Department of Legislative Services

Maryland General Assembly
2017 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

Senate Bill 309 (The President, *et al.*) (By Request - Administration)
Education, Health, and Environmental Affairs Health and Government Operations

State Finance and Procurement - Small and Minority Business Participation

This emergency Administration bill establishes expectations related to offshore wind projects complying with the State's Minority Business Enterprise (MBE) program; the recently completed 2017 disparity study must be analyzed for its relevance to the type of work likely to be performed by such projects. Effective October 1, 2017, the bill expands the Small Business Reserve Program (SBR) to apply to all State agencies, raises the program's goal from 10% to 15% of the value of agency procurements, and alters the method of measuring whether agencies reach the goal. The bill also clarifies the conditions under which an MBE may be removed from a contract and alters the calculation of MBE participation in State procurement for selected MBEs.

Fiscal Summary

State Effect: Transportation Trust Fund (TTF) expenditures increase by approximately $60,000 in FY 2017 to conduct the required analysis of the 2017 disparity study. General fund expenditures increase by $131,200 in FY 2018 to accommodate the anticipated increase in registered small businesses; future years reflect annualization and elimination of one-time costs. To the extent the bill limits contract awards to large firms, which can often provide goods and services more efficiently than small businesses, State procurement expenditures (all funds) likely increase (not reflected below). Any such increase may be at least partially offset by increased competition for State contracts among small businesses. No effect on revenues.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Revenues	$0	$0	$0	$0	$0
GF Expenditure	0	131,200	165,400	172,800	180,600
SF Expenditure	60,000	0	0	0	0
Net Effect	($60,000)	($131,200)	($165,400)	($172,800)	($180,600)

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

Local Effect: None.

Small Business Effect: The Administration has determined that this bill has a meaningful impact on small business (attached). The Department of Legislative Services concurs with this assessment as discussed below. (The attached assessment does not reflect amendments to the bill.)

Analysis

Bill Summary:

Small Business Reserve Program: Effective October 1, 2017, the bill repeals the listing of 23 agencies currently subject to SBR and requires instead that all State agencies implement the SBR requirements, which is expected to add 31 additional agencies to the program. Each State agency must, to the maximum extent practicable, structure its procurement procedures to provide a minimum of 15%, up from 10%, of its respective total dollar value of procurement contracts directly to small businesses. An agency can apply toward its total SBR participation goal only payments made under a contract that was designated as an SBR procurement. The Special Secretary of Minority Affairs must, in consultation with the Attorney General, establish standards and guidelines for participation in SBR every five years.

Minority Business Enterprise Program: Effective October 1, 2017, the bill clarifies that good cause for the removal of a certified MBE from an executed contract includes documented nonperformance by the MBE or election by the certified MBE to cease work on the contract. However, failure of a certified MBE to provide a bond requested by a contractor in violation of current law may not be considered nonperformance by the MBE.

The bill defines "regular dealer" to be a firm that owns, operates, or maintains a store, warehouse, or any other establishment in which materials, supplies, articles, or equipment are of the general character described by the specifications required under the contract and are bought, kept in stock, or regularly sold or leased to the public in the usual course of business. A "regular dealer" does not include a packager, broker, manufacturer's representative, or any other person that arranges or expedites transactions.

A State agency may apply only 60% of the cost of materials and supplies provided by a regular dealer that is a certified MBE toward achieving an MBE contract goal. For materials or supplies purchased from a certified MBE that is neither a manufacturer nor a regular dealer, only the fees, commissions, or transportation charges related to the purchase can be counted toward achieving the MBE contract goal, if the agency determines that they are reasonable and not excessive; the actual cost of materials and supplies cannot be counted toward the MBE contract goals.

Offshore Wind Projects: To the extent practicable and authorized by the United States Constitution, approved applicants for a proposed offshore wind project must comply with the State's MBE program. The Maryland Department of Transportation (MDOT) must conduct an analysis of the 2017 disparity study, to determine if it applies to the type of work likely to be performed by an approved offshore wind project, and report its findings to the Legislative Policy Committee by December 1, 2017.

Within six months of the approval of an offshore wind renewable energy credit (OREC) by the Public Service Commission (PSC), the Governor's Office of Minority Affairs (GOMA), in consultation with the Office of the Attorney General (OAG) and an approved applicant, must establish a clear plan for setting reasonable and appropriate MBE participation goals and procedures for each phase of the qualified offshore wind project. To the extent practicable, the goals and procedures for offshore wind projects must be based on the requirements of the State's MBE program. Every six months following the approval of an OREC application, an approved applicant must submit a report to PSC on its progress in establishing and implementing MBE participation goals and procedures.

Current Law/Background: In February 2016, the Governor established the Commission to Modernize State Procurement, chaired by the Lieutenant Governor. The commission met eight times and held three regional public forums. The commission issued its final report in December 2016, which included 57 recommendations divided into five major categories. This bill implements several of the commission's recommendations.

For a complete description of the State's MBE program, please see the **Appendix – Minority Business Enterprise Program**.

Offshore Wind Projects: Chapter 3 of 2013 established an application and review process by PSC for proposed offshore wind projects. It prohibited PSC from approving an application until GOMA, in consultation with OAG and the applicant, established a clear plan for setting MBE goals and related procedures for each phase of an offshore wind project. To the extent practicable, those goals and procedures had to be based on MBE program requirements. The provisions related to MBE procedures and goals terminated June 30, 2016, before any offshore wind projects were approved by PSC.

Small Business Reserve Program: SBR requires 23 State procurement units to structure their procurements so that at least 10% of the total dollar value of their procurements is made directly to small businesses. Under regulations adopted by the Department of General Services (DGS), each agency must prepare an annual forecast of its total procurement spending. The agency must then develop a plan to allocate at least 10% of its forecasted spending to contracts for small businesses serving as prime contractors.

Chapter 75 of 2004 established SBR and defined a small business as either a certified minority-owned business or a business other than a broker that is independently owned and operated, not a subsidiary of another firm, and not dominant in its field of operation. In addition, Chapters 538 and 539 of 2012 (as amended by Chapter 76 of 2014) established that, to qualify as a small business under SBR, a business must meet *either* of the following criteria in its most recently completed three fiscal years:

- the firm did not employ more than 25 people in its retail operations; 50 people in either its wholesale or construction operations; or 100 people in either its service, manufacturing, or architectural and engineering operations; *or*

- average gross sales did not exceed $2.0 million for manufacturing operations, $3.0 million for retail operations, $4.0 million for wholesale operations, $4.5 million for architectural and engineering services, $7.0 million for construction operations, and $10.0 million for service operations.

Small businesses self-report their small business status by registering on eMaryland Marketplace, the State's online procurement portal. Chapter 119 of 2016 transferred responsibility for administering SBR from DGS to GOMA and repealed its termination date, making the program permanent. In its new role overseeing the SBR program, GOMA is charged with conducting periodic compliance audits to ensure that businesses that register as small businesses meet the statutory requirements. Since the enactment of Chapter 119, however, GOMA advises that it has not completed any such audits, in part because it was not given any additional staff when authority for the program was transferred from DGS.

Currently, almost 6,000 certified small businesses in Maryland are eligible to participate in SBR. Fiscal 2014 was the first year since its inception that the program achieved its target of 10% of procurement dollars being awarded to certified small businesses, and it again achieved the goal in fiscal 2015. **Exhibit 1** shows the program's results for the 23 agencies subject to SBR in fiscal 2015, the most recent data available. Based on these figures, 16 of the 23 agencies achieved the program's 10% target. Procurement expenditures under SBR totaled $418.7 million in fiscal 2015, which is 10.6% of total State procurement expenditures. This represents a decrease from 11.8% in fiscal 2014.

Exhibit 1
Percentage of Procurement Dollars Going to Certified Small Businesses
Fiscal 2015

Agency	% of Procurement Dollars
Business and Economic Development*	66.0
Education	8.9
Environment	16.3
General Services	23.9
Health and Mental Hygiene	4.8
Housing and Community Development	22.1
Human Resources	10.4
Information Technology	12.1
Insurance Administration	14.2
Juvenile Services	6.3
Labor, Licensing, and Regulation	13.7
Lottery and Gaming Control	10.8
Morgan State University	7.7
Natural Resources	23.3
Public Safety and Correctional Services	5.3
Retirement	21.1
Stadium Authority	14.1
State Police	13.0
Transportation	12.8
Maryland Port	15.5
Transportation Authority	5.6
Treasurer's Office	2.8
University System of Maryland	12.0
Program Total	**10.6**

*Former name of the Department of Commerce

Source: Governor's Office of Minority Affairs

Other Procurement Provisions: The 60% rule for regular dealers as well as the broker rule are already incorporated under the federal Disadvantaged Business Enterprise program. As most major road and bridge construction projects in the State involve federal funds, most such projects funded by MDOT already include those provisions.

If a prime contractor requires a subcontractor to provide a bid, performance, or payment bond on a procurement contract with the State, the prime contractor may not require bid, performance, or payment bonding from the subcontractor that is more stringent than the bonding requirements that the State imposes on the contractor.

State Expenditures:

Small Business Reserve Program: The SBR provisions require 31 additional agencies to comply with the SBR requirements. The additional agencies include a mixture of large and small entities; the larger ones can likely implement the program with limited disruption, but smaller agencies with limited staff may experience operational delays and disruptions. Nevertheless, they are expected to implement the program with existing resources.

The SBR provisions may also result in an increase in SBR registrations. The higher statewide participation target, the restriction that only SBR solicitations can count toward SBR goals, and the expansion in the number of participating agencies all likely provide an incentive for more small businesses to register to do business with the State. Therefore, GOMA requires additional staff for outreach (both to vendors and to agencies) and compliance monitoring. General fund expenditures by GOMA increase by $131,164 in fiscal 2018, which accounts for the bill's October 1, 2017 effective date. This estimate reflects the cost of hiring one outreach officer and one compliance officer to handle the expected increase in SBR registrations. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	2
Salaries and Fringe Benefits	$120,946
Operating Expenses	10,218
Total FY 2018 State Expenditures	**$131,164**

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

Other agencies can likely implement the bill's provisions with existing budgeted resources, but some smaller agencies may experience operational disruptions.

To the extent that the expansion of business opportunities for small businesses that results from the bill reduces contract awards to large firms that can often provide goods and services more efficiently than small businesses due to economies of scale, State procurement expenditures (all funds) may increase. A reliable estimate of any such increase is not feasible, but it may also be at least partially offset by increased competition for State contracts from small businesses.

Offshore Wind Projects: Following the enactment of Chapter 3 of 2013, MDOT reanalyzed data from the 2012 disparity study to identify the capacity of MBE firms to participate in the development and installation of offshore wind energy facilities. The reanalysis was necessary because, in the absence of an existing offshore wind farm industry, the study could not identify existing MBE capacity or potential disparities. The reanalysis examined comparable industries to estimate potential MBE capacity in the offshore wind farm industry. That reanalysis cost approximately $50,000; with inflation, MDOT estimates that a reanalysis of the 2017 disparity study will cost approximately $60,000. Given the bill's emergency status, this analysis assumes that MDOT spends and/or encumbers those funds in fiscal 2017.

GOMA and PSC can implement the provisions related to offshore wind projects with existing resources.

Small Business Effect: Most of the bill's provisions benefit small and minority-owned businesses in the State, especially those that manufacture goods and provide direct services. The 60% rule and the broker rule both reduce MBE participation rates on some State contracts, requiring prime contractors to recruit either more MBEs or more MBEs that are manufacturers or providers of direct services to meet contract goals. The establishment of MBE standards for offshore wind projects also benefits MBE firms that may be able to participate in that industry. The expansion of the SBR program, raising the program goal, and limiting SBR participation only to SBR-designated contracts all require State agencies to dedicate more State procurement dollars to small businesses.

Additional Information

Prior Introductions: None.

Cross File: Although designated as a cross file, HB 433 (The Speaker, *et al.*) (By Request - Administration - Health and Government Operations) is not identical.

Information Source(s): Governor's Office of Minority Affairs; Office of the Attorney General; Department of Budget and Management; Department of General Services; Board of Public Works; Maryland Department of Transportation; Department of Legislative Services

Fiscal Note History:	First Reader - February 15, 2017
kb/ljm	Third Reader - March 15, 2017
	Enrolled - May 11, 2017
	Revised - Amendment(s) - May 11, 2017

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Appendix – Minority Business Enterprise Program

The State's Minority Business Enterprise (MBE) program 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.

In August 2013, GOMA announced a new statewide goal of 29% MBE participation that applied to fiscal 2014 and 2015; as no new goal has been established, the 29% goal remains in effect for fiscal 2017. GOMA issued subgoal guidelines in July 2011, summarized in **Exhibit 1**, which are also 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. In June 2014, new regulations took effect allowing MBE prime contractors to count their own work for up to 50% of a contract's MBE goal and up to 100% of any contract subgoal. Previously, certified MBE prime contractors could not count their own participation toward any goal or subgoal on an individual contract, but their participation was counted toward the State's MBE goal.

Exhibit 1
Subgoal Guidelines for MBE Participation

	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%**

MBE: Minority Business Enterprise

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 made 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. A new disparity study is in process; by statute it was required to be completed by September 2016, but it was not completed by that date.

The MBE program is scheduled to terminate July 1, 2017; it has been reauthorized seven times since 1990, the latest by Chapters 200 and 201 of 2013. **Exhibit 2** provides MBE participation rates for major Executive Branch agencies based on contract awards made during fiscal 2015, the most recent year for which data is available.

Exhibit 2
MBE Participation Rates, by Agency
Fiscal 2015

Cabinet Agency	% MBE Participation
Aging	30.0%
Agriculture	3.4%
Budget and Management	2.4%
Commerce	8.8%
Education	17.0%
Environment	10.1%
Executive Department	17.2%
General Services	21.5%
Health and Mental Hygiene	66.3%
Higher Education Commission	59.5%
Housing and Community Development	32.0%
Human Resources	9.8%
Information Technology	6.8%
Juvenile Services	10.0%
Labor, Licensing, and Regulation	30.7%
Military	24.5%
Natural Resources	12.5%
Planning	7.8%
State Police	21.9%
Public Safety and Correctional Services	53.9%
Transportation – Aviation Administration	24.1%
Transportation – Motor Vehicle Administration	38.9%
Transportation – Office of the Secretary	39.0%
Transportation – Port Administration	9.5%
Transportation – State Highway Administration	24.1%
Transportation – Transit Administration	15.6%
Transportation – Transportation Authority	25.8%
Statewide Total[1]	**26.2%**

MBE: Minority Business Enterprise

[1]Includes University System of Maryland and non-Cabinet agencies.

Source: Governor's Office of Minority Affairs

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.

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 2017 is $1,692,682.

ANALYSIS OF ECONOMIC IMPACT ON SMALL BUSINESSES

TITLE OF BILL: State Finance and Procurement – Small and Minority Business Participation

BILL NUMBER: SB 309/HB 433

PREPARED BY: GLO
(Dept./Agency/GLO)

PART A. ECONOMIC IMPACT RATING

This agency estimates that the proposed bill:

_____ WILL HAVE MINIMAL OR NO ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

OR

___X__ WILL HAVE MEANINGFUL ECONOMIC IMPACT ON MARYLAND SMALL BUSINESSES

PART B. ECONOMIC IMPACT ANALYSIS

SB309 will have a meaningful economic impact on Maryland small businesses because it will increase the Small Business Reserve mandate by 50% and require the participation of all procuring units. The vast majority of businesses registered in the Small Business Reserve are from Maryland.