

Date of Hearing: April 22, 2014

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT AND THE ECONOMY

Jose Medina, Chair

AB 1734 (Jones-Sawyer) – As Introduced: February 14, 2014

SUBJECT: Public contracts: small business participation: disabled veterans

SUMMARY: Requires each state agency to establish and achieve a 25% small business participation goal and increases the annual procurement participation goal for disabled veteran business enterprise (DVBEs) from 3% to 5% of the total value of state contracts. Specifically, this bill:

- 1) Increases the DVBE procurement participation goal from 3% to 5%. This includes contracts for goods, services, professional bond services, equipment rentals, construction, professional services, alterations, repairs or improvements, general public advertising, and electronic data processing.
- 2) Requires all state agencies, boards, departments, and commissions to establish and achieve an annual goal of 25% small business participation. Heads of these state agencies are responsible for meeting this goal and reporting his or her agency's progress in meeting the goal.
- 3) Requires agencies that fail to meet their annual small business goal to submit a corrective plan to the Department of General Services (DGS) within 45 days of the close of any fiscal year.
- 4) Requires DGS to regularly monitor the progress agencies are making in meeting the 25% goal and to regularly share related information with the Office of the Small Business Advocate (OSBA) including providing a copy of the corrective action plans. DGS and the OSBA are directed to assist agencies, to the extent feasible, in implementing their corrective action plans.
- 5) Requires all state agencies to use the Small Business and DVBE 5% preferences for contracts under \$100,000 and construction contracts under \$120,000.
- 6) Requires DGS to actively outreach and promote the small business preference program and in doing so collaborate with the OSBA.
- 7) Specifies that the small business provisions of this act apply to the University of California, the California State University, and the California Community Colleges when contracting with state funds.

EXISTING LAW

- 1) Establishes the California Disabled Veteran Business Enterprise Program, administered by DGS, for the purpose of addressing the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices California's disabled veterans made during their military service. Contracts for professional bond services are administered through the State Treasurer's Office.
- 2) Applies the 3% DVBE participation goal on each awarding state agency, department, and officer that enters into a contract for materials, supplies, equipment, alteration, repair, or improvement. This requirement can be waived on a specific contract with the approval of the department director or another designated person. Contracts with a DVBE for equipment rentals do not count toward the goal.

- 3) Defines the following terms:
- a) A DVBE contractor, subcontractor, or supplier is any person or entity that has been certified by the administering agency and that performs a commercially useful function, as defined.
 - b) A disabled veteran is a veteran of the military, naval, or air service of the U.S. who has a service-connected disability of at least 10% and who is domiciled in the state.
 - c) A DVBE is a business certified by the administering agency as meeting all of the following requirements:
 - i) The legal structure of the business is a:
 - (1) Sole proprietorship with at least 51% owned by one or more disabled veterans;
 - (2) Publicly owned business with at least 51% of its stock unconditionally owned by one or more disabled veterans;
 - (3) Subsidiary that 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; or
 - (4) Joint venture in which at least 51% of the joint venture's management, control, and earnings are held by one or more disabled veterans.
 - 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) It has a home office located in the United States, which is not a branch or subsidiary of a foreign corporation, foreign firm, or other foreign-based business.
- 4) Requires an awarding state department to require a prime contractor that had committed to using a DVBE to certify upon completion of the contract:
- a) The total amount the prime contractor received under the contract.
 - b) The name and address of the DVBE that participated in the performance of the contract.
 - c) The amount each DVBE received from the prime contractor.
 - d) That all payments under the contract have been made to the DVBE.
- 5) Provides that a person or entity that knowingly provides false information shall be subject to a civil penalty for each violation in the minimum amount of \$2,500 and the maximum amount of \$25,000.

FISCAL EFFECT: Unknown

COMMENTS:

- 1) Author's Purpose: According to the author, "Governors Gray Davis and Arnold Schwarzenegger, in 2001 and 2006, respectively, each signed an executive order requiring all departments, agencies and commissions to establish and achieve a 25% small businesses participation rate in state procurement contracts. Unfortunately, the state has only met this target three times despite the importance small businesses play in the state's economy. Businesses with less than 100 employees comprise more than 98.3% of all California businesses, and are responsible for employing more than 57.9% of all workers in the state. Codifying this executive order, not only places the policy in statute, only to be removed by

the Legislature, but also sends a strong message to potential investors that the State of California supports small businesses.

Created in 1989, the DVBE program grants preference within the state's procurement process to businesses owned by disabled veterans. According to DGS, there are currently 1,400 certified DVBE businesses within the state. Current law requires that 3% of all state contracts go to DVBEs. Between 2009-2012, the program has exceeded expectations with participation rates of 3.78%, 4.82% and 4.67%. Increasing the rate can provide significant economic support to businesses owned by disabled veterans."

- 2) Framing the Policy Issue: Small businesses play an essential role within the California economy, contributing the most net new jobs, offering an alternative to un- and underemployment, and helping to disburse the financial advantages of the state's globally connected economy. In recognition of the sacrifices already made by California's disabled veteran community and the important economic role of small businesses, state agencies are mandated to take certain actions to include these two groups in state procurement opportunities. Unfortunately, participation rates have not been as high as desired with state agencies meeting the 25% small business procurement goal and DVBE 3% goal only four times in the last 11 years.

This bill takes a multifaceted approach to addressing the long standing challenges of small business and DVBE procurement participation including codifying the 25% small business goal and increasing the DVBE goal from 3% to 5%. These provisions have been included in one or more pieces of prior legislation, which have almost universally died in the legislative fiscal committees. New evidence that the existing programs need improvement was released by the State Auditor in February 2014, which may offer an even stronger case for the fiscal committees. This analysis includes information on the state's DVBE program, historic compliance issues, current and prior legislation, and the recently completed state audit of the DVBE program. Comment 8 includes amendment recommendations.

- 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 trillion economy. Among other advantages, small businesses are crucial to the state's international competitiveness and are an important means for dispersing the positive economic impacts of trade within the California economy. California small businesses comprised 96% of the state's 60,000 exporters in 2009, which accounted for over 44% of total exports in the state. Nationally, small businesses represented only 31.9% of total exports. These numbers include the export of only goods and not services.

Businesses with no employees make up the single largest component of businesses in California, 2.8 million out of an estimated 3.5 million firms in 2010. As these businesses grow, they continue to serve as an important component of California's dynamic \$2 trillion economy. Microenterprises, meaning businesses with less than five employees represent approximately 93% of all businesses in the state, or approximately 3.2 million of all businesses. Businesses with 99 or less employees comprise nearly 98% of all businesses and employ approximately 38% of all workers. These non-employer and small employer firms create jobs, generate taxes, and revitalize communities.

In hard economic times, smaller size businesses often function as economic engines. In this most recent recession the trend continued, with the number of nonemployer firms increasing from 2.6 million firms (\$137 billion in revenues) for 2008 to 2.8 million firms (\$138 billion in revenues) for 2010. In

the post-recession economy, small businesses are expected to become increasingly important due to their ability to be more flexible and better suited to meet niche market needs.

Their small size, however, results in certain challenges in meeting regulatory requirements, accessing capital, and marketing their goods and services. California's network of SBDCs provide small size businesses, including business start-ups, with access to quality education, one-on-one counseling, and other business development resources.

- 4) Small Business Procurement Act: The Small Business Procurement Act, administered through DGS, was implemented more than 30 years ago to establish a small business preference within the state's procurement process that would increase the number of contracts between the state and small businesses. A DBVE component was added in 1989.

The Small Business Procurement Act states that it is the policy of the State of California that the state aid the interests of small businesses in order to preserve free competitive enterprise and to ensure that a fair portion of the total purchases and contracts of the state be placed with these enterprises. The statute further states that DVBE participation is strongly encouraged to address the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices of California's disabled military veterans. Statute sets an annual 3% DVBE participation goal, and a 25% goal for small and microbusinesses (through executive order).

Unfortunately, participation rates have not been as high as desired, with state agencies meeting the 25% small business goal and DVBE 3% goal, in only four out of the last 11 years. In the most recent report on procurement, 2011-12, DGS reported that the state had entered into \$7.4 billion in contracts with \$1.8 billion (24.16%) being awarded to small businesses and \$337 million (4.67%) to DVBEs.

- 5) Challenges in meeting Procurement Goals: If small businesses (over 85% of DVBEs are small businesses) are so important to the California economy, why has it been so hard for state agencies to meet the small business and DVBE procurement goals? Every year, Members craft a range of bills to improve outreach, increase preferences, and use their bully pulpit to help increase small business and DVBE participation rates. Over the years, direct and innovative approaches have been added including mandating small business and DVBE liaisons at every agency, establishing official state-level Small Business and DVBE Advocates, and requiring the state join a national on-line contracting platform (BidSync).

The 2011-12 Statewide Consolidated Annual Report offers some interesting insights. As an example, only 86% of the mandatory reporting entities actually reported their contracting activity to DGS. Of those that did report: mandatory reporters awarded 24.16% of their contracts to small business (failed to meet the goal) and 4.67% to DVBEs (met the goal).

The DGS report suggests that part of the challenge in increasing small business and DVBE participation lies with helping the state's largest contracting agencies have more outreach and be more effective. In 2011-12, 62% of all state contracts were awarded by the Department of Corrections (SDCR), the Department of Transportation, the Franchise Tax Board, and the Department of Health Care Services (DHCS). The top 10 agencies were awarded 80% of all contracts by dollar amount. This means that regardless of the efforts of the Department of Education (76.23%) and Labor and Workforce Agency (40.59%), the state's largest contracting entities must do a better job in contracting with small and microbusiness if the state is going to reach its goal. The chart below shows the top 10 contracting departments.

Top 10 Contracting Agencies in 2011-12				
Departments	Total Contact Dollars	Percentage of Statewide Spending	Small Business and Microbusiness Participation Percentage	DVBE Participation Percentage
All Mandatory Reporters	\$7,434,297,407		24.16%	4.67%
Corrections and Rehabilitation	1,960,625,290	26%	22.34%	5.32%
Transportation	1,872,767,028	25%	23.53%	4.04%
Franchise Tax Board	442,705,911	6%	21.11%	4.57%
Health Care Services	397,931,111	5%	5.41%	0.97%
State Hospitals	320,585,676	4%	36.27%	4.46%
Water Resources	295,652,449	4%	29.26%	8.98%
Finance (primarily the FISCAL)	217,578,977	3%	26.06%	5.48%
General Services	187,246,007	3%	38.54%	9.64%
Parks and Recreation	163,909,725	2%	36.06%	2.82%
Motor Vehicles	116,203,306	2%	24.46%	5.97%
Top 10 Total	\$5,975,205,480		23.65%	3.7%

Source: 2011-12 Statewide Consolidated Annual Report prepared by DGS

According to DGS, the state's inability to reach its procurement goal in 2011-12 is directly attributable to DHCS' poor performance. In the report year, DHCS issued a multiyear contract for Medi-Cal Dental Services worth \$300 million per year without any small business or DVBE participation. Had they met their small business goals on this one contract, DHCS would have had a 21% small business participation rate, instead of the reported 5%. DGS suggests that DHCS focus on certifying the individual dentists that will be subcontracting under the master Delta Dental contract, otherwise this single contract will continue to hold down the state's overall participation rates for years to come.

In contrast to DHCS, the SDCR committed to small businesses participation in its largest size contracts including its \$225 million bulk pharmaceutical purchase, which allowed the department to increase its small business participation by 4.25% over the prior year (18.09% v. 22.34%). AB 1734 places greater administrative oversight on the performance of poor performing agencies by requiring mitigation plan was departments that fail to meet their 25% goal. Further, state agencies would have greater pressure to include DVBE participation in every contract with the 5% DVBE goal.

- 6) The DVBE Program: Existing law sets a 3% DVBE participation goal in recognition of veterans' contribution and service to the county. The goal is applied to the state agency or department's overall contracting activities in the given fiscal year and may be achieved by awarding state contracts to DVBEs as prime contractors or when DVBEs are subcontractors on a state contract.

Awarding departments have an option of including DVBE participation in every contract or making alternative arrangements, as long as the 3% objective is met at the end of the year. Each agency and department is required to designate a small business and DVBE contracting liaison to facilitate it in meeting the 3% DVBE goal and the 25% small business goal. Departments also have the option of offering a 1% to 5% DVBE contracting preference to assist bidders in helping to meet the state DVBE goal. Bidders that are unable or unwilling to include a DVBE in a contract have the option of submitting a DGS approved utilization plan, that commits the businesses to using DVBEs in the future. DGS is authorized to audit businesses that submit utilization plans to ensure compliance.

State departments that fail to meet the annual 3% goal can have their delegated contracting authority removed, although DGS has never removed program authority solely based on an agency or department's failure to meet its DVBE contracting goal. DGS' responsibilities for the DVBE program include:

- Certifying DVBEs (1,300 certified DVBEs);
- Performing outreach to the potential bidders and the veteran community (over 100 events in FY 2012-13);
- Marketing the DVBE program to state agencies;
- Consulting with the California Procurement Contracting Academy on the DVBE training of state contracting staff;
- Preparing an annual report on DVBE participation within state contracting activities; and
- Looking into program abuse by bidders and failure to preform by state agencies.

- 7) Concerns with DVBE Program: As noted above, the state has only met its DVBE participation goal 4 times in 11 years, however the state has met its goal in each of the last three years. In addition to the challenges in meeting the goal, significant issues have been raised relative to the accuracy of the reporting data and on fraudulent bidder practices. In the past several years, the Committee has repeatedly heard from veteran groups about bidders that fail to follow-through on the DVBE commitments made in bid proposals, bidders that use DVBEs but haven't renewed their certification, and of DVBEs being included within bid proposals, but never actually performing a commercially useful function. Some of these program concerns have been addressed in recent legislation which increased penalties and heighten some areas of DVBE program oversight, including AB 177 (Ruskin and V. Manuel Pérez) Chapter 342, Statutes of 2010 and SB 1510 (Wright), Chapter 421, Statutes of 2012, respectively. A longer list of related bills is included later in the analysis.

Other concerns, such as poor reporting of data, lack of enforcement tools, and challenges to increasing the number of certified DVBEs have not been addressed. Responding to these and other issues, Senator Hueso, Chair of the Senate Committee on Veterans Affairs, and Senator Calderon, requested the Joint Legislative Audit Committee in May 2013 to approve a comprehensive review of the DVBE program by the California State Auditor. The audit was released in February 2014 and among other findings, the State Auditor found the following:

- a) The objective of the program "to increase DVBE participation in state procurement," is not appropriately being measured through the current reporting system. The system measures the award value and the actual amount DVBEs' receive.
- b) Only a small percentage of certified DVBEs serve as prime contractors. As an example, only 19% of certified DVBEs served as primes and, of those, 30 firms received 83% funding.
- c) There is inadequate documentation by state contracting agencies on DVBE participation.
- d) Reporting methodologies differ by state agencies on DVBE participation.
- e) DGS has inadequate control over the state's procurement vendor, Bidsync.
- f) CalVet needs to take a more active role in working with state agencies and tracking outreach activities.

Based on these findings, the Auditor recommended key actions for the Legislature, DGS, and CalVet. These recommendations focus on better and more consistent reporting including: verification of DVBE status before finalizing the contract, increasing the number of DVBEs that participate in state

contracting, better management of state vendor, and a heightened role and accountability for CalVet. SB 839 (Correa) was amended in March to include proposed remedies to the reporting and certification issues. This bill, AB 1734, addresses the issue of how to increase DVBE participation in state contracting.

- 8) Amendments: Committee staff have been working with the author on amendments to address concerns raised in the state audit and not currently addressed in other legislation. Staff understands that the following amendments will be presented in committee:
- a) Require state agencies with contracts over \$100 million be certified by DGS, prior to the issuance of the bid request, that the agency has met their DVBE participation goals in two of the last three years including the prior year and that the agency will likely meet their DVBE goal in the current year.
 - b) Phase-in the increase in DVBE participation using the following schedule: 3% in 2013-14 to 3.5% in 2014-15, and 4% in 2015-16, and 4.5% in 2016-17, and 5% in 2017-18 and thereafter.
 - c) Require DGS to report on the use of utilization plans as an alternative to using DVBE as a prime or subcontractor.
 - d) Require DGS to modify the existing DVBE incentive program to provide for a higher incentive when the bid comes from a DVBE than from a non-DVBE prime that commits to using a DVBE subcontractor.
 - e) Update the CalVet tracking requirements by requiring that the list of attending at promotion events be annually compared to new DVBE certifications and DVBE prime and subcontract lists.
 - f) Add specificity to the role of the California DBVE Program Advocate.
 - g) Require department-level DVBE liaisons track the impact of their promotional events.
 - h) Make other technical and implementing changes.
- 9) Related Legislation: Below is a list of related measures including those from the current session and prior sessions.
- a) Bills introduced in the 2013-14 Legislative Session:
 - i) *AB 172 (Weber) State Agency Contracts and Microbusiness Preference*: This bill would have created the microbusiness procurement preference from 5% to 7% for state contracts to purchase goods, services, information technology, and construction of state facilities. The preference may be awarded to either a microbusiness bidder or a non-microbusiness bidder that uses a microbusiness subcontractor. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2013.
 - ii) *AB 550 (Brown) Office of Small Business and Disabled Veteran Business Enterprise Services*: This bill would have codified the 25% small business participation goal in state procurement, which was initially set through Executive Order (EO) D-37-01 and EO S-02-06. The bill also would have made key changes to state procurement procedures for the purpose of increasing small business, including microbusiness, and disabled veteran-owned business enterprise participation rates. Status: Held on the Suspense File of the Assembly Committee on Appropriations, 2013.

- iii) *AB 1568 (Grove) Small Business and DVBE Option*: This bill increases the number of quotes from two to three before a state agency can enter into a non-bid contract under \$250,000. Status: Pending in the Assembly Committee on Appropriations.
 - iv) *SB 276 (Roth) Streamline Contract Maximum Value*: This bill modified the Small Business Procurement and Contract Act by increasing the upper limit (from \$250,000 to \$500,000) of the value of certain contracts that a state agency may award to a certified small business, including a microbusiness, or to a DVBE without complying with specified competitive bidding requirements. Status: Held in the Senate Committee on Appropriations, 2013.
 - v) *SB 733 (Block) Disabled Veteran Business Enterprise Participation Goals*: This bill deletes provisions of law allowing an awarding department to accept submission of a disabled veteran business enterprise utilization plan to meet the 3% statewide participation goal for awarded contracts. The bill authorizes, instead, a new review process for demonstrating a business' long-term commitment to using veteran-owned businesses. Status: Pending in the Assembly Committee on Jobs, Economic Development, and the Economy.
 - vi) *SB 839 (Correa) DVBE Program Improvements*: This bill makes changes to the reporting, documentation and oversight of state contracts that include DVBE participation. Status: Pending in Assembly Committee on Government Organization.
- b) Bills introduced in a prior legislative sessions:
- i) *AB 31 (Price) Public Contracts: Small Business Procurement and Contract Act*: This bill increased the maximum contract threshold amount for awards to small business (SME), including microbusiness, and DVBEs under the states streamlined procurement process, from \$100,000 to \$250,000, as specified. This bill requires contractors to report the contract amount allocated to SMEs and DVBE 's with which they made contract commitments. Status: The bill was signed by the Governor, Chapter 212, Statutes of 2009.
 - ii) *AB 177 (Ruskin and V. Manuel Pérez) Enforcement of Small Business Act*: This bill increases and conforms penalties for persons who falsely engage in activities relating to the Small Business Procurement and Contract Act, including small businesses, microbusinesses, and disabled veteran-owned business enterprises. Status: The bill was signed by the Governor, Chapter 342, Statutes of 2010.
 - iii) *AB 309 (Price) Public Contracts: Small Business Participation*: This bill would have required the establishment of a 25% small business participation goal for all state entities and directs DGS to monitor each agency's progress in meeting this goal. The bill would have required that the Office of the Small Business Advocate receive the same progress report information as state entities and directs DGS and the Office of the Small Business Advocate to work collaboratively to assist state entities in meeting their goal. This goal is currently provided for in Executive Order (EO) D-37-01 and EO S-02-06. Status: Held in the Assembly Committee on Appropriations in May 2010.
 - iv) *AB 2249 (Ruskin) DVBE Documentation*: This bill requires applicants for small business or DVBE certification to submit a written declaration, under penalty of perjury, that the information submitted to DGS is true and correct. The bill also authorizes DGS, if it determines that just cause exists, to require the owner of a DVBE or small business to submit the Internal

Revenue Service Form 4506-T which would allow DGS to obtain a copy of their tax return. Finally, the bill requires that at least 51% of the stock or voting stock of a disabled veteran business enterprise be unconditionally owned by disabled veterans. Status: Signed by the Governor, Chapter 383, Statutes of 2010.

- v) *SB 67 (Price) Small Business Participation in Public Contracts*: This bill would have authorized DGS to direct all state entities to establish an annual goal of achieving no less than 25% small business participation in state procurement contracts, as specified. Status: Held in the Assembly Committee on Appropriations in 2011.

 - vi) *SB 733 (Price) High Speed Rail*: This bill would have required the California High-Speed Rail Authority (HSRA) to include in its January 1, 2012 business plan a strategy for ensuring California-certified small business participation in contracts awarded with state and federal funds during all phases of the high-speed rail project. It also would have required the HSRA to have a strategy for working with the Employment Development Department to ensure that at least 25% of the project workforce at each worksite is from the local workforce. Status: Held in Senate Committee on Appropriations in 2011.

 - vii) *AB 941 (Florez) DVBE Advocates*: This bill requires the Department of Veteran's Affairs and awarding departments to appoint DVBE advocates to assist in meeting participation goals. Status: Signed by the Governor, Chapter 666, Statutes of 2002.

 - viii) *SB 1510 (Wright) Commercial Useful Purpose*: This bill tightens the bidder requirements for demonstrating that a small business, microbusiness, or DVBE will serve a commercially useful function (CUF) in carrying out a state contract. The purpose of the CUF requirement is to prevent a bidder from using a business as a "pass through" or "front" for another business that would otherwise not qualify for the small business, microbusiness or DVBE bid preference. By meeting the CUF requirements, a bidder may claim a bid preference on competitive state contract awards goods, services, informational technology and public works. Status: The bill was signed by the Governor, Chapter 421, Statutes of 2012.
- 9) Double Referral: This measure has been referred to two policy committees by the Assembly Committee on Rules. Should AB 1734 pass this committee, the measure will be referred to the Assembly Committee on Accountability and Administrative Review.

REGISTERED SUPPORT / OPPOSITION:

Support

CalAsian Chamber of Commerce
Coalition of Small and Disabled Veteran
Businesses
Disabled Veteran Business Enterprise Alliance

National Federation of Independent Business
Small Business California
The American Federation of State, County, and
Municipal Employees

Opposition

None received