Department of Legislative Services

Maryland General Assembly
2013 Session

FISCAL AND POLICY NOTE
Revised

Senate Bill 1066 (Senator Pugh)
Education, Health, and Environmental Affairs Health and Government Operations

Minority Business Enterprises - Not-for-Profit Entities

This bill enhances existing procurement preference programs for specified not-for-profit entities and requires various annual reports to, and from, the Department of General Services (DGS) on State contracting with them. The bill also removes not-for-profit entities that promote the interests of physically and mentally disabled individuals from the definition of minority business enterprise (MBE) and exempts specified contracts (entered into on or after July 1, 2015) with them from the calculation of MBE participation rates. The Department of Disabilities (DOD) must evaluate the bill's effect on the participation of not-for-profit entities in State procurement and issue a final report by December 1, 2016.

The bill takes effect July 1, 2013, and applies only prospectively to any contract awarded after that date. Provisions related to the involvement of not-for-profit entities in the MBE program and to the DOD study take effect July 1, 2015.

Fiscal Summary

State Effect: General fund expenditures by DGS increase by $39,300 in FY 2014 to carry out the reporting functions specified in the bill. Out-year expenditures reflect annualization, inflation, turnover, and termination of one-time costs. General fund expenditures by DOD increase by $50,000 in FY 2016 and $75,000 in FY 2017 to conduct the mandated study. No effect on revenues.

(in dollars)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Revenues	$0	$0	$0	$0	$0
GF Expenditure	39,300	72,200	125,500	153,800	82,400
Net Effect	($39,300)	($72,200)	($125,500)	($153,800)	($82,400)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Preferred Providers

"Preferred provider" is defined as a provider of supplies or services given preference in specified provisions of current State procurement law, which are Maryland Correctional Enterprises (MCE), Blind Industries and Services of Maryland (BISM), the Employment Works Program, and businesses owned by individuals with disabilities.

Within 60 days of the enactment of the State budget, each State or State-aided or -controlled entity, including the University System of Maryland (USM), Morgan State University (MSU), and St. Mary's College of Maryland (SMCM), must prepare and submit to DGS a forecast of expenditures with preferred providers for the upcoming fiscal year. The forecast must include activities planned to increase the number of contracts awarded to preferred providers. Within 90 days of the end of each fiscal year, each of the same entities must report to DGS on its actual contracting with preferred providers in the previous fiscal year, as specified in the bill. Also within 90 days of the end of the fiscal year, each preferred provider must report to DGS on the number of individuals with disabilities who contributed to work performed under contracts with the State. Within 60 days of receiving all required reports from agencies and preferred providers, DGS must compile a summary report for the Board of Public Works and designated committees of the General Assembly. By July 1, 2015, DGS must identify all State agencies and State-aided or -controlled entities subject to the forecasting and reporting requirements.

To the extent practicable, a maintenance contract entered into by a State agency or State-aided or -controlled entity that includes a component for housekeeping or janitorial services must include a requirement that the prime contractor purchase janitorial products from BISM if the specified products are available.

MBE Not-for-profit Entities

"Not-for-profit entity" is defined as a corporation that has been determined by the federal Internal Revenue Service to be exempt from federal taxation and that is organized to promote the interests of physically or mentally disabled individuals.

Contracts that are (1) with preferred providers; (2) awarded to not-for-profit entities in accordance with State or federal mandates; or (3) by the Developmental Disabilities Administration for specified social services are excluded from the calculation of total State procurement spending for the purpose of calculating MBE participation rates.

A not-for-profit entity that is participating as an MBE on a State contract awarded before July 1, 2015, may continue to participate until the contract expires, including all options, renewals, and extensions. However, the entity's participation may not be counted toward achieving the State's MBE participation goals. A unit may not require that the not-for-profit entity be replaced by a certified MBE in order to meet MBE goals for the contract.

Evaluation

DOD, in consultation with the Governor's Office of Minority Affairs (GOMA) and DGS, must evaluate the bill's effect on the participation of not-for-profit entities in State procurement and related activities. A preliminary report is due to designated committees of the General Assembly by December 1, 2015, and a final report is due by December 1, 2016.

Current Law: For a complete description of the MBE program, please see the **Appendix – Minority Business Enterprise Program**.

Under State procurement law, State agencies and State-aided or -controlled entities must procure services and supplies from MCE, BISM, the Employment Works Program, or a business owned by an individual with a disability, in that order of preference. Only if none of those entities produces or provides the desired supplies or services may a State agency issue a competitive procurement. Under the bill, procurements from these four entities, among others, are exempt from the calculation of total procurement spending for the purpose of calculating agencies' MBE participation rates.

Background: Of the more than 5,600 certified MBEs as of March 2013, 171 are nonprofit entities or community service providers participating in the Employment Works Program organized to serve the needs of mentally or physically disabled individuals.

A 2011 analysis of State payments under the MBE program from fiscal 2006 through 2009 by the *Baltimore Business Journal* found that MBE certified not-for-profit firms received about one-third of total MBE payments. In fiscal 2009, for instance, not-for-profit firms were paid $373 million of the total $989 million in MBE payments, or 37.7%. Most of the payments went to five firms, all of which rank among the top 20 recipients of MBE payments over the four years examined for the analysis. In fiscal 2012, GOMA reports that certified nonprofits and community service providers together accounted for 35.0% of total MBE procurement.

State Fiscal Effect: The bill requires DGS to compile, analyze, and summarize annual reports from dozens of State agencies, an unknown number of State-aided or -controlled entities, and the preferred providers – which may include as many as 171 not-for-profit entities under the Employment Works program. The annual reporting requirement for which DGS is responsible is roughly equivalent to the annual MBE report published by GOMA, which involves extensive staff time and resources. Due to multiple rounds of budget and staffing cuts during the recent recession, DGS lacks the staffing capacity to perform this function.

Therefore, general fund expenditures by DGS increase by $39,311 in fiscal 2014, which accounts for a 180-day start-up delay from the bill's July 1, 2013 effective date due to the timing of the reporting requirement in the bill. This estimate reflects the cost of hiring a program manager to manage DGS's reporting responsibilities under the bill and assist with the evaluation conducted by DOD. It includes a salary, fringe benefits, one-time start-up costs, and ongoing operating expenses. It assumes that the bill's reporting requirement does not apply to fiscal 2014, since it takes effect after the enactment of the fiscal 2014 budget bill and the end of the previous fiscal year. Nevertheless, staffing is necessary to establish procedures for agencies to report their forecasts and actual procurements beginning with the enactment of the fiscal 2015 budget bill in March/April 2014.

Position	1
Salary and Fringe Benefits	$32,008
Operating Expenses	7,303
Total FY 2014 State Expenditures	**$39,311**

Future year expenditures reflect a full salary with annual increases and employee turnover as well as annual increases in ongoing operating expenses and the termination of one-time costs. To the extent that DGS identifies a substantial number of State-aided or -controlled entities not currently subject to MBE reporting requirements, additional resources may be necessary.

The evaluation required by the bill is beyond the function and expertise of DOD. Therefore, general fund expenditures by DOD increase by $50,000 in fiscal 2016 and by $75,000 in fiscal 2017 to hire a firm with procurement expertise to conduct the mandated study and prepare the preliminary and final reports by the mandated deadlines.

Overall MBE participation rates may be affected by the bill, but not by very much. Although procurements with nonprofits and community service providers are not counted toward an agency's MBE participation rate under the bill, they also are not counted in the agency's total procurement (*i.e.,* the denominator in the MBE rate calculation). Therefore, the overall effect on MBE participation rates is likely minimal.

Small Business Effect: The 171 not-for-profit entities, including community service providers, will no longer benefit from the preference given under the MBE program, beginning in fiscal 2016. However, the State procurement preference for providers participating in the Employment Works Program remains in place and is strengthened by the bill. Moreover, GOMA advises that less than 1.0% of preferred providers' revenues from State contracts comes from subcontracting opportunities under the MBE program.

Additional Comments: The Department of Legislative Services notes that the reporting requirements for State agencies and State-aided or -controlled entities begin July 1, 2013, but DGS is not required to develop the list of agencies and entities subject to the reporting requirements until July 1, 2015.

Additional Information

Prior Introductions: None.

Cross File: HB 48 (Delegate B. Robinson, *et al.*) - Health and Government Operations.

Information Source(s): Board of Public Works, Department of Budget and Management, Governor's Office, Department of General Services, Department of Disabilities, Maryland Department of Transportation, Department of Legislative Services

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Appendix – Minority Business Enterprise Program

The State's Minority Business Enterprise (MBE) program, which is scheduled to terminate July 1, 2016, requires that a statewide goal for MBE contract participation be established biennially through the regulatory process under the Administrative Procedure Act. The biennial statewide MBE goal is established by the Special Secretary for the Governor's Office of Minority Affairs (GOMA), in consultation with the Secretary of Transportation and the Attorney General. In a year in which there is a delay in establishing the overall goal, the previous year's goal applies. The Special Secretary is also required to establish biennial guidelines for State procurement units to consider in deciding whether to establish subgoals for different minority groups recognized in statute. In a year in which there is a delay in issuing the guidelines, the previous year's guidelines apply.

Prior to the enactment of Chapters 252 and 253 of 2011 (HB 456/SB 120) and Chapter 154 of 2012 (HB 1370), State law established a goal that at least 25% of the total dollar value of each agency's procurement contracts be awarded to MBEs, including subgoals of 7% for African American-owned businesses and 10% for woman-owned businesses. As of January 2013, a new statewide goal had not been issued by GOMA, so the 25% statewide goal remains in effect. GOMA issued subgoal guidelines in July 2011, summarized in **Exhibit 1**, which are still in effect. The guidelines state that subgoals may be used only when the overall MBE goal for a contract is greater than or equal to the sum of all recommended subgoals for the appropriate industry, plus two percentage points.

Exhibit 1
Subgoal Guidelines Issued July 2011

	Construction	Architectural/ Engineering	Maintenance	Information Technology	Services	Supplies/ Equipment
African American	7%	6%	8%	7%	7%	6%
Hispanic	–	2%	3%	2%	–	–
Asian	4%	–	3%	–	4%	5%
Women	–	9%	–	8%	12%	10%
Total	**11%**	**17%**	**14%**	**17%**	**23%**	**21%**
Total +2	**13%**	**19%**	**16%**	**19%**	**25%**	**23%**

Source: Governor's Office of Minority Affairs

There are no penalties for agencies that fail to reach the statewide target. Instead, agencies are required to use race-neutral strategies to encourage greater MBE participation in State procurements.

History and Rationale of the MBE Program

In 1989, the U.S. Supreme Court held in the *City of Richmond v. J.A. Croson Co.*, that state or local MBE programs using race-based classifications are subject to strict scrutiny under the equal protection clause of the Fourteenth Amendment to the U.S. Constitution. In addition, the ruling held that an MBE program must demonstrate clear evidence that the program is narrowly tailored to address actual disparities in the marketplace for the jurisdiction that operates the program. As a result, prior to each reauthorization of the State's MBE program, the State conducts a disparity study to determine whether there is continued evidence that MBEs are underutilized in State contracting.

The most recent disparity study was completed in February 2011 and serves as the basis for the most recent reauthorization of the MBE program. It found continued and ongoing disparities in the overall annual wages, business earnings, and rates of business formation between nonminority males and minorities and women in Maryland. For instance, average annual wages for African Americans (both men and women) and nonminority women were 33% lower than for comparable nonminority males. It also found continued disparities in the use of MBEs compared to their availability in the marketplace to perform work in designated categories of work. For instance, African American-owned businesses were paid 4.5% of State construction contract dollars, but they make up 9.7% of the construction sector in the State. Woman-owned businesses were paid 8.5% of maintenance contract dollars, despite making up 18.0% of the maintenance contract sector. Similar disparities were found in other contracting sectors and for other MBE categories.

Another disparity study is due by December 31, 2015, prior to the July 1, 2016 termination date for the MBE program. (The program has been reauthorized six times since 1990, most recently by Chapter 154 of 2012.) **Exhibit 2** provides MBE participation rates for major Executive Branch agencies for fiscal 2011, the most recent year for which data is available.

Requirements for MBE Certification

An MBE is a legal entity, other than a joint venture, that is:

- organized to engage in commercial transactions;
- at least 51% owned and controlled by one or more individuals who are socially and economically disadvantaged; and

- managed by, and the daily business operations of which are controlled by, one or more of the socially and economically disadvantaged individuals who own it.

MBEs include not-for-profit entities organized to promote the interests of physically or mentally disabled individuals. There are no restrictions on the size or management structure of not-for-profit entities that can be considered MBEs.

A socially and economically disadvantaged individual is defined as a citizen or legal U.S. resident who is African American, Native American, Asian, Hispanic, physically or mentally disabled, a woman, or otherwise found by the State's MBE certification agency to be socially and economically disadvantaged. An MBE owned by a woman who is also a member of an ethnic or racial minority group is certified as either owned by a woman or owned by a racial or ethnic minority, but not both. The Maryland Department of Transportation is the State's MBE certification agency.

A socially disadvantaged individual is someone who has been subject to racial or ethnic prejudice or cultural bias within American society because of his or her membership in a group and without regard to individual qualities. An economically disadvantaged individual is someone who is socially disadvantaged whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities compared with those who are not socially disadvantaged. An individual with a personal net worth in excess of $1.5 million, adjusted annually for inflation, is not considered economically disadvantaged. The inflation-adjusted limit for calendar 2013 is $1,615,663.

Exhibit 2
MBE Participation Rates, by Agency
Fiscal 2011

Agency	% MBE Participation
Aging	30.7%
Agriculture	6.9%
Budget and Management	10.5%
Business and Economic Development	43.9%
Education	20.3%
Environment	25.2%
Executive Department	14.0%
General Services	33.9%
Health and Mental Hygiene	46.1%
Higher Education Commission	14.0%
Housing and Community Development	21.9%
Human Resources	8.4%
Information Technology	13.7%
Juvenile Services	8.9%
Labor, Licensing, and Regulation	36.1%
Morgan State University	22.3%
Natural Resources	10.9%
Planning	8.3%
State Police	8.8%
Public Safety and Correctional Services	33.0%
Transportation – Aviation Administration	26.2%
Transportation – Motor Vehicle	46.7%
Transportation – Office of the Secretary	29.5%
Transportation – Port Administration	7.8%
Transportation – State Highway	26.1%
Transportation – Transit Administration	16.8%
Transportation – Transportation Authority	25.4%
University System of Maryland	19.7%
Veterans Affairs	18.2%
Statewide Total[1]	**23.8%**

[1] Includes additional nonCabinet agencies.

Source: Governor's Office of Minority Affairs