

Disadvantaged Business Enterprise Certification: Is It Right for Your Business?

By Danica L. Mathes, Esq.*

BELL NUNNALLY
& MARTIN LLP
CLIENT DRIVEN®

Is your small business at least 51% owned and operated by a woman, minority or otherwise socially and economically disadvantaged individual? If so, you may want to consider certification as a Disadvantaged Business Enterprise[†] (“DBE”).

Generally, federal agencies or programs that are not directly governed by the Small Business Act reference or adopt the detailed and strict Small Business Act Section 8(a) standards governing DBE certification, as do many state and local programs. Therefore, while certification standards may vary slightly depending on the regulations governing the applicable certifying agency, this article will review the typical requirements for DBE certification using the U.S. Small Business Administration’s 8(a) Business Development Program[‡] requirements as a model. Although certification in the SBA’s 8(a) Program is not universally recognized, it is frequently accepted as proof of eligibility for DBE contracts.

Advantages to Certification

The objective of most DBE programs is to help small disadvantaged businesses compete in the American economy, and many companies and government agencies are required or have goals to increase the number of DBEs in the procurement process to further this objective. Many firms require DBEs to be certified. Certification -- the process of confirming the ownership, control and management of a company – is usually performed by an authorized regulatory agency or third party. Being certified as a DBE can be an important marketing tool to expand your company’s visibility and opportunities in both the private and public sectors with major corporations and government agencies.

Basic Criteria for Certification

The basic criteria for DBE certification, which we will explore in more detail below, requires that the applicant firm:

- must be an independent *small business*,
- must be at least 51% directly and unconditionally *owned and controlled* by one or more *socially or economically disadvantaged individuals* who are of good character and citizens (or legal resident aliens) of the United States, and
- must demonstrate *potential for success*.

Small Business

A small business concern is one that is independently owned and operated, is organized for profit, and is not dominant in its field. Depending on the industry (such as manufacturing, wholesaling, services, retailing, general and heavy construction, special trade construction, and agriculture), size standard eligibility is based on the average number of employees for the preceding twelve months or on sales volume averaged over a three-year period.

Ownership and Control

The *ownership* of a business by a disadvantaged individual must be real, substantial and continuing, going beyond the pro-forma ownership of the firm as reflected in its ownership documents. *Contribution of capital and/or expertise* by a disadvantaged owner to acquire his/her ownership interest must be real and substantial and be in proportion to the interest acquired. The

organizational documents of an applicant firm must not contain any provision which directly or indirectly restricts the disadvantaged owner's *governance* of the firm, such as the individual's ability to exercise managerial control and operational authority of the business. The disadvantaged individual must possess *operation and control* of the business, including the power to direct or cause the direction of and to make the day-to-day as well as major decisions on matters of management, policy and operations. The applicant firm must exhibit *independence* and have the ability to perform in the business' area of specialty/expertise without substantial reliance upon finances or resources of nondisadvantaged individuals or business enterprises.

Socially Disadvantaged Individuals

Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as members of a group (such as African American, Hispanic American, Native American or Asian Pacific American) from circumstances beyond their control. Social disadvantage may be established by individuals who are not members of a designated group (i.e., via information showing disproportionate underrepresentation in a particular industry).

Economically Disadvantaged Individuals

Economically disadvantaged individuals are socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities. For initial eligibility, the disadvantaged individual's net worth, after excluding the individual's equity in the firm and in this individual's primary residence, may not exceed \$250,000. For continued eligibility after initial certification, the disadvantaged individual's net worth must be less than \$750,000. The disadvantaged individual's average two-year income, fair market value of all assets, access to credit and capital, and the financial condition of the applicant firm will be considered in evaluating economic disadvantage. Any assets that she has transferred to an immediate family member for less than market value within two years prior to the firm's application for certification will also be considered.

Potential for Success

To determine potential for success, the following factors will be evaluated:

- the technical and managerial experience of the applicant firm's managers.
- the firm's operating history and ability to access credit and capital.
- the firm's financial capacity.
- the firm's record of performance.
- whether the applicant firm or individuals employed by the firm hold the requisite licenses if the firm is engaged in an industry requiring professional licensing.

Furthermore, the applicant firm must have been operational for at least two full years as evidenced by business income tax returns showing operating revenues in the primary industry in which the firm is seeking certification. This requirement may be overcome if the firm obtains a waiver by meeting certain conditions, such as having substantial business management experience, necessary technical experience, and adequate capital, personnel and any other requirements needed to perform contracts if it is certified.

Restrictions Regarding Nondisadvantaged Individuals' Involvement

Nondisadvantaged individuals may be involved in the ownership and management of an applicant firm as stockholders, limited liability members, partners, directors, and/or officers. However, ownership limitations apply, and such nondisadvantaged individual or immediate family member may not:

- exercise actual control or have the power to control the applicant firm.
- Be an officer or director or more than a 10% owner, stockholder or partner of another firm in the same or similar line of business.
- be a former employer or principal of a former employer of any disadvantaged owner of the firm.
- receive compensation from the firm in any form as a director, officer, or employee, including dividends that exceed the compensation to be received by the highest officer.

If one or more of these situations exist, the nondisadvantaged individual will be found to control the firm. Additionally, nondisadvantaged individuals or entities having an equity interest in an applicant firm and who provide critical financing, bonding, or licenses, may be found to control the firm.

Application Process

A final decision regarding eligibility will be made within 90 days after determination that the application is complete. Applicants who are certified must undergo annual reviews for compliance with eligibility requirements. If an application is declined, the applicant has the right to request that the agency reconsider such application by filing a written request within 45 days after receiving notice of denial. The applicant has the burden of overcoming each reason cited in the agency's decision to decline the application. If an application is declined after reconsideration, the agency will not accept a new application until twelve (12) months after the date of the final agency decision on reconsideration.

DBE Certification Tips

This article is a brief overview of the DBE certification process, and even if you do not meet all the criteria set forth above, you may want to do some research to see if your business may still qualify as a DBE. If you are currently operating or are contemplating starting a disadvantaged business enterprise, consult with an attorney who is familiar with DBE certification regulations *before* you form a business entity, if at all possible, and *before* you apply for DBE certification. You will also want to provide the DBE certification agency to which you are applying with *any and all* information you want them to consider about your business when you submit your application and/or during the certification agency's on-site visit, if applicable. In the event you are denied certification, usually you will be unable to present any new information during the appeal, even if it would clarify the agency's findings regarding your denial (such as Affidavits from employees or spouses).

* **Danica L. Mathes** is an attorney with Bell Nunnally & Martin LLP. For more information, please contact her at 214.740.1474 or danicam@bellnunnally.com.

† Also known as Women Business Enterprise ("WBE") or Minority Business Enterprise ("MBE").

‡ The 8(a) Program offers a broad scope of assistance to socially and economically disadvantaged firms, but Small Disadvantaged Business ("SDB") certification strictly pertains to benefits in federal procurement. 8(a) firms automatically qualify for SDB certification. The requirements for both types of certification are similar, with a few major exceptions: (1) for SDB eligibility, the individual's net worth, after excluding the individual's equity in the firm and in the primary residence, may not exceed \$750,000; (2) potential for success is not required; and (3) some ownership restrictions do not apply.