



SECURED TRANSACTIONS SERVICES

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# **Minority Contractor Sales**

**Understanding and Mitigating the Risk  
Associated with Accepting Orders**



## 25044. Managing Minority Contractor Sales

*Speakers: Chris Ring, NACM's Secured Transaction Services, Karen Hart, Esq., Bell Nunnally & Martin LLP, Kevin Burke, CCE, Erie Materials, Inc. and Shaun Papperman, CCE, CCRA, CICP from Baltimore Aircoil Company, Inc.*

Certain Public Construction projects require a percentage of the contract be completed with "Minority" Contractor Participation. When a material supplier accepts an order from a minority contractor on a public construction project, that minority contractor is most likely required to serve a "Commercially Useful Function (CUF)." If the minority contractor is not serving a CUF, they are deemed to be a "pass through" distributor. If a material supplier knowingly (and in certain cases unknowingly) accepts an order from a "pass through" distributor, then that goes against the spirit of the program and the material supplier may be subject to a fine or a lawsuit, or both. This session will help the attendees understand what steps they can take to spot pass through distributors, how to avoid the transaction, and legal insight.



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**In 1983 Ronald Reagan signed an Executive order to improve Federal planning for minority business programs. Department and agency heads were directed to develop and implement incentives to encourage greater minority business subcontracting by Federal prime contractors.**



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**The intent was and is to help legitimate minority subcontractors.**

**When Pass Through Subcontractors are allowed to participate it creates an environment that's not advantageous for legitimate minority contractors.**



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**Material Suppliers who sell to “subcontractors” must not only assure that they are a certified DBE contractor, but also providing a CUF (Commercially Useful Function)**



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What are the rules?





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<http://www.fhwa.dot.gov/federal-aidessentials/commusefunction.pdf>

## **FHWA Tips on Evaluating a Commercially Useful Function**

Of all the many elements in the DBE program there is one that can have the most detrimental impact on the ability of the prime contractor to meet its contract goal as well as the ability of a recipient to meet its overall goal. This element is commonly referred to as commercially useful function or “CUF”. How can just one element of the program have such an impact achieving the results Congress intended when it established the DBE program?

Both the prime contractor and the State Transportation Agency (STA) receive credit toward the DBE goal (contract and overall) only when a DBE working on a contract performs a CUF. DBEs generally perform work on a contract either as a contractor, a trucker, a regular dealer, or a manufacturer. While each of these categories is evaluated differently when determining whether the DBE has performed a CUF, there is one guiding principle that must be followed. Under the terms established in 49 CFR §26.55, a DBE firm performs a CUF when it is:



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***The USDOT DBE regulations identify the following key factors that should be analyzed when determining whether a CUF is being performed:***

- Evaluation of the amount of work subcontracted, whether it is consistent with normal industry practices;
- Whether the amount the firm is paid under the contract is commensurate with the work that is actually being performed to be credited towards the goal;
- When the DBE furnishes materials, the DBE must be responsible for negotiating the price, for determining the quality and quantity of the material, ordering the material, and paying for it. As a contractor, a DBE firm would typically be hired to both furnish the material and install it with its own labor force;
- Whether the DBE's role is limited to that of an extra participant in a transaction, contract, or project through which funds are passed in order to obtain the appearance of DBE participation. In essence, was the role merely a contrived arrangement for the purpose of meeting the DBE contract goal?





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**The best way to determine if a DBE is providing a (CUF) commercially useful function is to determine what “Value” they are adding to the completion of the construction project.**

**This should be a team effort between Sales and Credit**



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## **Erie Materials Checklist**

**Kevin Burke, CCE**



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## DIVERSITY PARTICIPATION ACKNOWLEDGMENT

I, \_\_\_\_\_, am an owner or authorized agent of  
\_\_\_\_\_, a \_\_\_\_\_-certified firm (the "Firm").

I hereby acknowledge and certify that the Firm is in compliance with all applicable laws and regulations, including those governing diversity enterprise certification and participation programs, further including, but not limited to, any/all commercially useful function requirements.

Firm Name: \_\_\_\_\_

Signed: \_\_\_\_\_

By: \_\_\_\_\_

Title: \_\_\_\_\_

Job Name: \_\_\_\_\_

Job Address: \_\_\_\_\_

\_\_\_\_\_

**Disclaimer: This is a sample. Credit Managers should consult with management and legal to design and implement.**



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## DIVERSITY PARTICIPATION CHECKLIST

*This form must be completed for all sales to diversity certified firms. Check all applicable boxes.*

Initial   Date

- Customer is diversity certified
- Customer is not diversity certified, but a diversity certified firm is involved in the sale
- Documentation of certification status has been provided
- Diversity Participation Acknowledgment has been signed and returned
- Erie Materials is in direct contact with the certified firm
- The certified firm provided estimates, specifications or otherwise directed the type and quantity of supplies that it will purchase
- Erie Materials provided a quote to the certified firm
- Erie Materials negotiated price/terms with the certified firm
- The certified firm placed the order
- Supplies will be delivered to the certified firm's place of business
- If supplies will be delivered directly to a project site:
  - the certified firm arranged for delivery
  - the certified firm will inspect the supplies and accept delivery
  - the certified firm will accept and take title to the supplies upon delivery
  - the certified firm will use/install the supplies

Notes and comments: \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Job Name: \_\_\_\_\_ Address: \_\_\_\_\_  
 General Contractor: \_\_\_\_\_ WMBE: \_\_\_\_\_

Completed By:  
 Name: \_\_\_\_\_  
 \_\_\_\_\_ Employee Signature \_\_\_\_\_ Date \_\_\_\_\_

Approved By:  
 Name: \_\_\_\_\_ Title: \_\_\_\_\_

**Disclaimer: On this page is a sample checklist. Credit Managers should consult with management and legal to design and implement an internal checklist for credit and/or sales.**



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## STATE OF NEW YORK

10017

### IN ASSEMBLY

May 5, 2016

Introduced by M. of A. CROUCH -- read once and referred to the Committee on Governmental Operations

AN ACT to amend the executive law, in relation to minority and women-owned business enterprises in state contracts

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

1 Section 1. Section 313 of the executive law is amended by adding a new  
2 subdivision 6-a to read as follows:

3 6-a. Notwithstanding the provisions of subdivision six of this  
4 section, contracting agencies shall only be required to contract with  
5 minority and women-owned business enterprises on state contracts and  
6 subcontracts at a rate that correlates with the percentage of minority  
7 and women-owned business enterprises in that industry in the economic  
8 development region where the contract is to be performed.

9 § 2. This act shall take effect immediately, provided, however, that  
10 the amendment to section 313 of the executive law made by section one of  
11 this act shall not affect the expiration of such section and shall be  
12 deemed to expire therewith.



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**For now, material suppliers must police their own actions regarding  
DBE's and CUF**

**They can face penalties, fines,**





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E. Both the DOT Regulations and EPA Regulations prohibit so-called “pass through” arrangements. For DOT-funded projects, a DBE’s participation may not count toward the contract goal “if its role is limited to that of an extra participant in a transaction, contract, or project through which funds are passed in order to obtain the appearance of DBE participation.” 49 C.F.R. § 26.55(c)(2). For EPA-funded projects, a DBE’s participation may not count toward the contract goal if it “acts merely as a broker or passive conduit of funds, without performing, managing, or supervising the work of its contract or subcontract in a manner consistent with normal business practices.” 40 C.F.R. § 33.503(e).



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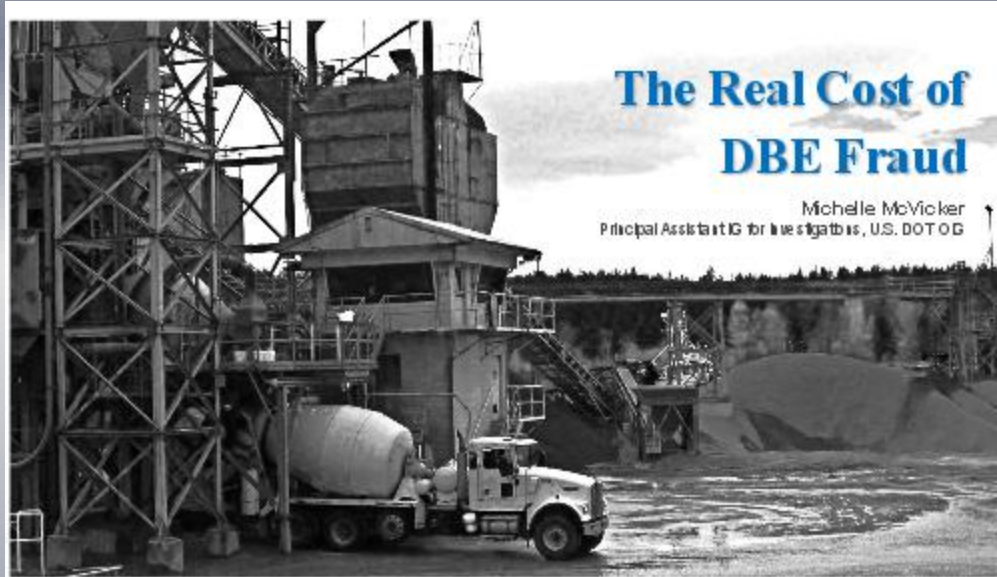
## TERMS AND CONDITIONS

1. [REDACTED] shall pay to the United States \$4,945,000 (“Settlement Amount”), plus interest accrued thereon at the rate of 3.25% per annum from [REDACTED] until the Effective Date of this Agreement, by electronic funds transfer pursuant to written instructions to be provided by the United States Attorney’s Office for the Northern District of [REDACTED] later than five (5) business days after the Effective Date of this Agreement.





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## The Real Cost of DBE Fraud

Michelle McVicker  
Principal Assistant IG for Investigations, U.S. DOT OIG

### Presentation Overview

- DOT OIG Office of Investigations
- DBE Program Fraud
- DBE Fraud Case Studies



## DOT OIG Office of Investigations

- Conducts criminal and civil investigations of fraud and other allegations affecting DOT Operating Administrations, programs, contractors, and grantees
- Partner with Federal, State, and local law enforcement agencies and prosecutors

### DOT OIG Resources

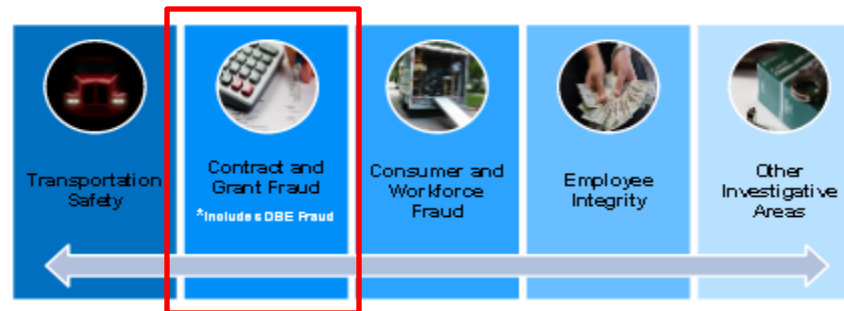
Special Agents with Federal law enforcement arrest authority

Investigative tools (subpoenas, search warrants, undercover ops)

Expertise in fraud investigations and financial/forensic accounting

Computer forensics unit

## What do we investigate?



## Common Fraud Schemes

Product substitution	<b>False claims and overcharging</b>	<b>DBE fraud</b>
Quality control testing fraud	Bribery and kickbacks	Racketeering
Embezzlement and theft	Bid rigging and collusion	Prevailing wage

## DBE Fraud Schemes

### FRONT COMPANY

- Company exists only on paper
- Work done by the prime or non-DBE subcontractor
- DBE is paid a small fee

### PASS-THROUGH

- Company qualified to be a DBE , but performs no commercially useful function
- Some or all work done by the prime or non-DBE subcontractor
- DBE is paid a small fee

**DBE fraud is often associated with other crimes such as bribery, extortion, money laundering, and tax fraud.**

## DBE Fraud Indicators

DBE owner lacks background, expertise, or equipment to perform subcontract work

Employee shuttle back and forth between prime contractor and DBE payroll

Names on equipment and vehicles covered with paint or magnetic signs

Orders and payment for supplies made by individuals not employed by DBE

Prime contractor facilitates purchase of DBE-owned business

DBE owner is never present at job site

Prime contractor always uses the same DBE

Financial agreements between prime and DBE contractors

Absence of written contracts

Prime contractor and DBE have joint bank accounts







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## How do some cases come to light???

### Whistle Blower!

Showing results for minority contractor **whistleblower**

Search instead for minority contractor whistleblow

**Construction contractor settles whistleblower lawsuit alleging f...**  
[whistleblowerlawinsights.com/.../construction-contractor-fraud-whistlebl...](#) ▼

May 18, 2016 - A construction contractor settled a whistleblower lawsuit for \$2.25 ... the company falsely claimed it sub-contracted work to a minority-owned ...

**Whistleblower Settlement Spotlights Cheating | Blog | Loevy ...**  
[www.loevy.com/.../12-million-whistleblower-settlement-spotlights-cheati...](#) ▼

May 2, 2014 - Construction giant McHugh used sham subcontractors to funnel millions in taxpayer dollars away from women and minority-owned firms.

**Construction and Minority Business Fraud | Loevy & Loevy**

[www.loevy.com/whistleblower.../construction-minority-business-fraud/](#) ▼

We have significant experience in representing whistleblowers in construction and M/WBE fraud matters. Call us today for more information.

**\$12 Million Whistleblower Settlement Spotlights Rampant Ch...**

[www.prnewswire.com/.../12-million-whistleblower-settlement-spotlights-...](#) ▼

May 1, 2014 - CHICAGO, May 1, 2014 /PRNewswire/ - \$12 Million Whistleblower ... women and minority-owned businesses, Chicago's McHugh Construction ...

**Chicago contractor settles whistleblower case over public con...**

[www.businessinsurance.com/article/20140502/NEWS07/140509956](#) ▼

May 2, 2014 - Chicago contractor settles whistleblower case over public contracts ... the work would be completed by women- or minority-owned businesses.

**Whistleblower to Cost Contractor \$12M : Durability + Design ...**

[www.durabilityanddesign.com/news/?fuseaction=view&id=11400](#) ▼

May 12, 2014 - Future public contracts will remain available to a Chicago contractor, ...



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TOPICS > [NATION](#) > [FALSE CLAIMS ACT](#)

## Top payouts to federal false claims whistleblowers in fiscal year 2014

In the last fiscal year, the federal government recovered a record \$5.69 billion under the False Claims Act, which means the payouts to the whistleblowers, who play a crucial role in exposing cases of fraud, have been some of the biggest ever.

Whistleblowers who file false claims lawsuits can receive up to **30 percent** of the money that a company pays to the government

## DOT OIG's DBE Fraud Investigative Results

Since January 1, 2011, DOT OIG's DBE fraud investigations have resulted in:

- Over **\$245 million** in financial recoveries, restitution, and forfeitures
- **425 months** of incarceration
- **1,161 months** of probation and supervised release
- **1,340 hours** of community service







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## Local concerns that NACM is monitoring

eNews August 18, 2016

### In the News

August 18, 2016

[State Legislators, Governor Battling Over Direction of DBE/MBE Use on Public Jobs](#)

[B2B Credit Card Payments Gaining Momentum](#)

[Nontraditional Analysis Tools Can Help Eliminate a Metrics 'False Positive'](#)

[China's New Economy Bifurcates Industries That Will Experience Growth, Risk](#)

[Short-term Prospects Bright in Construction, But Efficiency Still Critical](#)

### State Legislators, Governor Battling Over Direction of DBE/MBE Use on Public Jobs

A legislative chess match that warrants watching by construction suppliers and contractors nationwide is pitting New York Gov. Andrew Cuomo's efforts to further elevate disadvantaged business enterprise (DBE) or minority business enterprise (MBE) inclusion in state projects against lawmakers trying to reduce already hard-to-meet burdens on businesses.

Various proposals designed to lower the burden on material suppliers and small subcontractors, where DBE and MBE (in New York known as MWBEs) mandates are concerned, are working their way through the state legislature. Chief among them is A10017, which seeks to correlate the mandated use of minority- or women-owned enterprises on a state-backed project with the percentage of such businesses operating in the regions where the contract is being performed. New York already has one of the highest percentage requirements (30%) in the country, and the governor has made no secret about plans to increase required MWBE participation to 40% by 2017. It is a difficult, at times impossible, standard to meet based on the available suppliers and subcontractors that qualify, Assemblyman Clifford Crouch (R) suggested in proposed legislation.

"Certain areas of New York State are severely underrepresented in this category," Crouch wrote. "To qualify to be awarded a contract, the business would have to bring [in] outside MWBEs, thereby ignoring the local labor talents and contracts that live and work in the region."

Businesses in areas such as Upstate New York have limited options to choose from, said one veteran credit manager. It's left construction suppliers and subcontractors going to a limited pool that sometimes isn't qualified to do the work or isn't actually performing all-important "commercially useful functions" mandated by state and federal laws.

"There are some of these that aren't certified as roofers or plumbers or electricians, so they literally can't do the work," the creditor told NACM. "There are also suppliers that are too new or too small to have the wide variety of materials needed for certain state jobs. It's making things very difficult. This is not what the laws were intended to be doing. This is detrimental."



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Is this new?????

One case ended Wednesday when a Los Angeles Superior Court jury ordered construction giant Tutor-Saliba Corp. to pay more than \$29.5 million to the Metropolitan Transportation Authority for more than 1,000 acts of business misconduct during subway construction. Jurors said a key finding was that Tutor-Saliba used companies that posed as minority subcontractors to meet MTA diversity guidelines.



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**The spirit of the DBE program is to promote legitimate contractors who are adding value to the completion of a construction project**

**Bottom line – local statutes and case law are ill equipped to guide you in setting up what course you should follow.**



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We hope to see you all in Dallas in 2017

JUNE 11-14, 2017  
GRAPEVINE ★ DALLAS  
TEXAS

NACM's  
121<sup>ST</sup>  
CREDIT  
CONGRESS  
& EXPO