that an agency's leadership is committed to leveling the playing field for all businesses, including DBEs, not only in words, but in actions;
- DBE compliance reassures citizens that their tax dollars are not being wasted;
- DBE compliance helps to ensure that only responsible prime contractors and DBEs get an opportunity to work on projects funded by Federal, state and local taxpayer dollars; and
- DBE compliance provides meaningful data- such as the number of local jobs created and the number of DBE firms that increased revenues as a result of their participation in the DBE program- that supports the premise that DBE programs are a vital component of an agency's economic development strategy.

Leadership Matters

DBE programs succeed or fail as a result of leadership. An agency's leadership must understand three salient facts in order to build a world-class DBE program:

1. **Budgets Matter.** Agency budgets reflect agency priorities. A DBE program must be adequately funded to ensure it has the maximum practical opportunity to succeed and create meaningful contracting opportunities for DBEs.
2. **Compliance Matters.** An agency cannot build a world-class DBE program without DBE compliance as a major component.
3. **Leadership Matters.** Regardless of who manages the DBE program, it is leadership that will be commended if the program succeeds and leadership that will be held accountable if the program fails or becomes the target of DBE fraud investigations.

Compliance Matters by Norman David Roussell, MBA

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End Notes

1 The U.S. DOT's DBE Program was created in 1983. (Source: www.dot.gov)

2 Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their individual qualities. (Source: www.sba.gov)

3 Economically disadvantaged individuals are those socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same business area that are not socially disadvantaged. (Source: www.sba.gov)

4 A *DBE Compliance Plan*, at a minimum, identifies DBE subcontractors and their respective scopes of work, the dollar amounts of their subcontracts and their percentage of work contribution to the overall project cost. (Source: www.certassist.net)

5 *Commercially Useful Function* means that the DBE has a necessary and useful role on a project. For example, the DBE supplies the materials and performs, manages and supervises a specific scope of work. (Source: www.dot.gov)

6 www.oig.dot.gov

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