

SUBJECT: Revising programs for historically underutilized businesses

COMMITTEE: State Affairs — committee substitute recommended

VOTE: 10 ayes — Wolens, S. Turner, Alvarado, Bailey, Counts, Danburg, Hunter, D. Jones, McCall, Merritt

0 nays

5 absent — Brimer, Craddick, Hilbert, Longoria, Marchant

WITNESSES: For — Henry Wilfong, Jr., National Association of Small and Disadvantaged Businesses; Marilou Martinez Stevens, Texas Association of Mexican American Chambers of Commerce; Richard Huebner, Houston Minority Business Council; Deborah Trevino, Aaron Seaman, and Gloria Navales, San Antonio Hispanic Chamber of Commerce; Tristan Castaneda, Jr., Greater San Antonio Chamber of Commerce; Gary Bledsoe, Texas NAACP; Rose Batson and Vera Givens, Women’s Chamber of Commerce of Texas; Karen Box, Capital City African American Chamber of Commerce; Isaac Jackson, Texas Association of African American Chambers of Commerce; Nash Martinez, Canales Martinez & Nash; Anthony Dovie, Scientific Applications International Corporation; Jalaiah Unnam, AS&M, Inc.; Odysseus Lanier; Jan Triplett

Against — None

BACKGROUND: Since 1991, the state has operated a program to encourage state agencies to do business with minority- and women-owned firms defined as historically underutilized businesses or HUBs. The HUB program was created in 1991 by the enactment of HB 799 by Dutton, now Government Code, chapter 2161. State agencies were instructed to attempt to award at least 10 percent of the value of all agency contracts to HUBs. HUBs must have ownership that is at least 51 percent African-American, Hispanic-American, Asian-American, Native-American, or female. The minority or woman owner must have a “proportionate interest” and demonstrate “active participation in the control, operation, and management” of the business.

Initially, HUBs were certified by the Texas Department of Commerce and the purchasing program was administered by the General Services Commission (GSC). In 1993, full operation of the program was put in GSC's hands.

In 1995, GSC adopted revisions to the HUB program rules. The rules do not require any specific amount of state contracting with HUBs, but they direct state agencies to make a "good faith effort" to meet or exceed the HUB goals, either through direct contracts or indirectly through subcontracts. Good faith is presumed if the agency informs HUBs about procurement procedures, provides general contractors with lists of certified HUBs for subcontracting, adjusts bond and insurance requirements, and divides contracts into smaller lots to make them more available to small businesses.

The rules also allow some flexibility, recognizing that it may not be practicable to apply the goals to every contract. Agencies may set higher or lower goals for each contract after considering factors such as HUB availability and utilization, the geographical location of the project, and the contractual scope of the work. The rules specify no statewide HUB goal but set various goals in six procurement categories: heavy construction, building construction, special trade, professional services, other services, and commodity contracts. Goals for each category are based on a statewide disparity study conducted in 1995.

GSC rules also provide that a HUB "graduates" out of the program when its revenues or employment levels rise above a certain ceiling for four consecutive years, based on guidelines established by the U.S. Small Business Administration.

DIGEST: CSHB 3032 would make numerous changes to the HUB law and related laws.

HUB subcontractor program. CSHB 3032 would set new requirements for contracts issued by state agencies with an expected value greater than \$100,000. Before an agency solicited interest on such a contract, the agency would have to determine if there were any subcontracting opportunities. If such possibilities existed, the agency's request would have to include a HUB subcontracting plan.

This subcontracting plan would be based on the extent to which HUBs would be available to enter into subcontracts according to the types of opportunities

available and the agency's knowledge of relevant information about the market, disparities in the area, and disparities in the type of work performed. The agency would have to use this information to establish a participation level for HUB subcontractors expressed as a percentage of the dollar value of the contract. To the extent that federal funds were used to pay the contract, the HUB subcontracting requirements would not apply to the contract.

A bid or other expression of interest submitted by a prospective contractor would have to include a plan for HUB contracting, including:

- ! the participation level expected;
- ! the name of each HUB the contractor expected to use;
- ! the part of the work those prospective subcontractors would perform;
- ! the expected dollar value of those subcontracts; and
- ! information about the methods used currently and in the past by the contractor to identify, contact, and evaluate available HUBs.

If the prospective contractor's plan for HUB subcontractor participation did not meet the agency's stated level, the plan would have to demonstrate that there were not enough HUBs available in the locality at that time to meet the agency's goal.

A state agency could not award a contract to a prospective contractor whose bid did not include a HUB subcontracting plan when required. In evaluating other bids, the agency would have to consider the merits of each prospective contractor's HUB subcontracting plan. When a contract was awarded, the HUB subcontracting plan submitted in the bid would be considered part of the contract. If the agency and the contractor negotiated a different percentage participation level, that level would be part of the contract.

Every contractor would have to file quarterly reports on the progress the contractor was making in meeting the participation level. The quarterly reports would have to include:

- ! whether the HUBs included in the subcontracting plan actually received expected contracts, and if not, the reasons for not awarding the contract and the efforts that the contractor undertook to find other HUBs;

- ! the cumulative dollar value of subcontracts awarded to HUBs to date; and
- ! the percentage of the cumulative amount the contractor had spent as payment to HUBs to date.

All contracts would have to include a clause requiring the contractor to pay a penalty to the state if the value of subcontracts awarded under the contract failed to meet or exceed the HUB participation level in the contract because the contractor did not make a good faith effort to meet that level. The penalty amount would be the difference between the value of subcontracts awarded to HUBs and the value included in the HUB subcontracting plan.

After a contract was completed, the agency's purchasing personnel would have to determine whether the value of subcontracts awarded met the plan and would have to notify the contractor of that determination. The contractor would have the opportunity to explain that the failure was not due to a lack of good faith effort to meet the participation level. In determining the good faith effort, the agency would have to consider whether the contractor:

- ! provided timely notice of the subcontract to HUBs with the ability to perform the subcontract;
- ! advertised the opportunity in all media that focus on serving HUBs;
- ! effectively used the services of organizations or groups that assist in identifying HUBs;
- ! divided the subcontracts to increase the possibility of HUBs being able to perform a subcontract; and
- ! awarded the contract to the lowest qualified HUB bidder or negotiated in good faith with interested HUBs.

If the state agency's purchasing personnel determined that a penalty should be assessed, that finding would have to be reported to the administrative head of the agency, who could initiate a contested case proceeding under the Administrative Procedures Act. If the contested case final order assessed a penalty, that order would be subject to judicial review. Enforcement of the penalty could be stayed pending a judicial review if the contractor posted a bond or filed an affidavit of inability to afford to post a bond.

Any penalty assessed would be sent by the state agency to the comptroller for deposit in the general revenue fund.

Mentor-protégé program. CSHB 3032 would require GSC to establish a HUB mentor-protégé program to foster long-term relationships between prime contractors and HUBs. Each state agency would have to implement the program established by GSC. The program would have to be designed to allow agencies to award incentives to contractors that agreed to and were successful in subcontracting with HUBs and to help HUBs increase their capabilities to perform more complex work. Participation in the program for the contractor and the HUB would be voluntary.

HUB coordinators. Every state agency with a budget exceeding \$5 million a year would have to designate a HUB coordinator. That person could be the procurement director, but if it were another person, that person would have to be at least equal to the position of procurement director. The coordinator would have to coordinate training programs to recruit and retain HUBs, report information to GSC, and match HUBs with agency personnel.

HUB forums. CSHB 3032 would require GSC to design HUB forums to allow HUBs to deliver technical and business presentations that demonstrated to state agencies the HUBs' ability to do business with the agency. Presentations would be given to senior managers and procurement personnel at the agency and to contractors with the state who might be subcontracting for goods and services of a type supplied by the HUBs. Forums would be held at state agency offices, and each agency would have to participate.

Any agency with a HUB coordinator would have to establish a HUB forum program and sponsor presentations by HUBs to the agency. GSC also would have to sponsor presentations at locations that could be attended by agencies and contractors that did not have HUB coordinators. GSC and agencies with HUB coordinators would have to aggressively identify and notify individual HUBs regarding presentation opportunities.

HUB orientation package. GSC would have to develop a HUB orientation package sent to a HUB upon certification or decertification that included a HUB certificate and description of the significance and value of certification. The package also would have to include a list of state purchasing personnel and information regarding electronic commerce opportunities, the Texas Marketplace website, and state procurement processes.

Multiple certification standards. CSHB 3032 would allow GSC to approve the use of local government certification programs. GSC would have to enter into agreements with local governments to allow automatic certification of HUBs certified under the local program, provide for updating of GSC's HUB database, and provide for communicating with HUBs certified by local government programs.

HUB size standards. GSC could establish size standards that HUBs could not exceed. The standards would be based on the size at which a business should be considered sufficiently large that it probably did not suffer present effects of past discriminatory practices.

GSC education and outreach. GSC would have to report annually on its education and training efforts. That report would have to include:

- ! GSC's vision, mission, and philosophy concerning HUBs;
- ! HUB marketing and education materials distributed;
- ! GSC's policy regarding HUB education, outreach, and dissemination of information;
- ! HUB goals attained during the year;
- ! HUB goals, objectives, and outcome measures for each outreach and education event; and
- ! planned future education and outreach initiatives.

State agency penalties. GSC would have to include in its annual report regarding HUBs whether agencies substantially failed to meet applicable HUB goals. The Legislature would have to consider this information in determining whether to revoke or reassign any purchasing authority granted to that agency.

Other changes made by CSHB 3032 would include:

- ! requiring GSC, to the extent possible, to track by vendor identification and social security number the graduation rates of HUBs that exceeded the size standards set by GSC;
- ! expanding reporting requirements to all state agencies for purchases from HUBs made through GSC's group purchasing program;
- ! requiring every state agency to include in its legislative appropriations

request (LAR) a detailed report showing the extent to which the agency met applicable HUB contracting goals;

- ! requiring an agency that failed to meet an applicable HUB contracting goal to include in its LAR the reasons for failing to meet the goal;
- ! considering the success or failure of a state agency to meet a HUB contracting goal a performance measure for purposes of the appropriations process;
- ! requiring GSC to provide electronic access to its certified HUB directory to each state agency; and
- ! adding falsely applying as a HUB subcontractor to the offenses included in the HUB law as a third-degree felony, punishable by two to 10 years in prison and an optional fine of up to \$10,000.

This bill would take effect September 1, 1999. Subcontracting requirements would apply to any request for bids, proposals, offers, or other expression of interest published or disseminated on or after that date.

**SUPPORTERS
SAY:**

The HUB program is an essential state program designed to provide business opportunities to businesses that historically have been subject to discrimination. The program has been successful in promoting the use of these disadvantaged businesses in state contracting, thus giving them the opportunity to compete on their own for other government and private-sector business. This program should be continued because there is still a great disparity between the percentage of businesses owned by minorities and women and their percentage in the general population.

The changes proposed in CSHB 3032 would help to strengthen the HUB program by increasing the outreach and education efforts of GSC and the state. These efforts would promote the certification of additional HUBs and, by providing technical help in preparing bids and providing opportunities for HUBs to present their skills to state agencies, would help to improve the chances that HUBs will receive state contracts.

According to GSC data, the number of certified HUBs in the state dropped from 10,873 in 1997 to 6,430 in 1999. Those numbers do not reflect a decrease in HUB businesses in the state, but simply that those businesses either did not choose to be certified by GSC or failed to see the benefits of HUB certification.

In fiscal 1997, about \$784 million or 14 percent of state expenditures in the six major procurement categories were directed to HUBs, according to GSC data. While total HUB expenditures continue to rise, the HUBs' share of overall state spending is falling. The semiannual report for fiscal 1999 puts HUB expenditures at 12 percent of all state spending in the six procurement categories. The drop in the share of total spending and in the number of certified HUBs shows that the disparity in business opportunities created by past discrimination has not been remedied.

As part of education and outreach efforts, CSHB 3032 would provide for the development of a mentor-protégé program that would pair HUBs with successful businesses to learn from their experience and foster relationships that could lead to expanded contracting and subcontracting opportunities. HUB forums, agency HUB coordinators, and HUB orientation packages also would help to increase the awareness of HUB programs among state agencies and potential HUBs. Adding HUBs to the electronic directory would make them easier to find when state agencies and others attempt to ensure that the largest number of people possible have the opportunity to bid on a particular contract or subcontract.

This bill would address the major concern of the bureaucracy involved in HUBs having to be certified by multiple agencies to compete for contracts on the state and local level. Many cities have their own HUB programs with their own certification procedures. It is difficult and time-consuming for a business to be certified by numerous cities and also to submit a certification to the state. CSHB 3032 would allow GSC to develop rules to adopt the certification of other governmental bodies so that these businesses would not have to provide the same type of information to many governmental agencies in order to be certified.

The HUB subcontractor program created by CSHB 3032 would provide additional agency oversight of subcontracting opportunities. Subcontracts awarded to HUBs are reported as a percentage of the award granted to the prime contractor and are included in the agency's overall HUB expenditures. However, it has been difficult to verify that the subcontracts actually are awarded to HUBs and that the money spent on such subcontracts actually flows to the HUBs. There also is little evaluation of the efforts undertaken by prime contractors to provide subcontracting opportunities to HUBs.

CSHB 3032 would provide for better identification of the actual HUB subcontracting goals that should be established for each major contract and for better monitoring of the outreach, selection, and participation of HUB subcontractors in these major contracts. It also would ensure continued compliance with the goals of the program by including a penalty for the failure to use HUB subcontractors adequately.

These subcontracting requirements would not be onerous, nor would they discourage contractors from bidding for state contracts. In many cases, establishing these clear goals would help to avoid traps some contractors fall into under the current amorphous good-faith-effort standard. This bill would allow the HUB subcontracting goals to be set on the basis of the availability of subcontractors in the areas that would be bid out. It also would establish clear parameters of what every contractor would be expected to accomplish in recruiting, selecting, and retaining HUB subcontractors.

CSHB 3032 would enhance the Legislature's authority to ensure compliance with the good-faith-effort standard required for HUB contracting. The Legislature could revoke or transfer the purchasing authority of a state agency that did not show a good faith effort in meeting established HUB goals. Each agency's LAR would have to include additional details on its use of HUB contracting and subcontracting. If an agency failed to meet the established goals, the agency would have to explain that failure.

Providing statutory authority for GSC to determine HUB graduation requirements would help to strengthen the integrity of the HUB program by ensuring that only businesses who actually felt the effects of past discrimination were included in the HUB program.

OPPONENTS
SAY:

CSHB 3032 would create overly burdensome requirements on contractors that would force many of them to avoid even submitting a bid on many state contracts. This bill would increase significantly the amount of bureaucracy in the HUB program by requiring examination of subcontracting opportunities on every contract worth more than \$100,000.

Any contractor who wanted to bid on such a contract would have to meet currently unstated goals for HUB participation. In addition, contractors who were awarded contracts would have to follow through on HUB plans

submitted at the bidding stage, file quarterly updates on HUB participation levels, and justify any change in HUB subcontractors.

Regardless of the merits of the contractor or the bid submitted, an agency could not award a bid to that contractor if the agency failed to meet the HUB subcontracting plan in its bid. Contractors also would be pressured to award subcontracting jobs to HUBs that were included in that contractor's plan, or else the contractor would have to explain the change and make an effort to find another HUB to fill that job.

While outreach and education efforts might help to attract additional HUBs to the state's certified HUB list, the primary reason for the drop in HUB certification was not a lack of interest but a change in the certification criteria. The number of certified HUBs fell after 1997 because GSC moved away from a self-certification procedure to one that required additional documentation. This change removed those that may have been certified falsely and those that did not want to go through the trouble of submitting the required documentation.

OTHER
OPPONENTS
SAY:

The HUB program is not necessary. All businesses should have to compete for state business on an equal footing. There should be no participation goals in state contracting that award contracts to certain businesses. The only contracting goal should be to obtain the best qualified bidder submitting the lowest bid.

Enough time has passed since discrimination against minorities and businesses was allowed by law. While some disparities in contracting may remain, these should not be remedied by providing preferential treatment to certain businesses over others.

The HUB program has done little to help improve the percentage of successful minority-owned businesses in the state. The primary beneficiaries of many of these program have been white females who qualify under the program but do not necessarily reflect a population that has been historically discriminated against.

NOTES:

The committee substitute incorporated provisions from other related bills, including HB 1343, HB 1567, HB 1890, and HB 2430, all by Dukes. The substitute also would:

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- ! authorize the Legislature rather than to GSC to revoke the purchasing authority of an agency that failed to meet HUB contracting goals;
- ! provide for a mentor-protégé program;
- ! provide for HUB forums; and
- ! allow GSC to determine graduation-size standards for HUBs.