

Date of Hearing: April 23, 2019

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sabrina Cervantes, Chair

AB 1533 (Eggman) – As Introduced February 22, 2019

SUBJECT: Public contracts: local agencies: preferences

POLICY FRAME: While California's overall economic growth has consistently outpaced that of most areas of the nation, individuals that live in some regions of the state and those that belong to certain population groups still face recession-related poor economic conditions. Business ownership among minorities and especially women of color is one policy path that has demonstrated the ability to support upward mobility and economic security. With net new job growth highest among businesses with less than 20 employees, supporting small business results in multiple positive outcomes for addressing the systemic challenges of income inequality.

A growing number of local agencies are seeking ways to leverage their public procurement expenditures to support local small business development. Legislation enacted last year, AB 2762 (Carrillo and Muratsuchi), Chapter 654, Statutes of 2018, established special procurement policies for local agencies in 11 of the state's 58 counties. When the measure passed the Assembly Jobs Committee, AB 2762 applied to all counties in the state. Senate committee amendments limited the bill to the 11 Bay Area counties and Los Angeles, the sponsor of the bill.

AB 1533 expands the special procurement provisions to San Joaquin County in order to assist local agencies within the county in increasing the number of small businesses, disabled veteran-owned businesses, and social enterprises participating in public contracting.

The policy committee analysis includes information on the California small business economy; the public procurement process, including how bid preferences are used in evaluating bids; and the rise of new forms of businesses, such as social enterprises.

SUMMARY: AB 1533 expands the number of counties authorized to use the enhanced procurement preference provisions from 11 to 12 by adding San Joaquin County to the list of eligible areas.

EXISTING LAW:

- 1) Authorizes a local agency to facilitate competitively bid contract awards to small businesses by doing all of the following:
 - a) Establish a small business preference for use in construction contracts, the procurement of goods, or the delivery of services, as specified.
 - b) Set a percent and financial value of each preference. The maximum percentage of a preference is limited to 7% of the lowest responsible bidder meeting specifications, and the maximum financial value is \$150,000 for any bid.
 - c) Establish a small business subcontracting procurement goal and a small business preference which can be applied to contracts that include a certain percentage of small businesses.

- d) Require bidders to make good faith efforts to meet the small business subcontracting participation goal, and to demonstrate what actions the bidder took in making the good faith efforts to meet the goal.
 - e) Authorize a prime contractor, subject to the approval of the local agency, to substitute a small business subcontractor with another small business. Among other specified limitations, all conditions qualifying the substitution are required to be verified by the local agency with the subcontractor being replaced.
 - f) Set additional guidelines for local preferences, including defining the term “small business” to the extent that the definition includes all state certified small businesses.
- 2) Authorizes a local agency within 11 of the state’s 58 counties (including Alameda, Contra Costa, Lake, Los Angeles, Marin, Napa, San Francisco, San Mateo, Santa Clara, Solano, and Sonoma) to facilitate competitively bid contract awards with *disabled veteran business* or *social enterprise* participation by doing all of the following:
- a) Establish a procurement preference for disabled veteran business participation and/or social enterprise participation for use in construction contracts, the procurement of goods, or the delivery of services, as specified.
 - i) The maximum percentage of a preference is limited to 7% of the lowest responsible bidder meeting specifications, and the maximum financial value is \$150,000 for any bid.
 - ii) If the local agency is allowing more than one preference to be used in a single bid, the local agency is required to set the percentage and maximum financial value of the combined preferences. The maximum percentage of all combined preferences – including those for disabled veteran business, small business, and social enterprise participation – is 15% of the lowest responsible bidder, and the maximum combined financial value of all preferences is \$200,000.
 - b) Establish a subcontracting preference for contracts which include a certain percentage of disabled veteran businesses or social enterprises.
 - c) Require bidders to make good faith efforts to meet the disabled veteran business or social enterprise subcontracting participation goal, and to demonstrate what actions the bidder took in making the good faith efforts to meet the goal.
 - d) Authorize a prime contractor, subject to the approval of the local agency, to substitute a subcontractor with another disabled veteran business or social enterprise, as applicable. Among other limitations, all conditions qualifying the substitution are required to be verified by the local agency with the subcontractor being replaced.
 - e) Set additional guidelines for local preferences, including:
 - i) Defining the term “disabled veteran business” to the extent that the definition includes all state certified disabled veteran business enterprises (DVBES).
 - ii) Defining a “social enterprise” to include a nonprofit or for-profit business whose primary purpose is to benefit the economic, environmental, or social health of the community and which uses the methods and disciplines of business and the power of the marketplace to advance its social, environmental, and human justice agendas, wherein the organization applies commercial strategies to maximize improvements in human and environmental well-being that may include maximizing social impact rather than profits for external shareholders.

A “social enterprise” is a business that has been in operation for at least one year providing transitional or permanent employment to a transitional workforce or providing social, environmental, or human justice services.

- 3) Requires every local agency that offers any of the preferences to, prior to offering a preference, adopt a procurement policy that includes, at a minimum, all of the following:
 - a) A definition of an eligible entity for each preference category being utilized by the local agency.
 - b) The percentage and maximum financial value of a single preference.
 - c) If the local agency is authorized to offer and intends to allow multiple preferences in a bid package, the percentage and maximum financial value of multiple preferences in a bid package.
 - d) A requirement that a preference only be awarded to a small business, disabled veteran business, or social enterprise, as applicable, that performs a commercially useful function, as defined.
 - e) A policy regarding oversight and potential fraudulent behavior on the part of a contractor, subcontractor, or other individual for the purpose of qualifying for a preference.
 - f) If the local agency is authorized to offer and intends to implement a preference for social enterprise participation, a certification process for social enterprises, as defined.
 - g) A policy for determining whether a contractor has made a good faith effort, as specified.
 - h) Policy on how a prime contractor may substitute a subcontractor, as specified, including, but not limited to, a requirement that construction subcontractors be afforded all the protections of the Subletting and Subcontracting Fair Practices Act, as specified, and that substitution of a social enterprise or small business may only be made due to the subcontractor’s inability to execute the contract due to staffing or scheduling conflicts that have arisen since the submittal of the bid. All conditions qualifying the substitution are required to be verified with the subcontractor being replaced.
- 4) Designates DGS as the administrator of the state Small Business Procurement and Contract Act (Small Business Procurement Act), which includes certifying and implementing targeted preference programs for certified small businesses, microbusinesses, and disabled veteran business enterprises (DVBEs). For the purposes of state contracting, the following definitions apply:
 - a) A “small business” is an independently owned enterprise that is not dominant in its field of operation, is domiciled in California, has a principle office in California, employs 100 or fewer employees, and has average annual gross receipts of \$15 million or less over the previous three years.
 - b) A DVBE is a business certified as being a sole proprietorship, corporation, or partnership with its home office located in the U.S. and which is not a branch or subsidiary of a foreign corporation, foreign firm, or other foreign-based business. In addition, a DVBE meets all of the following:
 - i) The disabled veteran is a veteran of the military, naval, or air service of the U.S., including, but not limited to, the Philippine Commonwealth Army, the Regular Scouts, “Old Scouts,” the Special Philippine Scouts, “New Scouts,” and those who have at least a 10% service-connected disability and are domiciled in the state.

- ii) The management and control of the daily business operations are by one or more disabled veterans. The disabled veterans who exercise management and control are not required to be the same disabled veterans as the owners of the business.
- iii) The DVBE's ownership of the business meets the following criteria:
 - (1) If the DVBE is a sole proprietorship, it is at least 51% owned by one or more disabled veterans.
 - (2) If the DVBE is a publicly owned business, at least 51% of its stock is unconditionally owned by one or more disabled veterans.
 - (3) If the DVBE is a subsidiary, it is wholly owned by a parent corporation, but only if at least 51% of the voting stock of the parent corporation is unconditionally owned by one or more disabled veterans.
 - (4) If the DVBE is a joint venture, it is an entity in which at least 51% of the joint venture's management, control, and earnings are held by one or more disabled veterans.

FISCAL EFFECT: None

COMMENTS & CONTEXT:

- 1) **Expands on 2018 Legislation:** Legislation enacted last year, AB 2762 (Carrillo and Muratsuchi), Chapter 654, Statutes of 2018, established special procurement policies for local agencies in 11 of the state's 58 counties. When the measure passed the Assembly Jobs Committee, AB 2762 applied to all counties in the state. Senate committee amendments limited the bill to the 11 Bay Area counties and Los Angeles County, who was the sponsor of the bill. Repeated requests to the Chair of Senate Governance and Finance Committee to expand the number of counties authorized to use the enhanced provisions were denied.

AB 1533 expands the authority to use the special procurement provisions to San Joaquin County. More specifically, this bill authorizes the use of two additional preference categories and increases the value of the existing preferences for contract bids that include certified small businesses, disabled veteran businesses, and social enterprises.

In order to implement these new preferences and increased preference values, the bill requires the local agency to establish a targeted procurement policy that reflects best public procurement practices, including policies that:

- Address potentially fraudulent behavior on the part of a contractor, subcontractor, or other individual committed for the purpose of qualifying for a preference;
- Provide a process for determining whether a bidder has made a good faith effort to meet a procurement participation goal;
- Require that substitutions of subcontractors only occur in instances where the qualifying conditions have been verified by a local agency; and
- Require that any contractor or subcontractor that is used to meet a preference serves a commercially useful function, as defined.

- 2) **Growing Income Inequality:** While California’s dominance in innovation-based industries is unquestionable, the divide between the middle and lower income households and the top income earners is accelerating. Even as California’s unemployment is at historic lows, unemployment within certain geographic regions and population groups remains significantly higher, as does the number of people in the state who are not participating within the core economy.

According to the U.S. Census Bureau, California’s poverty rate is 14.3% as compared to a national rate of 13.4%. Using the federal Supplemental Poverty Measure, which accounts for geographic differences, transfer payments, and out-of-pocket expenses, 19% of California residents live in poverty, as compared to 14.1% nationally averaged from 2015 to 2017. Significant contributing factors to these poverty rates are education and basic skill deficits experienced by many Californians from rural and inner city areas and other historically underserved population groups, as well as those who are more recently encountering employment challenges, including returning veterans.

A review of the February 2019 unemployment numbers illustrates this expanding pattern of economic disparity between regions and population groups in California. **Chart 1 – Selected Data on Unemployment** shows unemployment-related information by selected counties and population groups.

Chart 1 – Selected Data on Unemployment					
	Unemployment Rate February 2019 (not seasonally adjusted)	Unemployment Rate February 2018 (not seasonally adjusted)		Unemployment Rate February 2019 (12-month moving average)	Unemployment Rate February 2018 (12-month moving average)
California	4.4%	4.6%	California	4.2%	4.7 %
Colusa County	20.5%	19.2%	Blacks	6.5%	6.8 %
Imperial County	17.4%	16.5%	Hispanics	5.1%	5.5%
Los Angeles County	4.2%	4.7%	Whites	4.1%	4.7 %
Riverside County	4.5%	4.6%	16 to 19 year olds	14.9%	17.3%
Sacramento County	4.1%	4.1%	20 to 24 year olds	7.4%	7.4 %
San Bernardino County	4.2%	4.3%	25 to 34 year olds	4.4%	5.0%
San Luis Obispo County	3.2%	3.2%	**The Employment Development Department reports a February 2019 labor participation rate (LPR) of 62.2%, representing 11.7 million people in California who were not participating in the workforce. The LPR for veterans is 44.9%, as opposed to a nonveterans LPR of 66.0%.		
San Mateo County	2.3%	2.4%			
Tulare County	11.3%	11.4%			

Source: www.edd.ca.gov

The data shows income disparities are increasing, which is impacting a range of economic and societal issues. California is not unique in experiencing a rise in income inequality. National data shows that while the top 1% of income households were significantly impacted by the recession, by 2017, annual revenues had risen to the highest levels ever. Between 1979 and 2017, the income for the top 1% of income households cumulatively rose by 157%.

In February 2019, California's seasonally adjusted unemployment rate was 4.2%. For comparison purposes, Chart 1 uses data not seasonally adjusted for county and uses a 12-month moving average for demographic data. While the state's not seasonally adjusted unemployment rate for February 2019 was 4.4%, some areas of the state had lower rates and others had considerably higher. San Mateo County recorded the lowest at 2.3%, while Colusa County experienced the highest unemployment rate at 20.5% and Imperial County the second highest at 17.4%. Under the provisions of the federal Workforce Innovation and Opportunity Act, an area of substantial unemployment is considered any contiguous area within a state with an unemployment rate above 6.5%. California had 23 counties which experienced unemployment rates at or above 6.5% in February 2019. There were four counties, all in the Bay Area, with unemployment rates below 3%.

Looking more specifically at different population groups, the data also shows the disparities between the statewide rate of 4.2% and the rates of key subgroups, including unemployment among Blacks and Hispanics being 6.5% and 5.1% respectively. For the youngest members of the workforce, obtaining quality jobs remains a significant issue, with unemployment among 16 to 19 year olds and 20 to 24 year olds being well above the state average, ranging from 14.9% to 7.4% respectively. According to the February 2019 figures, 11.7 million people in California are not participating in the labor force, an increase of 29,000 individuals during a 12-month period.

- 3) **The Role of Small Businesses within the California Economy:** California's dominance in many economic areas is based, in part, on the significant role small businesses play in the state's \$2.7 trillion economy. Two separate studies, one by the U.S. Census Bureau and another by the Kaufman Foundation, found that net job growth was strongest among businesses with less than 20 employees. Among other advantages, small businesses are crucial in the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy.

In 2016 (most recent data), of the 4.2 million establishments in California, there were 3.2 million nonemployer establishments as compared to 922,000 employer establishments. The top three industry sectors with the largest number of nonemployer sole proprietorships included professional, scientific, and technical services (507,000 establishments); transportation and warehousing (297,000); and real estate and rentals (271,000). Total establishments revenues for nonemployer sole proprietorships, across all industry sectors, were \$113 billion in receipts in 2016. As these non-employer businesses grow, they continue to serve as an important component of California's dynamic economy.

Excluding sole proprietorships, businesses with less than 20 employees comprise over 88.3% of all businesses and employ approximately 18.2% of all workers. Businesses with less than 100 employees represent 97.3% of all businesses and employ 35.8% of the workforce. These non-employer and small employer firms create jobs, generate taxes, support important industry sectors, and revitalize communities. Since the recession, these businesses have become increasingly important because they are more flexible and well-suited to meet niche foreign and domestic market needs.

However, their small size also results in certain market challenges, including having difficulty in meeting the procedural requirements of the state's complex regulatory structure and the traditional credit and collateral requirements of mainstream financial institutions. Specialized technical assistance, access to credit enhancements, and targeting of state procurement activities help many small businesses overcome or at least minimize these difficulties.

- 4) **Small Business Procurement and Contract Act:** California has a 40 year history of utilizing state contracting to support business development within targeted business populations. Statute sets an annual 3% DVBE procurement participation goal, and a 2006 executive order sets a 25% small business and microbusiness participation goal for state agencies, departments, boards, and commissions.

While encouraging small business participation furthers the state's interest in having a robust small business sector, the Small Business Procurement and Contract Act also establishes the policy foundation for DVBE contract participation. The DVBE procurement program is intended to both recognize the sacrifices of California's disabled military veterans, as well as address the unique needs of disabled veterans seeking rehabilitation and training through entrepreneurship.

To assist state agencies in reaching these targeted procurement participation goals, state law authorizes a procurement preference for bids using a certified small business or DVBE as a prime or subcontractor and a streamlined alternative procurement process for smaller size contracts (between \$5,000 and \$250,000) whereby an awarding department can contract directly with a certified small business or DVBE after comparing the bid against two other similar businesses.

The state also administers a DVBE incentive which allows an awarding department to set an incentive percentage for a particular transaction based upon the department's business strategy to achieve their annual 3% DVBE procurement participation goal. Awarding departments are also required to recognize a 5% preference in cases where a bid includes a certified small business.

Similar to the procurement laws state agencies follow, local agencies are also authorized to offer procurement preferences, including preferences of up to 7% or \$150,000 for contracts which have small business or disabled veteran business participation. As noted in a prior comment, some local agencies have authority to offer higher value preferences, allow more than one preference in a single bid package, and include preferences for additional types of businesses and organizations. In the state's experience, a majority of DVBEs are smaller size firms, with 75.4% having dual certifications as a DVBE and microbusiness and 9.6% having dual certifications as a DVBE and small business. The remaining 15% of DVBEs operate with only a single DVBE certification.

- 5) **New Forms of Business:** Demographic and economic shifts are giving rise to new forms of business development and new types of working relationships between owners, employees, contractors, and other businesses. AB 1533 proposes to expand the authority for local agencies to set procurement participation goals and offer financial preferences for bids to those that include a social enterprise. The following is some preliminary research on this emerging form of "business."

Among other models, the social enterprise model combines entrepreneurial activity with a social purpose. Because they prioritize social impact over the need to maximize profit for owners or shareholders, a growing number of public entities are looking into how the model could be used in their communities to tackle what had previously been considered intractable problems.

To date, much of the work has been at the pilot level, but outcomes seem to be promising. One study by Mathematica, a U.S. based research firm, looked at the outcomes from seven social enterprise programs assisting 282 workers. As part of the same study, Mathematica also undertook a comparative analysis of workforce outcomes for 154 social enterprise workers and 37 eligible workers who were not hired at a social enterprise. According to the report, the results suggest that “social enterprises may help workers gain employment and move toward economic self-sufficiency and life stability; however, the impact-study results are inconclusive, in part because of the small samples.”

Another recent study by Social Ventures in Australia found that social enterprises have demonstrated that they can create jobs for people excluded from the mainstream workforce, particularly the long-term unemployed, and showed that this equity outcome is also efficient, as government investment in the creation of businesses is returned via taxation revenue and savings in social security expenditure. These findings are similar to the Mathematica study, which also found that the percentage of total income from government transfers decreased from 71% to 24% and that total monthly income for the workers increased by 91%.

The European Union regularly measures the economic impact of this evolving area of businesses' development and reports that the "social economy" employs over 11 million people in the EU, accounting for 6% of total employment.

6) **Related Legislation:** Below is a list of related legislation.

- a) **AB 415 (Chiu) Employment Social Enterprise:** This bill authorizes the California Department of Social Services to contract with employment social enterprises to provide CalFresh Employment and Training services. The bill also authorizes a county to contract with an employment social enterprise and designated intermediary to provide services to its CalFresh Employment and Training Program participants. Status: Signed by the Governor, Chapter 340, Statutes of 2017.
- b) **AB 1084 (Wesson) Small Businesses and Microbusinesses:** This bill establishes a subcategory of small businesses called microbusinesses and establishes a 5% small business preference for state and local agencies. The bill also allows for a non-small business to receive the preference when subcontracting to small businesses, as specified. Status: Signed by the Governor, Chapter 882, Statutes of 2001.
- c) **AB 1125 (Weber) Small Business Preference:** This bill would have increased the maximum financial value of an individual bid preference from \$50,000 to \$100,000 and increased the maximum value of multiple preferences from \$100,000 to \$150,000. Status: Held in the Senate Committee on Appropriations, 2015.
- d) **AB 1783 (Perea) State Certified Small Businesses and Local Contracting:** This bill aligns local agency procurement programs with the state's certified small business program in order to ensure that small businesses that were currently certified by the state to do contracting would be assured of being eligible to engage in procurement activities with local agencies. Status: Signed by the Governor, Chapter 114, Statutes of 2012.
- e) **AB 2726 (Carrillo and Muratsuchi) Enhanced Local Procurement:** This bill increases the maximum value of a small business procurement preference used by a local agency when awarding a contract based on the lowest responsible bidder from 5% to 7% and sets a maximum financial value of \$150,000, as specified. In addition, the bill authorizes, effective January 1, 2019, through January 1, 2024, a specified local agency to establish a disabled veteran business preference and a social enterprise preference for use in a public contract awarded to the lowest

responsible bidder. When more than one preference is applied to a bid package, the bill sets a maximum percentage value of multiple preferences at no more than 15% of the lowest responsible bidder and a maximum financial value of multiple preferences at no more than \$200,000. These provisions only apply to a public contract awarded by a local agency within Los Angeles County and the Bay Area, as specified. Status: Signed by the Governor, Chapter 654, Statutes of 2018.

- f) **AB 2022 (Medina) Target Area Contract Preference Act:** This bill modifies the Target Area Contract Preference Act by redefining what qualifies as an economically distressed area. Specifically, a "distressed area" is in the top quartile of census tracts for having the highest unemployment and poverty in the state as determined by the Department of Finance. Status: Signed by the Governor, Chapter 780, Statutes of 2014.
- g) **SB 21 (Evan) Eliminates Good Faith Effort:** This bill requires awarding departments to award contracts to the lowest responsible bidder meeting specific statewide goals for disabled veteran business enterprise participation, instead of only requiring awarding department to make a good faith effort to do so. The bill also requires state agencies to report to DGS and the Legislature on the impacts upon outreach efforts and the actual awarding of contracts to bidders meeting the statewide participation goals following the elimination of the demonstration of good faith effort as a means to meet state DVBE contracting goals. Status: Signed by the Governor, Chapter 19, Statutes of 2009, Fourth Extraordinary Session.
- h) **SB 1219 (Hancock) Social Enterprise Preference:** This bill would have authorized a 5% employment social enterprise preference for bid packages applying for a state contract, including a contract with the California State University. This is an identical provision to the small business and microbusiness preference: a single preference which may not exceed \$50,000, or, when added to other preferences, the total value cannot exceed \$100,000. Status: Vetoed by the Governor in 2016. The Governor's veto message stated: "*SB 1219 establishes a new procurement preference for employment social enterprises. While the goal of these bills are well-intentioned, the implementation of these bills require an expensive modification to FISCAL at a time when the state must focus its resources on the project's successful deployment.*"

REGISTERED SUPPORT / OPPOSITION:

Support

City of Stockton
Ready to Work

Opposition

None on File

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