

Date of Hearing: July 11, 2017

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

SB 605 (Galgiani) – As Amended May 26, 2017

SENATE VOTE: 39-0

SUBJECT: Small Business Procurement and Contract Act: small business

SUMMARY: Expands the number of businesses which can utilize the special provisions in the Small Business Procurement and Contract Act when bidding on a state contract. The bill creates a new category of certified small business for public works contracts, and increases the maximum revenue limits on the existing definition of certified small business and microbusiness. Specifically, **this bill:**

- 1) Makes Legislative findings and declarations, including, but not limited to:
 - a) It is the policy of the state to aid the interests of small business enterprises in order to preserve reasonable and just prices and free competitive enterprise, to ensure that a fair proportion of the total purchases and contracts or subcontracts for commodities, supplies, technology, property, and services, including, but not limited to, renewable energy, wireless telecommunications, broadband, smart grid, rail, and other mega infrastructure projects, for regulated state departments are awarded to small business enterprises, and to maintain and strengthen the overall economy of the state.
 - b) The opportunity for full participation in our free enterprise system by small business enterprises is essential if this state is to attain social and economic equality for those businesses and improve the functioning of the state economy.
 - c) State agencies that have established small business contracting goals are awarding less than 25 percent of their mandated goals. Small business enterprises have traditionally received less than their proportional share of public entity procurement contracts, especially in renewable energy, wireless telecommunications, broadband, smart grid, rail, and other mega infrastructure projects.
 - d) It is in the interest of the state to expeditiously improve the economically disadvantaged position of small business owners and employees.
 - e) The position of small business enterprises can be substantially improved by expanding the definition of a small business that would allow these businesses to amass the capital and expertise necessary to compete for state procurement of technology, equipment, supplies, services, materials, and construction work, especially in renewable energy, wireless telecommunications, broadband, smart grid, rail, and other mega infrastructure projects.
 - f) This expansion also benefits the state departments and consumers of the state by encouraging the expansion of the number of small business enterprise suppliers for procurements, thereby encouraging competition among suppliers and promoting economic efficiency in the process.
- 2) Commencing with January 1, 2019, increases the average annual gross revenue limit for businesses eligible for state small business procurement benefits and incentives, as follows:
 - a) The revenue cap for small businesses is increased from \$10 million to \$15 million; and
 - b) The revenue cap for microbusinesses is increased from \$2.5 million to \$5 million.

- 2) Commencing on January 1, 2019, establishes a new category of small business for the purpose of state public works contracts, including the erection, construction, alteration, repair, or improvement of any kind, upon real property, as specified. The new category of small business is identical to the existing category, except that the business may employ up to 200 employees and have average annual gross receipts of up to \$36 million over the preceding three years.
- 3) Effective January 1, 2018, through December 31, 2018, mandates the Department of General Services (DGS) to conduct a biennial review of the average annual gross receipts of small businesses undertaking state contracting activities, as specified. DGS is then authorized to adjust the average annual gross receipt levels to reflect the changes in the California Consumer Price Index (CPI).
- 4) Commencing January 1, 2019, requires DGS to conduct a biennial review and make necessary adjustments to the maximum gross receipts based on the CPI.

EXISTING LAW:

- 1) 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 owned business enterprises (DVBE).
- 2) Authorizes a 5% preference for state contract bidders that are either a certified small business, microbusiness, or a noncertified business that commits to using a certified small business or microbusiness in undertaking the contract. This 5% is calculated based on the bid of the lowest responsible bidder.
- 3) Authorizes a streamlined small business procurement option for state contracts over \$50,000 and under \$250,000. Under this process, the contract is not put out to public bid, instead the contracting agency is allowed to award the contract to a certified small business after obtaining two price quotes from two certified small businesses. Similar provisions may be used for contracting with a certified DVBE and obtaining two price quotes from certified DVBEs.
- 4) Sets a 30% small business participation goal for state contract dollars used to complete the state's High Speed Rail project, including certified small businesses, DVBEs, and disadvantaged business enterprises (federal target category).
- 5) Provides the following definitions:
 - a) A "small business" as independently owned, not dominant in its field of operation, domiciled in California, having a principle office in California, employing 100 or fewer employees, and having average annual gross receipts of \$10 million or less over the previous three years.
 - b) A small business "manufacturer" as a small business (refer to definition above) that is also primarily engaged in the chemical or mechanical transformation of raw materials or processed substances into new products and is classified within the 31000 to 33000 codes of the North American Industry Classification System.
 - c) A "microbusiness" as a small business (refer to definition above) that has average annual gross receipts of \$3.5 million or less during the previous three years or is a manufacturer with 25 or fewer employees.

- d) A "DVBE" as an enterprise that is at least 51% owned by one or more disabled veterans and the daily business operations are managed and controlled by one or more disabled veterans. For certification purposes a "disabled veteran" is a veteran of the U.S. military, naval, or air service who resides in California and has a service-connected disability of at least 10% or more.
- 6) Requires DGS to conduct a biennial review of the average annual gross receipt levels of small businesses engaged in state bidding practices and authorizes the department to adjust these levels to reflect changes in the California Consumer Price Index (CPI). To reflect unique variations or characteristics of different industries, the director may establish, to the extent necessary, either higher or lower qualifying standards than those specified in statute (described in number 5 above), or alternative standards based on other applicable criteria.

FISCAL EFFECT: Unknown

POLICY FRAME:

Over the next five years, the state is anticipated to initiate over \$50 billion in construction projects related to transportation and community services including health care, water, education, courts, and recreation. To the extent that they can qualify, these public works projects represent excellent business opportunities for small businesses.

This bill expands the number of businesses which would be able to compete for state contracts under the Small Business Procurement and Contract Act rules. In proposing this change, the author notes that these large and complex projects require a wider range of skills and services, which necessitates increasing the statutory confines of the current definition of a small business.

The policy question is whether the definition change disadvantages currently certified small businesses that may choose to participate in procurement activities related to the development of public works projects. In assessing this policy question, staff notes that this is the second bill introduced by the author to expand the size of businesses who qualify as a small businesses for state contracting purposes. Neither this bill nor the prior bill received letters of opposition nor were concerns raised during the development of the current bill analysis.

The analysis includes background on the role small businesses play within the overall economy, current small business procurement activities, and related legislation. Technical amendments are described in Comment 8.

COMMENTS:

- 1) **Author's Purpose:** According to the author, "*SB 605 updates the average annual gross receipts limit California small and micro businesses must adhere to as a condition for certification to participate in certain state procurement programs. The measure proposes to statutorily increase the three-year average annual gross receipts limit requirement from \$10 million to 15 million for small businesses and \$2.5 million to \$5 million for micro businesses.*

For businesses involved in public works projects, the limit is raised to \$36 million and up to 200 employees. Given the type and complexity of projects the state is currently building, or will build in the near future – dams, water systems, rail - the technical expertise many construction businesses must maintain has increased requiring companies to invest in greater amounts of human and

technical capital, thus limiting the entry of relative small construction companies from being considered a small business for state contracting purposes.

And, lastly the proposed measure also requires the Director of General Services to biennially adjust the revenue limits based on the California Consumer Price Index. This proposed adjustment to the small business definition takes into consideration inflation, the benefits of increased competition as more small businesses become eligible for state contracting preferences."

- 2) **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 \$2.4 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.

Sole proprietorships comprise the single largest component of businesses in California, 3.1 million out of an estimated 4 million firms in 2014, representing over \$162 billion in revenues with the highest number of businesses (over 539,000) in the professional, scientific, and technical services industry sector. 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 86% of all businesses and employ approximately 24% of all workers. Businesses with less than 100 employees represent 97% of all businesses. 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 of their ability to be more flexible and suited to 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.

- 3) **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 for the purpose of increasing the number of contracts between the state and small businesses. A DBVE component was added in 1989. Today, approximately 85% of DVBEs have dual certification as a small business or microbusiness.

While statute sets an annual 3% DVBE participation goal, the 25% small business goal is provided through two executive orders, EO D-43-01 issue by Governor Gray Davis in 2001 and EO S-02-06 issue by Governor Arnold Schwarzenegger in 2006. In the last 10 report periods, the 25% small business procurement participation goal has been met six times.

The chart below shows small business and microbusiness aggregate procurement participation rates for the approximately 80% of mandatory reporting agencies that chose to report in the 2011-12 through 2015-16 fiscal years.

Small Business and Microbusiness Contracting Activity				
Mandated Reporters (dollars in millions)				
Fiscal year	Total Contract Dollars	Total Small Business and Microbusiness Contract Dollars	Total Percent	Total Number of Contracts
2015-16	\$5,855	\$2,112	36.08%	116,169
2014-15	\$8,117	\$2,079	25.61%	482,707
2013-14	\$7,101	\$2,013	28.35%	90,784
2012-13	\$7,616	\$1,801	23.66%	105,617
2011-12	\$7,399	\$1,796	24.28%	165,523
Average	\$7,217	\$1,960	27.66%	192,160

DGS Statewide Consolidated Annual Report 2013-14 to 2015-16

Small business participation rates have been improving under Governor Brown's Administration with state agencies meeting the 25% small business goal in 3 out of the last 5 report periods, including each of the last three report periods.

The current practice by DGS is to have each of the state entities that failed to meet their goal to submit a remediation plan that outlines ways in which the state entities would improve small business and DVBE participation. In addition, DGS holds meetings with underperforming state agencies. In 2015-16, DGS, in collaboration with the California Department of Veterans Affairs, met with 13 departments that did not achieve one or both of their targeted procurement goals, including:

- High spend state entities with over \$20 million in annual contracting: California High Speed Rail Authority; California Public Utilities Commission, and the Office of Systems Integration.
- Small and medium-spend state entities with under \$20 million in annual contracts: Agricultural Labor Relations Board; California Housing Finance Agency; California Arts Council; California Human Resources/State Personnel Board; California Science Center; Delta Stewardship Council; Department of Managed Health Care; Governor's Office of Business and Economic Development; Office of Environmental Health Hazard Assessment; and the California Coastal Conservancy.

- 4) **High Spend State Agencies:** According to the 2015-16 Statewide Consolidated Annual Report, the top five contracting agencies awarded more than 63% of all state contract dollars.

In 2015-16, three-out-of-five of the top five contracting entities met the small business procurement goal. However, both the Water Resources Agency and CalRecycle had targeted small business procurements below 20%. The chart below shows information on the contracting activities of the top five contracting departments for 2015-16.

Top 5 Contracting Agencies in 2015-16 (dollars in millions)				
Departments	Total Contact Dollars	Percentage of Statewide Spending	Small Business and Microbusiness Participation Percentage	DVBE Participation Percentage
All Mandatory Reporters	\$5,855	100%	36.08%	4.67%
Corrections and Rehabilitation	\$1,502	25.65%	34.22%	4.85 %
Transportation	\$1,129	19.28%	46.05%	5.07%

State Hospitals	\$389	6.64%	60.23%	2.78%
Water Resources	\$349	5.96%	19.31%	3.23%
CalRecycle	\$308	5.26%	14.82%	0.79%
Top Five Total	\$3,677	62.80%	39.42%	3.34%

Source: 2015-16 Statewide Consolidated Annual Report prepared by DGS

SB 605 could make it easier for several of the high spend state entities to meet the 25% goal by opening up a larger number of businesses and expertise to state contracting opportunities, including the California High Speed Rail Authority and the Department of Water Resources.

- 5) **Existing Law and Small Business Revenue Limits:** Existing law requires DGS to biennially review state CPI and make a determination as to whether the state should adjust the small business revenue limits for certified small businesses. As of January 2017, the maximum revenue limit for a certified small business is \$15 million, meaning that the statutory change proposed in this measure conforms statute to the current regulatory practice. The bill would, however, effectively increase the maximum for microbusinesses \$5 million.

DGS refers to this calculation as determining the escalation factor, which is the relationship between the current CPI to the base year CPI in 1999 of 168.5. DGS describes the process as follows:

- o To determine the small business “escalation factor,” the most recent annual CPI (as posted on the [Department of Industrial Relations Website](#)) is divided by 168.5.
- o The escalation factor is then multiplied by \$10 million (the threshold set in statute) to determine the “escalation amount.”
- o The Director compares the escalation amount to the current small business threshold to determine whether or not it should be adjusted.
- o The Director compares the escalation amount to the current small business threshold to determine whether or not it should be adjusted.

Below is a summary of the CPI reviews and DGS discretionary actions for 2005 to 2017.

- In 2006, based on an escalation analysis performed in November 2005, DGS pursued regulatory changes to increase the small business threshold from \$10 million to \$12 million. The increase went into effect in January 2007.
- In 2009, based on an escalation analysis performed in September 2008, DGS pursued regulatory changes to increase the small business threshold from \$12 million to \$14 million. The increase went into effect in January 2010.
- In December 2014, based on an escalation analysis completed in May 2013, DGS pursued regulatory changes to increase the small business threshold from \$14 million to \$15 million. Through the regulatory process, DGS solicited feedback throughout 2015. This feedback was incorporated into a new regulatory package submitted in May 2016. The increase went into effect in January 2017.

Under the provisions of SB 605, DGS would be mandated rather than authorized to adjust both certified small business and the certified microbusiness revenue limits, based on CPI. The author believes that it is appropriate to remove the discretion from DGS in order to ensure that there is a

robust field of small businesses in which to compete for state contracts, including public works contracts.

- 6) **Public Works Projects:** This bill would create a split system of small business certification. Firms with less than 100 employees and \$15 million in revenue would continue to qualify as small businesses for all contracts. Other firms (with 101-200 employees and/or up to \$36 million in revenue) would qualify as small businesses only for the purposes of public works contracts. This second category of small business requires DGS to establish a separate certification this second category of small business firms.

As of December 2015, there were 26,404 businesses in California which DGS had certified as small businesses. According to DGS it is difficult to determine the actual impact of the second small business category on procurement participation. In 2016, DGS had a contract with Dunn and Bradstreet, which allowed them to obtain an estimate of 25,000 businesses, becoming eligible under SB 1167 (Galgiani), which increased maximum revenues from \$10 million to \$25 million. SB 605 increases maximum revenues to \$36 million making the likely estimate larger.

Based solely on the proposed increase in employment, a maximum of 7,543 firms would become eligible for certification. Looking at firms in the construction industry only, the increase in employment adds approximately 800 businesses.

- 7) **Veto on Prior Legislation:** SB 605 is substantially similar to SB 1167 (Galgiani) from 2015-16, which was vetoed by the Governor. In his veto message, the Governor noted concerns with the bill's impact on FISCAL, which would necessitate an "expensive modification" to the platform. Amendments have been made to SB 605 to delay implementation to January 1, 2019, in order to align with FISCAL's buildout. According to the May 25, 2017, analysis by the Department of Finance, the extended implementation date will result in absorbable costs to FISCAL.
- 8) **Technical Amendments:** Staff recommends two technical amendments, which clarify the author's purposes. These amendments have been shared with the author's office.
- a) Replace the definition of public works project in the bill with a cross reference to the definition of a public works contract, Section 1101 of the Public Contract Code, and contracts for engineering, Section 4525 of the Government Code.
 - b) A prior set of amendments delayed implementation of the bill to January 1, 2019. The amendments, however, did not correctly return the January 1, 2018 to December 31, 2018, to existing law.
- 9) **Related Legislation:** Below is a list of the related bills.
- a) **AB 31 (Price) Public Contracts: Small Business Procurement and Contract Act:** This bill increased the maximum contract threshold amount for awards to small businesses (SME), including microbusiness, and DVBE under the states streamlined procurement process, from \$100,000 to \$250,000, as specified. It required contractors to report the contract amount allocated to SMEs and DVBEs with which they made contract commitments. Status: Signed by the Governor, Chapter 212, Statutes of 2009.
 - b) **AB 172 (Weber) State Contracting Microbusiness:** This bill would have increased the microbusiness procurement preference from 5% to 7% for state contracts to purchase goods, services, information technology, and construction of state facilities, and allowed the preference to

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.

- c) **AB 351 (Jones-Sawyer) 25% Small Business Goal:** This bill would have required each state agency to establish and achieve a 25% small business participation goal. Status: Held on Suspense in the Assembly Committee on Appropriations, 2015.
- d) **AB 550 (Brown) State Procurement Procedures for Small Businesses:** This bill 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.
- e) **AB 1125 (Weber) State Agency Small Business Contracts:** This bill would have increased the maximum financial value of an individual small business bid preference on specified state contracts from \$50,000 to \$100,000. Status: Held on Suspense in the Assembly Committee on Appropriations, 2015.
- f) **AB 1734 (Jones-Sawyer) Public Contracts and Small Business and DVBE Participation:** This bill would have required each state agency to establish and achieve a 25% small business participation goal and increases the annual procurement participation goal for DVBEs from 3% to 5% of the value of state contracts: Status: Held in the Assembly Committee on Appropriations, 2014.
- g) **AB 1783 (Perea) Streamlining Small Business Certification:** This bill required the Department of General Services to publish on the department's website, and make available to local agencies, a list of small businesses and microbusinesses that have been certified as such by the department. Status: Signed by the Governor, Chapter 114, Statutes of 2012.
- h) **AB 2278 (Weber) Small Business Procurement Preferences:** This bill would have revised the maximum small business bid preference amount and made related changes to the maximum value of all procurement preferences. Status: Held in the Assembly Committee on Appropriations, 2014.
- i) **SB 67 (Price) Small Business Participation in Public Contracts:** This bill would have authorized the Department of General Services 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, 2011.
- j) **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 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, 2011.
- k) **SB 1167 (Galgiani) Increase Size of Small Businesses:** This bill would have expanded the number of businesses which can utilize the special provisions in the Small Business Procurement and Contract Act when bidding on a state contract. The bill would have modified the definition of a small business and microbusiness by increasing the maximum revenue limits and the number of employees, as specified. Status: Vetoed by the Governor, 2016. His message stated: "*While the goal of these bills are well-intentioned, the implementation of these bills require an expensive*

modification to FI\$Cal at a time when the state must focus its resources on the project's successful deployment.”

REGISTERED SUPPORT / OPPOSITION:

Support

Greater Los Angeles African American Chamber of Commerce

Opposition

None on File

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