

In the Matter of the Proposed Revision to  
Minnesota Rules, Chapter 1230.0100 to  
1230.1910 Relating to State Contracts and  
Relating to the Small Business Procurement  
Program

Statement of Need  
and Reasonableness

## I. Introduction

The Department of Administration (hereinafter Department) proposes to revise the rules governing state contracts and the rules governing the program for small businesses owned by disadvantaged persons. These rules are now contained in MR 1230.0100 through 1230.2300. The need for the proposed revised rule, to be adopted as a "permanent rule relating to business", MR 1230.0100 through 1230.1300, and a "permanent rule governing the Small Business Procurement Program", MR 1230.1400 through 1230.1910 arises from the legislative amendments to the Small Business Procurement Program laws of 1990, Chapter 541. In addition there is a need to update the existing rules to reflect organizational changes, improved technology, or options to provide in the administration of these programs. Grammatical changes and reorganization of the rule format have also been undertaken to provide clarification, ease of reading, and consolidation of like subject matter.

Chapter 1230 has been operative with subsequent amendments for more than 25 years under prior MCAR designations and as MR 1230. The rules governing state contracts under 1230.0100 through .1300 cover the competitive bidding process with provisions for soliciting, advertising, bid securities and the opening of bids. The award of contracts, contract performance, penalties for failure to perform, suspension or debarment, appeals of such actions,

probation and reinstatement are described, all of these provisions are key facets of the various model code recommendations developed for public procurement activities. The rules governing the Small Business Procurement Program 1230.1400 through .1910, except for a few definitions, are all new as a result of significant statutory changes. The statutory changes and these rules reflect the need to meet a variety of "tests" outlined by the United States Supreme Court in *J. A. Croson Company, Inc. v. City of Richmond*, 57 U.S.L.W. 4132 (1989). The court described the restrictions under which state and municipal governments can enact preference programs to counter discrimination encountered by businesses in dealing with public entities. The statute was enacted with tests such as "narrow scrutiny", "specific remedy" and "narrowly tailored" as requirements. The rules reflect the administrative procedures, actions and documentation needed to carry out the program while meeting the court restraints and legislative provisions established.

The impact of the revisions falls primarily on the Department in its administrative activities. The criteria used in determining eligibility for targeted group or economically disadvantaged area businesses, the application of programs and requirements effecting these groups, the investigations, or circumstances, leading to consideration of suspension or debarment and the management of the appeal processes for all categories of vendors increase the burden on the Department in the administration of the program. These procedures are necessary, and needed to ensure the integrity of the program, to maintain the documents and data needed under the concept of "narrow scrutiny" and to carry out the legislative intent that the benefits of these programs are delivered solely to those for whom the program was "narrowly tailored".

The additional definitions, more precisely described criteria and the description of appeal provisions should impact on small businesses in a positive manner and on all responsible vendors beneficially by discouraging and eliminating illegal and unfair competition from state bidders lists. The development of size standards defining small businesses that vary by industry and market should open up the benefits of the small business procurement program to small vendors previously excluded.

The statutory authority to adopt these amendments to the rules is contained in Minnesota Statutes §16B.04, 16B.18, 16B.19 and 16B.22.

## II. Proposed changes

General: Throughout the rule, nonsubstantive changes were made, including improving form or language reducing "legalese" and using "layperson" language, correcting job titles and division references and deleting gender references.

Part .0150 Definitions: Twenty-five definitions are needed to understand and clarify terminology or procedures involved in administering state contracts and the Small Business Procurement Program. These definitions have been consolidated under this part for more effective organization and ease of reference.

Subpart 2, "affiliate or subsidiary of a business dominant in its field of operation" - affiliates or subsidiaries of dominant businesses or businesses owned by persons actively involved in dominant businesses, have

access to an established support and mentoring system, and are not normally in need of the assistance provided by the Small Business Procurement Program. A 20% (or more) interest in a business normally has an impact on how that business is operated. This definition, when used in conjunction with program eligibility criteria, will ensure that only those small businesses without significant ties to dominant businesses will receive the benefits of the program.

Subpart 3, "broker" - has been expanded to include ongoing agreements with a manufacturer's authorized distributors as a means of establishing that a business does not operate as a broker.

Subpart 4, "business" - limits the definition of business for the purpose of this program to "for profit" enterprises. Non-profit endeavors have other support and benefit programs available to them.

Subpart 5, "contractor" - no change.

Subpart 6, "dealer, jobber or distributor" - no change.

Subpart 7, "debarment" - defines the term in relation to the program and eligibility to bid on state contracts. The rule as proposed includes a debarment procedure which is needed to eliminate unfair, unscrupulous, ineffective or criminal vendors from participating in public procurement programs.

Subparts 8, and 9, "director" and "division", existed in the previous rule and have been revised to reflect changes in organizational titles and responsibilities in the Department of Administration.

Subpart 10, "franchises" - franchise operations normally do not meet the criteria for "ownership and control" of a business required of individuals seeking certification under the Small Business Procurement Program. As specified in 1230.1700 subpart 5 (a) "criteria for

determinations", cites the terms meeting test of ownership needs under which franchise agreements will be evaluated for eligibility.

Subpart 11, "joint venture" - rewritten to reflect new terminology such as "targeted group" or "economically disadvantaged area businesses" provided in the statute which authorized the Small Business Procurement Program (see definition of targeted group businesses) as it applied to that program. Balance of definition unchanged under meanings used for state contracts in general.

Subpart 12, "liquidated damages" - no change.

Subpart 13, "manufacturer" - no change.

Subpart 14, "manufacturer's representative" - expanded to include agreements with manufacturer's authorized distributors, this recognizes that some large manufacturers are organized to deal only through authorized distributors.

Subpart 15, "material variance" - no change.

Subpart 16, "open market" - purchases made at amounts below specified statutory limits may be made by bid or on the open market. This definition is needed to clarify what is meant by the term "open market".

Subpart 17, "person" - needed to clarify the meaning when "business" or "person" terminology is used interchangeably.

Subpart 18, "principal place of business" - needed to clarify meaning when benefits or preferences are dependent on location.

Subpart 19, "reinstatement" - is needed to define the precise meaning when a debarment action is involved. Eligibility one year from the end of the debarment period is needed to provide sufficient time for the applicant to meet all the reinstatement criteria specified in Part .1175.

Subpart 20, "responsible bidder", was expanded to include an ability to obtain bonding and to be free from criminal activities, or debarment by other government entities, and unresolved tax problems, as additional requisites defining responsible bidder. These requisites are needed to prevent the loss of time, effort and money by the state in dealing with "irresponsible" vendors. Inability to obtain sufficient bonding would expose the state to losses in the event of failure to perform if the project were awarded without such security. Additional costs and time are involved in rebidding projects or awarding to the next lowest bidder. Criminal activities, debarments and unresolved tax issues are all indicators of potential contract problems so such vendors should not be competing for state awards while those conditions exist. Provisions to expedite the exchange of information needed to qualify under this definition is also included so that the state and the bidder may establish status in a time period reasonable to both parties.

Subpart 21 - "SIC or Standard Industrial Classification" - the use of Standard Industrial Codes is needed as a statistical organizing and reference format for Department program reports, business size standards, and certified directory listings. The Department was directed by statute to consolidate reports from state agencies, the University of Minnesota and several Metropolitan Council Agencies, to develop size standards to describe small businesses that are variable by industry, and to publish a directory of certified businesses for use by the State and public entities cited above. The organizing format most easily maintained, referenced and updated, by the Department, given the variety of purposes, availability of data, and reporting needs involved is the SIC since the federal government keeps the code system and definitions updated on a regular basis.

Subpart 22 - "suspension" - both parties need to be protected when suspicious illegal or unacceptable activity is present. Suspension gives the State time to investigate, prevents further occurrence of the prohibited activity and places time limits on the process so that the vendor may know when activity can resume if the problem is resolved or the suspicion removed.

Subpart 23 - "targeted group businesses" - reflects new terminology created by statutory change. Identifies groups which are eligible for certain benefits under the Small Business Procurement Program, when so designated by the Commissioner as authorized in the Statute.

Subpart 24 - "terms governing socially disadvantaged persons" - no change.

Subpart 25 - "third party lessor" - no change.

Subpart 26, "small business eligible for certification as socially disadvantaged business or economically disadvantaged area business" - rewritten to provide a needed definition as Minnesota Statute 645.445 subdivisions 2 and 5 defining small business no longer apply to the Small Business Procurement Program enacted by the 1990 legislature. The "narrowly tailored" requirement of the court in *Croson v. City of Richmond* is met in restricting the program to for profit operations, located in Minnesota and owned by eligible persons as defined in subpart 24; all such needs or requirements are specified in the Statute enacting the Small Business Procurement Program.

Subparts 3, 5, 6, 11, 13, 14, 24, 25 and 26 have been relocated from definitions under the existing emergency rule 1230.1550. Subparts 3, 5, 6, 11, 13, 14, 24 and 25 also exist in the permanent rule now in effect and are incorporated here with no substantive changes other than those language or format changes shown under "general", II. proposed changes.

Part .0300 "soliciting bids" - purchase limitations will change over time in dollar amounts which reflect economic conditions of inflation or deflation resulting in the need to repeatedly update the rule. The statutory reference is not likely to change, therefore the rule, as revised, will normally reflect the existing limitations without constant revision. Use of the term "will be advertised" allows the Division, over time, to take advantage of developing technology such as electronic media in addition to the printed page to solicit bids. In subpart 2 the addition of the term "services" in conjunction with "commodities" reflects changes in the economy and in the administration of programs as more service type activities are contracted for state operations. Subpart 3 has been amended to provide for initial screening before being placed on bid lists. The numbers of vendors seeking access to state bid lists have grown over time. Managing these lists has become an administrative problem and a cost factor. Preparation and distribution of bid solicitations are a rising cost factor. Initial screening through an application process will help to ensure only responsive, responsible bidders are kept on state bid lists. Removing non-responsive bidders from the bid list without notice is needed to keep such lists effective and confined to bidders who actively respond to invitations to bid. In most cases non-responsive bidders have moved, gone out of business or no longer care to do business with the State. Notification is an unnecessary and additional cost factor to the State.

Part .0400 "Submission of advertised bids". Wording was rearranged for clarification and ease of reading, and is needed to emphasize that all bid conditions are not standard and that bidders should respond to



specified special conditions. The invitation to bid will be the defining document. It is reasonable to require that specific bid conditions which are applicable to a purchase supersede general bid terms.

Part .0500 "bid security". Grammatical, word choice changes only. No change of meaning or substance.

Part .0600 "bidder errors". Reworded to be gender neutral and to include technology improvements such as "facsimile" when appropriate.

Part .0700 "opening of bids". No significant change except that reference to 16B.07 on records retention and public availability is redundant in that Division records are public records for access purposes.

Part .0900 "tied bids". No significant change.

Part .1000 "contract performance". Grammatical and word changes only to reflect organizational titles, clarify, or for ease of reading.

Subpart 8, is revised to clarify that "discount" times offered by vendors do not commence, if testing is required, until test results are in hand.

Part .1100 "failure to perform". No significant changes. References and word changes made for clarity or for ease of reading. "Not promptly replaced" was deleted as being vague in terms and permitting the delivery of unacceptable goods or materials if replacement is then made.

Part .1150 "authority to debar or suspend". The authority and need for provisions to suspend or debar vendors arises from the Department responsibility to protect the public interest and public funds in state purchasing. The authority to administer the state purchasing programs encompasses the authority to preclude irresponsible bidders from bidding on state contracts and to debar when justified. Large scale procurement

programs such as that operated by the State provide vendors with opportunities for a variety of means to defraud, misrepresent, or provide inferior commodities and services. Circumstances also arise in which an otherwise legal vendor cannot, or will not, abide by the terms of a contract in-so-far as delivery times, quantities of goods or place and condition of delivery. Such circumstances going unresolved necessitates removal from State bid lists. The Department has a need to maintain a list of responsive and responsible bidders, therefore a means to remove vendors not meeting such criteria is required. Debarment provides the process needed to purge the lists of irresponsible or fraudulent vendors. This part describes the process which provides protection to the State and provides due process rights to the vendor through a suspension procedure while an investigation is conducted. It provides for written notice to the vendor, details acts and circumstances which can cause debarment, provides for reciprocity honoring debarment by other governmental activities, provides for an appeal and review process, defines and places limitations on the length of debarment, and requires that a public list of debarment actions be maintained for record purposes and as a reference for future "responsible bidders" determinations. The lengths of time specified in the appeal process are minimized so that the vendor may be protected from overly long administrative processes while providing time for the Department to conduct an effective review. Debarment periods of one to three years are considered reasonable. These terms provide protection to the State from continuous involvement in a running series of disputes with a contentious vendor while providing sufficient time for a debarred vendor to correct deficiencies and establish a new "track record" prior to applying for reinstatement. Each

of the debarment causes criterion in subpart 2 are necessary and reasonable grounds for debarment. Sections A, B, and C are all convictions, should a bidder be convicted of an offense related to public procurement it is reasonable to prohibit the bidder from participating in the state bid process. Part D is reasonable in that the performance of an awarded contract under all the specifications, time limits and other contract criteria is inherent to the concept of competitive bidding and contract awards. Part E is needed and reasonable in that the actions cited all violate and contaminate the integrity of the bid process.

Part .1175 "reinstatement and probation" - provides a means and process for a debarred vendor to be reinstated to State bid lists. Lists the information needed to apply for reinstatement and provides for a probationary period following reinstatement. Protects the applicant vendor from arbitrary administrative processes by describing the reinstatement process and information required. In providing for probation it protects the State from again needing to debar a vendor and in the case of continued failure authorizes permanent removal from State bid lists. The one year time period specified in the rule is considered reasonable. This allows the vendor time to correct deficiencies or establish a new "track record" while freeing the State from continuous investigation or litigation with a contentious applicant. The requirements for reinstatement in subpart 3 are reasonable and needed to provide sufficient information, data or performance statistics so that the method of evaluating whether or not a vendor should be reinstated is consistent, fair and based on an informed process.

Part .1200 - "contract cancellation" - recognizes that timeliness in delivery, as well as a condition of delivery, are important

considerations in contract performance. Late or untimely deliveries add costs to State activities and prevent the best application of public funds, it is therefore reasonable to include this condition as a basis for cancellation of the contract.

III. Proposed Rule - MR 1230.1400 through .1910 - Small Business Procurement Program

Extensive revision of these parts of the rule are necessitated by statutory changes that enacted a new program, based on the clientele of the old program (which was invalidated by Court stipulation) in *Sorenson Bros. Inc. v. Commissioner of Transportation and Commissioner of Administration* 1989, while incorporating some features and experience involved in administering the one year interim program which filled the gap between the two authorizations. These rules are more complex, extensive, and detailed than the previous rules because the authorizing legislation needed to respond to a wide variety of concerns, particularly those involving accountability, documentation and scrutiny outlined by the Courts in *J. A. Croson v. City of Richmond* and other similar cases.

Every effort has been made to minimize the impact on small businesses. When documentation or financial data is required the rule asks for, or accepts, only that which is normally provided to taxing, licensing or financial institutions in the public and private sectors. These data and disclosures are normal in the conduct of business by most private concerns.

The primary impact is absorbed or placed on the Department in administering or managing all the various provisions of the program. When data sources are used such data, as required, is commonly available in public reference libraries or through federal government publications. Even though the rule describes complex processes the net impact on the small business is no more burdensome than under the prior program which applied for more than 15 years.

Key words used throughout this rule are "targeted group" and "economically disadvantaged area" small businesses. Each has a very specific meaning, eligibility for various benefits or preference are based on those meanings.

"Targeted group" - means small businesses owned and operated by specified minorities or persons of color, women, or the physically disabled, which are identified by and so designated by the Commissioner of Administration based on data and statistics showing that the group or subgroups in question have failed to receive an equal share of public contract awards in proportion to their representation and availability in the market providing commodities and services needed by the State and other public entities. The "targeting" of businesses can be by groups or subgroups of people providing specific commodities or services. Such groups are identified with reference to the four-digit SIC (Standard Industrial Code) numbers published by the Federal Government.

"Economically disadvantaged area small business" means businesses owned by persons regardless of race, color, gender or physical ability who live in, or conduct business from, a designated economically disadvantaged area. At the county level the U.S. Department of Labor designates labor surplus areas based on unemployment statistics. These labor surplus areas are eligible as economically disadvantaged areas. Also eligible as economically disadvantaged areas are counties where the median income for married couples is less than 70% of the statewide median income for married couples as determined by the State Department of Revenue. Sub-county areas based on targeted neighborhoods as described in Minnesota Statutes Section 469.202 or enterprise zones described in Section 469.167 may also be designated as economically disadvantaged areas by the Commissioner of Administration. Rehabilitation facilities or work activity programs are eligible for the same preferences as economically disadvantaged areas.

These definitions result in 10 categories of businesses eligible for certification under the program: businesses owned by Women, Alaskan Natives, American Indians, Asians, Blacks, Hispanics, the disabled, and businesses located in or owned by persons living in a labor surplus area, a median income county, or other such area so designated and rehabilitation facilities or work activity programs.

Part .1400 "purpose" - corrects statute and rule citations and specifies that preference programs are limited to targeted group and economically disadvantaged area small businesses as required by the legislation.

Part .1450 "scope" - Since all businesses operating under this program must also abide by rules governing state contracts, this part outlines the order of effect when conflicts occur. It is reasonable to have the more specific applicable rules take precedence over the general rules.

Part .1600 "Eligibility for Socially Disadvantaged or Economically Disadvantaged Area Small Business Program" - The "socially disadvantaged" program includes all targeted group businesses, and may also include businesses owned by socially disadvantaged persons providing commodities and services in non-targeted SIC classifications who are encountering a "lack of adequate external support". These businesses are eligible for certification under special criteria as an individual business, and not as a group, when they encounter discriminatory practices in the private sector which leads to inadequate economic support to maintain a viable, competitive business.

Under subpart 2 franchises are not eligible because in most cases franchise agreements do not meet the criteria for ownership or control. Where these criteria are met the business can be eligible for certification, but this is not normally the case.

The statute also requires that the program be limited to small businesses, and that the Department create criteria defining small business. This requirement recognizes that "small" in one commodity or service field may not necessarily be "small" in another field. The rule selects gross revenues or sales as the easiest factor to monitor, and describe a system, for defining the small business segment of the market in relation to that factor. The limitation that no size standard will

be set at less than \$1,000,000, is needed to ensure that no previously certified business which is otherwise eligible would be excluded when such business was certified under the provisions of Minnesota Statutes section 645.445 which is no longer applicable to this program.

Aggregate data from various financial reporting services is used to feed the calculation. Such data is available through subscription or is available in public reference libraries. Robert Morris Associates (R.M.A.) data will be the primary source as the breakdown of various financial data reported in their "annual statement studies" most closely matches the size categories involved in small businesses eligible for this program. The R.M.A. data also covers more than 90% of the SIC categories needed to classify the commodities and services offered by vendors doing business with the State. Data provided by Dun and Bradstreet or other appropriate reporting services will be used for the balance when needed. Using the average of 3 to 5 years of financial data from the reporting services is needed to determine trends free of one year anomalies caused by variables and unknowns in the economy.

Under subpart B.(4) the need to aggregate size standards under two and three digit SIC codes whenever feasible is directed at simplifying the standard lists to reduce the number of 4-digit standards from a potential of 1,002 to less than 400. Setting variance percentages requiring a 3-digit or 4-digit standard is needed to prevent excluding an otherwise eligible business because averaging reduced the standard.

The Department is responsible for establishing the size standard under the process outlined in the rules. Small businesses are not involved in



the definition process but do provide data on their own gross revenues or sales when applying for certification. The rule also provides for a recurring sequenced revision of the size standards so as to reflect current economic conditions. Use of the lower quartile data to establish small business size standards was selected as it coincides with the statutory requirement that 25% of all state procurements be acquired from small businesses. For example; under the concept of proportional purchasing used elsewhere in this rule, as a requirement specified by statute, the objective is to award contracts in accordance with representation in the marketplace. Since the statute also requires that 25% of all state procurements be obtained from small businesses it is reasonable to apply that percentage as a factor in determining small business size standards. The process examines individual segments of the marketplace as defined by SIC number and determines how many businesses share 25% of the reported market, based on total contract revenues or sales working upward from the lowest individual income reported and aggregating towards the 25% share. The small business standard is determined from the data so identified. It is reasonable then that the 25% share directed by statute for small businesses be obtained from the lower quartile in any given market segment.

Part .1700 "Certification of Eligibility" - The documentation specified in this part is needed to establish that the applicant meets the definition outlined in 1230.0150, subpart 26 "small businesses eligible for certification as a socially disadvantaged business or economically disadvantaged area business" and .0150, subpart 24 "terms governing socially disadvantaged persons" and subpart 23 "targeted group

businesses" or an individual business meeting socially disadvantaged criteria but not operating as a targeted business enterprise and "lacking adequate external support".

The need for financial statements is based on the requirement to limit the program to eligible small businesses. Providing the last complete three year statements, when feasible, permits the Department to compare the applicants sales or revenues averaged over a three year period with the appropriate size standard which is based on a three year average. Averaging both the standard and the applicants data minimizes the impact of one year anomalies in either the economy or the applicants enterprise. Longer term trends provide a more reliable basis to ensure that no applicant is unfairly excluded, and three years is a sufficiently adequate length of time to make this determination.

Definitions of the owners management responsibilities with appropriate resumes and descriptions of the duties of other key personnel, as required under subpart 1 D. (2), is critical in determining if the applicant actually manages the business or is a figurehead fronting for other interests.

Ownership is also a key element of certification, therefore documents establishing ownership, the percentage thereof, and the timing of acquisition as well as the method of acquisition are needed to prevent fraudulent applications and ensure that figurehead or "front" type organizations are not certified.

When the applicant seeks certification under the provision of "lacking adequate external support", provided for under subpart 1 B. (2), the financial data and organization of that data, outlined in subpart 1, E, F, and G, is based on a format in common use among the variety of loan and credit reporting associations such as Robert Morris Associates and Dun and Bradstreet. If the applicant was applying for credit with a supplier or financing from a lending institution the same data would be requested by those organizations, therefore it is reasonable for the Department to also request this information. In applying under the "lack of external support" provision the applicant is certifying that support from financial institutions in the private sector for financing, credit, bonding or insurance is not available. The intent of the Department is to review the applicant's financial statement in the same manner as did the private sector and arrive at conclusions such as; the applicant's company is not sound, and that the private sector action was justified, (in such case the applicant would be denied certification and would be referred for remedial assistance elsewhere in the public and/or private sectors), or that the applicants financial profile was adequate and that at some place in the private sector support should have been attainable but was not forthcoming, with the underlying assumption being the applicant is encountering private sector discrimination. Certification would then be granted assuming all other eligibility criteria were met. Investigation might also conclude that the applicant has a highly viable company and has access to adequate external support therefore the benefits of certification would be denied as superfluous or redundant.

While description of the financial data and documentation under the provision for "lacking adequate external support" seems highly detailed and complex it does not exceed that required by the private sector nor any of the various public taxing authorities with which the applicant must deal. The applicant is required to submit the data in the format provided from information which the applicant should have on hand in the normal course of yearly control of the enterprise, therefore all the requested information is needed and reasonable.

Subpart 2 and 3, "grounds for claiming disadvantaged status" and "income statement" respectively are repealed as being superceded by the requirements of subpart and statutory changes. This is needed and reasonable to preclude redundancy and to eliminate confusion in terms and requirements.

In subpart 5, grounds for denying certification are described in detail so as to provide a rational basis for such action and for an appeal process when needed. The purpose of certification is to certify that the applicant meets all eligibility criteria and is exactly who the applicant represents to be, therefore falsified information on an application is grounds for rejection.

Subpart 5 F. states that franchise operations are not eligible because such agreements do not meet with the criteria for ownership and control therefore a franchise usually must be denied certification.

Under subpart 5 H. the Department is required to place time limits on participation in the program stemming from Court decisions and court "scrutiny" requirements and the legislative statute, therefore when a previously certified business or owner is decertified based on the time limitations specified elsewhere in the rule any application based on shared ownership with the decertified owner or business must be denied.

Subpart 5 I. states that denial of applications under the "lacks adequate external support" provisions must be made when the profile is under, or exceeds, the parameters specified. If "under" the profile parameter the company is probably not viable and would not meet the criteria set for being a "responsible vendor" under general contract rules; other remedial action must be taken before the applicant can again seek certification. If the applicant "exceeds" the profile parameters the applicant is operating a highly viable company which has succeeded despite the presumed discrimination and is not in need of the benefit or support that certification in the program provides.

In subpart 5 a. A thru H a major requirement for certification is that the applicant owns and operates on a day-to-day basis the company for which certification is sought. This is necessary to prevent fraud through front organizations, by absentee ownership, or by concealing control by dominant businesses or partners not meeting the definition of socially or economically disadvantaged persons. The criteria specified in the rule justifies the documentation required, the uses to which such documentation is put, and the conclusions which can or must be drawn

from this process. These criteria also form the basis on which decisions to deny or decertify may be appealed, thereby providing the applicant with protection from arbitrary or unilateral unsupported administrative decisions.

Exceeding the size standard for a given field of business automatically disqualifies the applicant from certification. To prevent owners from splitting off operations and forming more than one company, when the size standard is exceeded thereby showing two or more companies "under" the standard, it is necessary to confirm sales or contract revenues for same ownership companies in related fields.

In subpart 5 A I. the standards shown for certification under the "lacks adequate external support" provisions are the same as those used by financial institutions in the private sector. Exclusion of companies operating in the lower or upper quartile of the financial profiles is self-explanatory as written in the rule. The ratios used in determining eligibility for certification based on "lack of support" in long-term or working capital financing or in attaining equipment, raw materials or supplier trade credit are the same as used in the private sector and have proven reliable over the years when based on economy or industry wide experience.

Under subpart 5 a I(3) the financial ratios which will be used and are to be developed from the data submitted by the applicant are needed to assess the company's viability and are reasonable in that such measures are used throughout the financial community in the private sector.

For long term or working capital financing; earnings before interest and taxes (ebit)/interest is a measure of a firm's ability to meet interest payments; a high ratio may indicate that a borrower would have little difficulty in meeting interest obligations of a loan. This ratio also serves as an indication of a firm's capacity to take on additional debt. Sales/working capital; working capital is a measure of the margin of protection for current creditors. Relating the level of sales arising from operations to the underlying working capital measures how efficiently working capital is employed. Quick ratio - is a conservative measure of liquidity, (liquidity is a measure of the quality and adequacy of current assets to meet current obligations as they come due.) The ratio expresses the degree to which a company's current liabilities are covered by the most liquid current assets. Fixed/worth ratio is the extent to which an applicant's equity (capital) has been invested in plant and equipment (fixed assets); a lower ratio indicating a proportionately smaller investment in fixed assets to net worth and a better "cushion" for creditors in case of liquidation. The debt/worth ratio expresses the relationship between capital contributed by creditors and that contributed by owners. It expresses the degree of protection provided by the owners for the creditors. In total these ratios measure an applicants "liquidity" (defined above), "coverage", which measures a firm's ability to service debt and "leverage" position which is important in that highly leveraged firms are more vulnerable to business downturns than those with lower debt to worth positions. This is also an

important consideration in establishing the criteria limiting business participation in, and reliance on, the program which is discussed later in this statement.

For a determination involving lack of adequate external support involving obtaining equipment, raw materials, or supplier trade credit the current ratios and quick ratio are used. The quick ratio is described above. The current ratio is a rough indication of a firm's ability to service current obligations. Generally the higher the current ratio, the greater the "cushion" between current obligations and a firm's ability to pay them. Both the "current" and "quick" are measures of "liquidity", an important factor in extending short term credit.

Under subpart 5a I. (3) (d) any effectively marketed company operating in a viable commodity or service niche should be able to capture a proportionate share of its market in the absence of other factors such as management inefficiency or discriminatory practices. The method of determining proportionate share is based on a ratio of assets employed to contract revenues or sales gained as compared to the average company in the same field. After ruling out mismanagement, and all other factors being within acceptable parameters, failure to capture a proportionate market share can reasonably be attributed to discrimination factors in both the private and public sectors. Setting the qualifying limit at 75% or less recognizes that not all companies in a given field will achieve parity of 100% for assets employed, nor should they be expected to, however consistently "underachieving" in a



market when all other factors are accounted for is good evidence of exclusionary or discriminatory factors at work.

Subpart 5a I (4) is reasonable and needed to satisfy the Department that the response of the private sector in treating the applicants requests were not arbitrary and prejudiced. No reasonable private institution will under normal circumstances advance credit to a company suffering from inadequate management, nor should the Department accept as a "responsible bidder" such a company, therefore an assessment of management efficiency is need and considered reasonable. A series of ratios based on financial data can provide such an assessment; the following are considered as "operating" ratios and are intended to assist in the evaluation of management performance.

Percent profit before taxes/tangible net worth expresses the rate of return on tangible capital employed and can be used as an indicator of management performance when used in conjunction with other ratios since a high return normally associated with effective management could indicate an under capitalized firm and a low return usually an indicator of inefficient management performance could on the other-hand reflect a highly capitalized conservatively operated business.

Percent profit before taxes/total assets expresses the pre-tax return on total assets and measures the effectiveness of management in employing the resources available to it.

Percent depreciation, depletion, amortization/sales and percent officers' compensation/sales are indicators of management stewardship in maintaining a viable company or depleting it for other interests.

Recognizing both the "prior remedy" requirement of the courts and the departments' need to protect public interests and public funds - in procurement by only dealing with "responsible" vendors, applicants whose financial and other supporting documentation indicate a company suffering from inefficient, ineffective or, at worst, outright mismanagement needs other help. The Minnesota Department of Trade and Economic Development is organized to assist in these matters therefore it is reasonable to refer such an applicant for assistance before again considering certification.

Having ruled out all other factors including management problems it is reasonable to conclude that the applicant is encountering discrimination and prejudice in the private sector and is eligible for, and in need of, the benefits available through the Small Business Procurement Program.

The need to account for, or recognize, both long term or short term business cycles is needed to protect otherwise eligible applicants from spikes in their own business fortunes which might become disqualifiers if considered only on an annual basis. Averaging over a two to five year period will help to reduce this potential. Companies dealing in a variety of commodities or services across more than one industry could be impacted by a boom or upward trend in one industry, or stagnation or a reverse trend in another.

Subpart 5 a I (5) recognizes that specific products or activities can be removed from the targeted group category when so designated by the Commissioner, therefore a means of certification that adjusts to these limitations when a company operates over more than one category of commodities or services is needed to prevent decertification of an otherwise eligible company. Should these circumstances arise the applicant has an alternative available by disassembling and differentiating the required financial statements. In this case the full burden for such falls on the applicant and is probably more than is normally required in private sector dealings. No suitable alternative appears feasible however and the number of such requests based on this provision are anticipated to be small. This provision is provided in rule solely for the convenience and accomodation of the applicant as there is no requirement on the part of the Department to develop this provision.

In establishing an appeal process under subpart 6 it must be recognized that the certification requirements have become more complex in order to meet Court directed guidelines. This means that disputes based on facts or the iterpretation of facts are more likely. To shorten the appeal process in order to minimize costs and time constraints on both parties the Commissioner in these cases is now the first point of appeal. The time for appeal has been shortened from 30 days to 15 days and this time has been added to the time limit specified for reaching a final decision. This permits the Commissioner to use the Small Business Procurement Advisory Council for a recommendation. The Council membership is generally from the private sector with small business

each award depending on the bid costs provided by the competing vendors. This can range from none upward to the maximum of 6% as provided by statute.

Part .1820 Required Subcontracting for Construction, Consulting, or Professional or Technical Services.

Goals are needed to ensure proportional use of subcontractors by prime contractors. The Department normally has no direct contact with subcontractors except in the case of "pre-bid" for designated specialties such as mechanical trades when such "pre-bid" procedure is invoked. Therefore, the best means feasible of exerting control is to establish subcontracting goals based on the work to be done and the availability of certified targeted group subcontractors or vendors.

Some subcontractors supply labor as well as materials and supplies while others provide only materials and supplies allowing the prime contractor the option of when, or from whom to supply labor, therefore the provision for a 60%/40% split in credit toward attaining a goal when labor is not furnished recognizes the general relationship, for most work efforts, between these two subcontract elements. The intent is to discourage primes from passing large amounts of materials and supplies through a favorite vendor while doing very little to encourage employment levels among targeted subcontractors. In the same manner the provision requiring the targeted subcontractor to perform at least 75% of the subcontracted work is directed at this concern.

To protect the interests of the prime when faced with impractical, unattainable or unanticipated problems in attaining goals a waiver system needs to be provided for. The process proposed provides for waivers at various stages of the project. Goal requirements may be waived in the request for proposals or invitation to bid issued by the Department. The prime may request a waiver based on unsuccessful efforts in developing the response to the bid or request for proposal. The prime may request a waiver if unforeseen problems arise during the accomplishment of an awarded project. At each step in the process, pre-bid, bid, and project accomplishment the prime is afforded protection from unreasonable or unattainable goals or from unforeseen circumstances.

If penalties for failing to attain goals without a waiver are appropriate, then incentives to exceed what is required should also be necessary. If the bid document invokes the incentive clause, then a prime contractor who exceeds the established goal is entitled to an incentive award. As in the case of penalties, the prime in effect represents the interests of the subcontractor. The percentage and cap to the award are similar to those for penalties and accrue to the prime in accordance with the formula described in the rule. This has the same effect on bid calculations by the bidder as would a 6% preference award to a targeted group vendor or subcontractor who is able to bid directly on the project. The intent is to deliver work and contracts to the targeted group. A prime contractor who exceeds goal requirements is accelerating the process of reaching proportional awards and should be encouraged and supported.

The need to exceed an established goal by 3% and the cap of 25% reflects the accuracy of department proportional representation statistics at + or - 3% and the statutory requirement to deliver at least 25% of all procurement and contracting awards to small businesses. Certified targeted group contractors who obtain awards in open competition without preference, or not under "set-aside", are also eligible for the same incentives.

Penalties are also needed to ensure that goals are attained when the circumstances justifying waiver are not present.

A penalty of 6% not to exceed \$60,000 in the case of an awarded contract failing to meet goals without a waiver or in the case of an apparent low bidder not meeting bid or request for proposal goal requirements without waiver is reasonable in that these amounts are similar to what a targeted vendor would receive to win an award if able to bid on the project. The presumption is that, in effect, the targeted subcontractors interests are represented by the good faith efforts of the prime in attaining a goal. A waiver system is available, therefore a prime who does not work within the system to attain goals should not profit nor benefit from such actions. The \$60,000 cap on penalties also recognizes that most targeted group vendors or subcontractors would normally not be in competition on contracts over \$1,000,000.00 and if they were, would probably not qualify for certification initially based on exceeding size standards for annual gross revenues or sales.

An appeal process on proposed penalties is necessary to protect the prime contractor's interest and is provided in much the same manner as that

provided for certification denials, except that the first step in the appeal goes to the Director of the Materials Management Division. The time limits specified are also similar and intended to ensure an appropriate decision within a reasonable time period. This process, including contested case rights if appropriate, assure due process rights.

Through its directory of certified businesses and the statistical data it keeps for reporting, size standards and proportional purchasing analysis the Division has the best source of information needed to determine if prime contractors are exerting a good faith effort to utilize targeted group subcontractors and vendors; therefore when an unsatisfactory response to a goal is received in bids or in response to a request for proposals, from all parties, cancellation and rebidding is an appropriate alternative.

Part .1830 Preference Procurements from Economically Disadvantaged Small Businesses.

Award of a 4% preference as specified in Minnesota statutes §16B.19 subdv. 2 d, to an economically disadvantaged business is applied in the same manner as the 6% award for targeted group businesses. Preference allowances of both types may be applied to bids and will be so specified in the invitation to bid. This provision encourages all bidders to submit competitive bids since the outcome is not pre-determined. It is necessary and reasonable to use the request for bid document as the primary source for determining how and when the various preference percentages will be used.

Part .1850 Removal from Eligibility Lists or Directory of Certified Businesses.

A certified business may fail to fulfill a contract under the conditions governing state contracts, the penalty for such being removal from the bid listings. Such removal however does not effect its certification status or listing in the directory. Reinstatement to the bid lists is possible under the reinstatement rule for state contracts. All businesses, certified or not, are subject to these requirements.

Removal from the certified directory, however, requires specific circumstances as outlined in the rule. Removal from the directory does not imply removal from bid lists - the two are not interlinked. Decertification and removal from the directory occurs when changes in the owners or businesses circumstances, which originally led to certification no longer qualify, such as exceeding size standards, loss of labor surplus, or median income county status. In the case of loss of economically disadvantaged area status the 120 day period of remaining effectiveness after notice which coincides with the federal standard is maintained in this rule so as to eliminate confusion as to qualifying dates since the labor surplus designation is made by the federal government. Changes in ownership or control, citizenship, or principal place of business are other examples requiring a review of certification status. The appeal process is similar to others in the rule in so far as timing and decision limitations are concerned, but in this case offer the appellant an option for an informal or formal review. The certification process has, out of necessity, become so complex, that matters of fact may more often be involved, so an



alternative to go directly to a formal review is provided, in order to reduce the time involved in resolving status.

Part .1860 Limits to Program Participation

One of the court requirements contained in Croson v. City of Richmond, previously cited, is that preference programs cannot be open-ended and that a resolution or termination point is needed for a valid program. All of the limitations provided in the rule are meant to recognize this requirement. It is also reasonable to state that the public sector should not be the sole source of revenue for business enterprises and that the limitations should be directed at ensuring businesses develop multiple sources of revenue. This is necessary so as to act as a buffer to changes in the availability of public monies or projects and the changing economic cycles in the private sector; therefore annual limitations on revenues from individual public sources are reasonable when those sources of revenues are gained through preference or set-aside. The three-tenths of one percent limitation existed in the previous program and proved effective so it was incorporated into the new rule. Applying the 3/10ths limitation to individual agency determinations is needed in that the accounting and tracking systems used by these entities are not integrated and cannot respond, at this time, to day-to-day determinations, therefore each agency will monitor and apply this limitation as it effects its own operation. In no way, however, is any limitation placed on any vendor in obtaining awards through the normal competitive process despite these limitations.

Businesses are recertified on an annual basis. When financial statements or Department reports indicate the source of gross revenues or sales exceeds the percentages specified in the rule, the business shall be decertified; again no limitations are placed on awards acquired through the normal competitive bid process. The percentages specified place no limit on the first year of operation when most businesses need all the assistance available but does gradually reduce or "wean" the enterprise over time, encouraging the business to find other sources of revenue.

Graduation from the program is another Court specified requirement; therefore in addition to the other means of decertification limiting participation, removal can occur when targeted groups attain a proportional share of awards, or an individually certified business exceeds the proportionate market share specified in the rule. The percentages used reflect the need to encourage a business in its initial year, and, as in awards gained under set-aside or preference reduce the reliance of the business on the public sector for its major share of sales or gross revenues. The percentages also recognize that over time in a new endeavor, in a new field, or an established endeavor in a stable or stagnant field that proportionate market shares may tend to become fixed. It is necessary to emphasize that the program is directed at helping small businesses survive and become viable, not in helping them to dominate the market.

Part .1900 General Terms and Conditions.

Inability to perform a contract for reasons beyond its control should not result in a punitive environment for a contractor, therefore remedial

assistance is a preferred option. The rule provides an opportunity for this assistance from qualified or responsible sources. The Division also has the option to postpone the award or completion of contract when circumstances permit so as to avoid loss of the awarded contract to the successful bidder while remedial actions are underway. The businesses record as a responsible bidder shall not be prejudiced unless the business fails to cooperate in the action of either the Division or the Department of Trade and Economic Development as provided for under Minnesota statutes §16B.20 subdv. 2. In such cases the handling of the problem shall revert to the regular procedure specified by rule for failure to perform.

Annual verification of data on file for a socially or economically disadvantaged business is needed so that the various provisions for size standards, limitations, graduation and ownership/affiliation requirements may be met. The process will involve verification of data on file with the Division and submission of any new data or changes applicable. This should limit the reporting requirement to only those items effected and minimize the burden on the business involved. Certification integrity is based on a cooperative exchange of information, failure to respond is sufficient grounds for removal from the directory.

#### Part .1910 Consultant, Professional and Technical Procurements

This part recognizes the role of individual agencies in managing and awarding these types of contracts and requires that the same criteria be applied to such awards. It also recognizes that some of this type of work is accomplished on an individual non-business related basis and exempts

such individuals from certification requirements but does require the agency involved to maintain records of such action and report the dollar amounts so awarded to the Department.

Repealer. Minnesota Rule 1230.0200 definitions has been renumbered as part .0150 by the revisor.

Part .0400 subpart 1 and 3 "invitation to bid" and "form and delivery" of bids have been repealed in that the process is too descriptive and proscriptive; repealing such provisions permits the Department the option of applying new technology and media advances when such is effective and feasible.

Part .0700 subpart 2 "recording and tabulation of bids" was repealed for the same reasons as stated above under part .0400.

Part .1500 - "scope" renumbered Part .1450 by the revisor and all subparts providing "definitions" relocated to part .0150.

Part .1700 subparts 2 and 3. " grounds for claiming disadvantaged status" and "income statement" have been superceded by new statutory terminology and requirements so are repealed as outdated, superfluous or redundant.

Part .1800 "establishment of set-aside procurements" repealed for the same reasons as shown under part .1700.

Part .1900 subparts 2, 3, 4 and 6. "Removal for set-aside list for failure to fulfill contract"; "removal from list when business no longer qualifies"; "appeal of removal"; and "subcontracting have been repealed for the same reasons as shown under part .1700.

Parts .2000 through .2300 "partial indemnification program" are repealed as this is no longer an operating program.

Impact on Small Business:

Minnesota statute §14.115 requires an agency to consider the impact of proposed rules on small business and to consider certain methods for reducing the impact of the rule on those businesses.

The Department considered all of the methods listed in §14.115 subdv. 2, for example, to the extent possible the Department established less stringent disclosure requirements. All of the information and disclosures required are necessary to determine if the business qualifies for the program. The financial information required should normally be in the hands of the business in order to conduct its day-to-day operations and to meet its annual reporting requirements to taxing authorities or to respond to private sector financial institutions when seeking assistance in that sector.

To require less information or reporting requirements for small businesses would controvene statutory objectives and direction that the benefits of the program be delivered only to legitimate qualified small businesses. The same need is also required to meet judicial "tests" outlined for such programs operated and administered by state and local governments.

In addition; the adoption of these proposed rules will not require expenditure of public money by local public bodies nor will it have any impact on agricultural land, therefore Minnesota statute §14.11 is not applicable.

Summarization

The rules proposed in parts .1400 through .1910 reflect the provisions of the Statute and are structured to carry out those provisions while maintaining the documentation needed, and the integrity of the program, as called for in the U.S. Supreme Court guidelines for the adoption of, and operation of, such preference based programs by state and local governments. The need for targeted groups, proportionate purchasing, limitations, and graduation all respond to the court requirements. The procedure for removal from bid lists, decertification or removal from the directory protect the State's interests and responsibility for management of public funds. The appeals processes provided protect the interests of the vendors and contractors in the private sector against arbitrary state decisions and prolonged administrative procedures. The program ensures that the assistance benefits intended for socially or economically disadvantaged groups by the legislation are delivered to those groups only. It also provides incentives for private sector actions in assisting to carry out the program and penalties for those who hamper or refuse to abide with the requirements. It meets the needs of the public sector, the court requirements and the legislative authorization. These rules are a reasonable balance of the interests of the parties involved and are directed at promoting cooperation and minimizing conflict in a fair and well defined process.

*Dana B. Badgerow*

\_\_\_\_\_  
Dana B. Badgerow  
Commissioner of Administration

April 1, 1991

\_\_\_\_\_  
Date