

Initial Statement of Reasons - DVBE Incentive

INITIAL STATEMENT OF REASONS

ADD SECTIONS 1896.99 "DEFINITIONS", 1896.99.100 "INCENTIVE APPLICATION" and 1896.99.120 "INCENTIVE AMOUNTS"

SPECIFIC PURPOSE OF THE REGULATION

The proposed regulation creates an incentive for bidders proposing participation of Disabled Veterans Business Enterprises (DVBE) when State departments are awarding contracts. The purpose of this incentive is to ensure that departments (1) meet their mandated 3 percent annual DVBE participation goal (3 percent goal) set forth in Public Contract Code section 10115, subdivision (c) and (2) make every effort to assure at least 3 percent DVBE participation as required by Military and Veterans Code section 999. This is accomplished by requiring departments to provide an incentive to bidders proposing DVBE participation to meet the DVBE program requirement. The amount of participation required is a minimum of 3 percent, unless changed by the awarding department's director as allowed in California Code of Regulations, title 2, division 2, chapter 3, subchapter 10.5, section 1896.62. The amount of the incentive is a minimum of 1 percent to a maximum of 5 percent if needed to meet the DVBE participation goal.

NECESSITY

The DVBE program requiring that departments meet the 3 percent goal was established more than 17 years ago. In July 2002, a Bureau of State Audits' report found that the State continues to struggle with the 3 percent goal. Current reporting on the statewide DVBE participation compliance continues to reflect this problem. There were several recommendations in the Bureau of State Audits report. In response to this problem, the Legislature adopted Military and Veterans Code section 999.5, subdivision (a), which requires DGS to "adopt written policies and guidelines establishing a uniform process for State contracting that would provide a disabled veteran business enterprise participation incentive to bidders." The Senate Committee Analysis states the intent of this statute to "establish a DVBE participation incentive to bidders that would be mandatory for all state agencies." (Senate Committee Analysis, Sen. Bill No. 115 (2005-2006 Reg. Sess.) April 21, 2005, p 1.) Additionally, the Senate Committee Analysis reflects, "it is the intent of the Legislature that every State procurement authority honor California's disabled veterans by taking all practical actions necessary to meet or exceed the DVBE participation goal of a minimum of three percent of total contract value." (Senate Committee Analysis, Sen. Bill No. 115 (2005-2006 Reg. Sess.) April 21, 2005, p. 3)

One of the problems lies in the "good faith effort" exception to the participation requirement for a particular contract. If bidders do not obtain DVBE participation, they must demonstrate "good faith efforts" to obtain DVBE participation. (See Public Contract Code sections 10115.2(b)(1)-(5)) Departments also have the authority to exempt specific solicitations from DVBE participation requirements. These exceptions contribute to the failure of departments to meet the required 3 percent goal. The DVBE incentive may operate independently of the DVBE participation requirement. It must be applied when there is a DVBE program requirement. Additionally it may be applied in other solicitations that require DVBE participation under Public Contract Code, section 10115, subdivision (c). Therefore, an incentive pursuant to this subchapter, will operate to encourage bidders to provide DVBE participation instead of documenting "good faith efforts."

A solicitation that has been exempted from the DVBE participation requirement by a department may still offer an incentive to attract any available DVBE participation. This ability to offer an incentive increases the opportunities for the department to meet its participation goal while still allowing the flexibility to exempt a contract from the participation requirement should the

department deem it appropriate. It should be noted that if a solicitation requires DVBE participation under Public Contract Code, section 10115, subdivision (c) in an amount higher than the participation amount required to qualify for the incentive, a bidder proposing only the lower amount of participation will still be required to document "good faith efforts" to meet the DVBE participation requirement.

The flexibilities in this regulation include: (1) the department option to provide higher levels of participation to qualify for greater incentives in section 1896.99.100 subdivision (b), (2) the \$100,000 optional caps to low price solicitations in section 1896.99.120, and (3) the use of a higher percentage than 1 percent not to exceed 5 percent to meet participation goals in section 1896.99.120. These flexibilities are necessary to offer departments options that they may use in their DVBE plan for improvement.

1896.99.100, subdivision (a):

Pursuant to the Military and Veterans Code section 999.5, subdivision (a), "the incentive program shall be used by all state agencies when awarding contracts." The scope of this incentive program is necessary to explain to whom and when the regulation applies. To be more consistent with the other sections of this regulation and the intent of the legislation that the incentive operate to assist departments in meeting the 3 percent goal, the term "awarding departments" has been used in the proposed regulation.

Under the current State process, departments use the DVBE program requirement to meet their DVBE goal. Subdivision (a) of these regulations enhances the DVBE program requirement value because it is the determinant of a required DVBE incentive.

The intent of using the DVBE program requirement is to leverage the departments' awareness of the DVBE firms in their particular areas of business. Using the DVBE program requirement to exclude certain purchases acknowledges that there are times when a DVBE incentive may not be needed. Government Code section 14838.5 provides a process where only certified small businesses or only DVBEs are contacted for acquisition of goods, service, or information technology over \$5,000 and under \$100,000. Government Code section 14838.7 provides a similar process for construction. Applying the DVBE incentive to DVBE-only solicitations would result in the State going through additional paperwork for the same result. This does not meet the goal to increase DVBE participation.

However, this regulation allows the awarding agency to include a DVBE incentive in acquisitions without the DVBE program requirement, thereby increasing DVBE participation. This provides flexibility to assist those departments finding it difficult to meet their 3 percent goal. With a special recruitment effort and the incentive, a department may be able to increase participation where it did not exist in the past.

Also in this subdivision, departments that have met the 3 percent goal in two of the last three years have the option to exempt contract(s) from the DVBE incentive. The purpose of this exemption is to allow departments that have a successful DVBE program to use the methods that they currently employ if they find these methods adequate to maintain at least the 3 percent goal. The purpose of the DVBE incentive is to gain at least the 3 percent goal. Departments have additional goals, such as keeping their costs of doing business down in the public interest. Providing departments choices also acts as an incentive to the departments to gain DVBE participation and rewards them for consistent goal attainment. On the other hand, only one year of meeting the 3 percent goal is not adequate to exempt a department, as the result might be that the department meets the 3 percent goal when using the incentive and does not meet the 3 percent goal when it does not use the incentive.

It is necessary to use a reliable and consistent source to find whether the 3 percent goal has been met. The source chosen by the DGS is a report already being produced. Public Contract Code section 10115.5 and Military and Veterans Code section 999.7 require that departments

report on a fiscal year basis the level of participation by DVBEs in contracts requiring the 3 percent goal. DGS compiles this information into a report that it makes available to the Legislature. The latest report is the "Consolidated Annual Report for the Statewide Disabled Veteran Business Enterprise (DVBE), the Small Business (SB)/ Microbusiness (MB), the Consulting Services, and the Ethnicity, Race, and Gender (ERG) for Fiscal Year 05-06." Any department will use the most current reports to determine if it may exempt the DVBE incentive in a solicitation.

1896.99.100, subdivision (b):

The incentive is only applied to bidders who are deemed responsive and responsible. This means that a bidder must meet the minimum requirements for the solicitation, as well as provide the required DVBE participation, in order to receive the applicable incentive amount. This protects the State by preventing the application of the incentive to give the award to a bidder that is not responsible.

The solicitation must identify the specific application of the incentive. This is necessary because the incentive may vary from one solicitation to another. The minimum required incentive amount will be determined according to section 1896.99.120 depending on need to meet the DVBE 3 percent goal. Information on the DVBE incentive must be provided to the bidders to inform them of the availability of the incentive and the details about how it will be applied in the particular solicitation.

Solicitations may also provide an incentive scale under which bidders obtaining higher levels of participation receive higher incentives. This may be needed to maximize DVBE participation. It also provides flexibility that the departments can use to gain additional DVBE participation if they need it to meet the 3 percent goal.

1896.99.100, subdivision (c):

For awards based on low price, the incentive will be applied the same way other similar incentives or preferences are applied. The department must use the 1 percent incentive or determine the appropriate incentive amount based on the criteria set out in section 1896.99.120. Then, if there is one or more responsive and responsible bidder(s) proposing the amount of DVBE participation required to qualify for the incentive, the department will calculate the incentive by multiplying the incentive amount times the lowest responsive and responsible bid price. This amount will then be subtracted from the bid price of the bidders proposing the required DVBE participation. Then the bids are reevaluated to determine the lowest bidder.

Government Code section 14838, subdivision (f) requires that small business and microbusiness bidders have precedence over non-small business bidders when preferences are applied. The Legislature did not want to provide an advantage to other types of bidders that would result in the denial of an award to an otherwise qualified small business. The proposed regulation confirms the application of this statute to the incentive by requiring that it not be applied to displace an award to a small business with a non-small business.

1896.99.100, subdivision (d):

For solicitations based on high points, the bidder must meet any threshold identified in the solicitation in order to be eligible for application of the incentive. If there is a minimum point threshold for any category, e.g. the technical score, the bidder must be responsive to that requirement and meet the minimum required score before the incentive will be applied. If the bidder does not meet the minimum required scores, that bidder will not be eligible for application of the incentive because s/he is not eligible for award of the contract. Incentive points will not be applied to help a bidder meet a minimum required score in the solicitation. This protects the State because the solicitation determines the minimum qualifications required for an acceptable bidder and the incentive will not operate to award the contract to a bidder who does not meet

those minimum qualifications. Although the State may pay a higher price for a contract, the incentive will not operate to allow an inappropriate or unqualified bidder to be the proposed awardee.

When solicitations are structured to award the contract to the bidder with the highest score, then the incentive is applied in the sum of non-cost points. The incentive points increase the bidder's score and the description is available in the solicitation.

1896.99.120: The incentive amounts provide incentive(s) that will have its intended consequence, i.e. increasing DVBE participation to the mandated goal. The minimum of 1 percent of the lowest responsive bidder is the lowest amount large enough to produce an effect on the outcome on State solicitations and result in additional DVBE participation. The departments may choose to provide a higher incentive up to 5 percent if it would assist them in meeting their 3 percent goal. Departments are in the best position to know the bidding community, the scope of the particular solicitation, the availability of DVBE participation, the historical application of the 3 percent participation requirement, and any other relevant factors that are useful in selecting the appropriate incentive amounts to meet their annual 3 percent goal.

1896.99.120, subdivision (a): The highest ranking executive officer or his/her designee may place a cap on the incentive for a solicitation of not less than \$100,000 or \$100,000 for all combined incentives and preferences. Agencies may need flexibility for use of a cap to manage a budget and accommodate industry or contract specific environments. A limitation is consistent with Government Code section 14838 (b) (4) that limits the total cost of the small business preference and any other provision of law to \$100,000. This limitation is particularly necessary in smaller solicitations. It is also needed where there is not enough money in a project to cover the additional monies. It might additionally be applied in years when the State budget is extremely tight. However, it is not a mandatory cap for all solicitations since limiting a multimillion-dollar solicitation to \$100,000 would negate its effect.

TECHNICAL, THEORETICAL, AND/OR EMPIRICAL STUDY, REPORTS, OR DOCUMENTS

1. DGS report titled "Consolidated Annual Report for the Statewide Disabled Veteran Business Enterprise (DVBE), the Small Business (SB)/ Microbusiness (MB), the Consulting Services, and the Ethnicity, Race, and Gender (ERG) for Fiscal Year 05-06."
2. California State Auditor, Bureau of State Audits report "Disabled Veteran Business Enterprise Program: Few Departments That Award Contracts Have Met the Potentially Unreasonable Participation Goal, and Weak Implementation of the Program Further Hampers Success." Report No. 2001-127, issued on July 3, 2002.

REASONABLE ALTERNATIVES TO THE REGULATIONS AND REASONS FOR REJECTING THOSE ALTERNATIVES

DGS initially considered at least two different incentive proposals. One proposal was a DVBE incentive tied to the DVBE requirement. It offered different participation requirements and different DVBE incentives. A suggested range for the incentive was 3 to 10 percent. A scale was allowed so that more participation received more incentive. This proposal was not specific enough for consistent application.

In a second proposal, the incentive was applied when awarding contracts. It was based on historical performance of each department. If a department met the 3 percent DVBE goals in all the previous 3 years, the incentive was 1 percent. If it met the goal in the previous year, the incentive was 3 percent. If it did not meet the goal in the previous year, the incentive was 6 percent. If it did not meet the goal in the last 5 years, the goal was 9 percent. However, it was

determined that this proposal was not flexible enough to meet the budgetary issues of individual State departments or allow flexibility to accommodate industry issues such as lack of DVBEs or needs of specific contract environments. Additionally, in management and legislative discussion of Senate Bill 115 (Flores, 2005), the cost of the DVBE incentive was identified as minimal.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS

The proposed regulation will not have any adverse impact on small business. Section 1896.99.100, subdivision (c) specifically states that the incentive cannot be used to displace an award to a small business with an award to a non-small business. Although one small business may displace another small business through application of the incentive, a small business cannot be displaced by a non-small business. In fact, since most DVBEs are small businesses, this incentive will have a favorable impact on certified DVBEs that are also small businesses.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON BUSINESS

The requirement that DVBEs receive an incentive in the solicitation process will have an adverse economic impact on those businesses that lose contract awards due to application of the incentive. This is an inherent consequence in the underlying legislation which requires the incentive. The proposed regulation will have no effect on California businesses ability to compete with businesses in other states. However, the proposed regulation could potentially shift jobs from a non-DVBE to a DVBE, because the intended result of the regulations is to increase the dollar amount of contracts awarded to DVBEs, which necessarily will decrease the dollar amount of contracts awarded to non-DVBEs. This could also lead to an increase in the number of DVBEs and a decrease in the number of non-DVBEs. It is difficult to estimate any shift from non-DVBEs to DVBEs will result in job shifts or the creation and/or elimination of existing businesses within California. It should expand DVBEs. Overall, the proposed regulation should not have a significant adverse economic impact on business. Rather, it should result in the shifting of State funds from one type of business to another. There is also a minor additional cost to non-DVBEs to recruit DVBEs for subcontracting.