

# THE CERTIFICATION ELIGIBILITY OF SMALL BUSINESSES: WHAT YOUR CLIENTS NEED TO KNOW (PART 2)



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Anita has more than 30 years of experience providing legal services, consultation, strategic guidance, training, and advocacy to government contractors, including industry leaders that are large, mid-sized, family-owned and small businesses that are disadvantaged-, minority-, women- and veteran-owned businesses. She has also served as legal counsel to several state and local governmental agencies, including public housing authorities on Section 3 business matters. Anita has been one of the nation's most effective advocates of supplier diversity in the public and private sectors. She has received a number of awards for her outstanding legal accomplishments. Preceding private practice, Anita served as the Director of Certification and Director of Contract Compliance for a major governmental agency. She is admitted to practice law in Illinois. She received her JD from the University of Florida Levin College of Law and her Bachelor of Science degree with honors from Fisk University.

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## INTRODUCTION

Government agencies and Fortune 500 companies nationwide have supplier diversity programs that are intended to facilitate the establishment, growth, and success of small businesses that are majority-owned, controlled, and operated by one or more persons who are deemed to be disadvantaged, minority, woman, veteran, disabled, and/or belonging to the LGBT community. Businesses that are owned by these individuals are commonly referred to as disadvantaged business enterprises (DBEs), minority business enterprises (MBEs), women business enterprises (WBEs), veteran-owned business enterprises (VBEs), business enterprises owned by people with disabilities (BEPD businesses) or LGBT-owned business enterprises (LGBT businesses). Small businesses obtain these designations after they apply for and receive certification from a certifying entity or certifier.

Supplier diversity programs help such certified small businesses become successful by offering them a variety of benefits and opportunities to compete for

and secure contracts and subcontracts from government agencies, their prime contractors and consultants, and from many of the top corporations nationwide. The first article in our Government Contracts and Diversity series<sup>1</sup> discussed: (i) the benefits that are available to small businesses after they obtain their certification eligibility; and (ii) how attorneys can help their small business clients navigate the certification process to achieve their business goals. This article will discuss: (i) common certification eligibility requirements; and (ii) how attorneys can help their small business clients obtain certification eligibility from governmental and not-for-profit certifying entities nationwide.

The certification application process is often extensive, document-intensive, time-consuming, and complex, as well as exhausting to applicants. Most applicants do not review the applicable certification requirements before they apply for certification eligibility. Among those applicants who do review them, they do not fully understand how certifiers apply the requirements to determine their certification eligibility. The more extensive

or comprehensive the requirements are, the more likely they will not be reviewed or understood by certification applicants. However, comprehensive certification requirements are generally considered to be more credible because they are more effective at preventing unqualified applicant businesses, commonly referred to as “front companies,” from obtaining certification eligibility and contract opportunities that are specifically targeted or set aside for certified businesses.

Certification requirements often differ from certifier to certifier, although there are some common requirements that typically must be met by most certification applicants. This article will focus on the federal certification requirements of the United States Department of Transportation (DOT) which we believe are the most comprehensive certification regulations nationwide. These certification regulations are implemented by state transportation agencies that are funded by DOT, as well as many local and not-for-profit certifiers. If you have small business clients or seek to represent them, you should not only know the benefits of certification and how you can help small businesses receive them, but also the certification eligibility requirements of the certifier from which your clients seek certification eligibility.

### **WHAT ARE THE CERTIFICATION ELIGIBILITY REQUIREMENTS?**

As we discussed in Part 1, a certified business is at least 51 percent or more owned, controlled, and operated by one or more United States citizens who are: (i) women; (ii) Black, Asian Indian, Asian-Pacific, Hispanic and/or Native American; (iii) veterans; (iv) persons with disabilities; or (v) persons who are LGBT. Whether a business is deemed to be majority-controlled by these individuals depends on its management and daily operations. Most certifying agencies have certification requirements that specify the eligibility criteria and application process for businesses that are seeking certification. DBE, MBE, WBE, and VBE certifications are the most common types of certifications.

Before you complete and submit a certification application for your client or approve an application for submittal, you should conduct a comprehensive certification eligibility analysis to determine whether there are any eligibility issues that should be addressed before the application is filed. You should also review the applicable certification requirements of the entity from which your client is seeking certification, which may differ from some of the requirements that we discuss here. Subsequently, you should review a draft application and the required supporting documents from your client to identify certification eligibility issues; propose a legal strategy to address each issue; and develop an action plan with the client to execute the legal strategy to facilitate its certification.

### **The DBE Program of the DOT**

A good place for attorneys to start to become familiar with certification eligibility requirements is with the DBE certification requirements of DOT. The DBE program is designed to remedy ongoing discrimination and the continuing effects of past discrimination in federally assisted highway, transit, airport, and highway safety financial assistance transportation contracting markets. The primary remedial goal and objective of the DBE program is to level the playing field by providing small businesses, owned and controlled by socially and economically disadvantaged individuals, a fair opportunity to compete for federally funded transportation contracts.

DOT’s operating administrations distribute substantial funds each year to finance construction projects initiated by state and local governments and public transit and airport agencies. DOT has the responsibility of ensuring that firms competing for DOT-assisted contracts for these projects are not disadvantaged by unlawful discrimination. The DOT’s most important tool for meeting this requirement has been its DBE program, which originally began in 1980 as a minority/women’s business enterprise program established by regulation under the authority of Title VI of the Civil Rights Act of 1964 and other nondiscrimination statutes that apply to DOT financial assistance programs. The DBE program

was reauthorized by Congress several times since its inception, most recently in the Fixing America's Surface Transportation Act or the FAST-ACT.<sup>2</sup> Section 1101(b) of the Act describes Congress's findings regarding the continued need for the DBE program due to the discrimination and related barriers that pose significant obstacles for minority- and women-owned businesses seeking federally-assisted surface transportation work.

To meet the objectives of the DBE program, recipients (i.e., state and local governments and public transit and airport agencies) that receive funding from DOT for construction projects, must develop and implement a DBE program that conforms to DOT standards.<sup>3</sup> The DBE programs of funding recipients must include contract goals for DBEs to participate on their DOT-funded contracts. The integrity of DOT's DBE program depends upon systematic certification procedures to ensure that only bona fide DBEs are certified to participate on DOT-funded contracts nationwide. The DBE regulations place the primary responsibility for the certification process upon state transportation agencies. We will now provide an overview of the federal DBE certification standards which include many of the requirements of certifiers nationwide.

### **DBE/MBE/WBE certification eligibility requirements**

A DBE must be a for-profit business that is at least 51 percent owned and controlled by a socially and economically disadvantaged individual. A DBE must also be a small business, as defined by the US Small Business Administration (SBA). There is a rebuttable presumption that certain individuals are socially disadvantaged: Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and members of other groups designated by the SBA. Most certifiers require that a certified business be at least 51 percent owned and controlled by minorities or women. The common requirements among certifiers that implement DBE programs and/or other types of programs (i.e., MBE and WBE programs) are the rules governing the determinations of majority ownership and control.

### **Majority ownership by minorities or women**

When determining whether an applicant is at least 51 percent owned by minorities or women, all facts in the record, as presented by the applicant in its certification application, are viewed as a whole, including the origin of all assets and how and when they were used in obtaining the business. The contribution by minorities or women to acquire their ownership interests must be considered substantial. An exception to this requirement includes interests in a business obtained in a final property settlement or court order in a divorce or legal separation or through inheritance.

Because the contribution from minority and women owners to acquire their ownership interests must be substantial, the federal regulations provide guidance to certifiers by identifying the types of contributions that should be deemed insufficient. Insufficient contributions include: (i) a promise to contribute capital; (ii) an unsecured note payable to the firm or an owner who is not a disadvantaged individual; (iii) mere participation in a firm's activities as an employee; and (iv) capitalization that is not commensurate with the value for the firm. Additionally, disadvantaged owners must enjoy the customary incidents of ownership, such as sharing in the risks and being entitled to the profits and losses commensurate with their ownership interests.

It should be noted that the federal DBE regulations have additional rules governing ownership that we do not discuss because they are not generally required by certifiers that do not implement DBE programs. These rules, for example, have specific ownership requirements for: corporations, partnerships, and limited liability companies; securities or assets held in trust; situations in which expertise is relied upon as part of a disadvantaged owner's contribution to acquire their ownership; situations in which marital assets form a basis for ownership; and gifts and transfers or ownership interests.

### **Majority control by minorities or women**

When determining whether an applicant is at least 51 percent controlled by minorities or women, all

facts in the record, as presented by the applicant in its certification application, are viewed as a whole—like ownership determinations. The primary reason why applicants are denied certification is because they fail to meet the control requirements for eligibility. Certifiers do not deem an applicant to be majority-controlled by minorities or women simply because it is majority-owned by minorities or women. There are separate and distinct requirements for determining whether an applicant is controlled by minorities and women—after the ownership requirement has been met.

A DBE applicant must be an independent business for certification eligibility. To be deemed an independent business, the applicant must be a viable business that does not rely upon the resources of non-DBE firms to operate and/or provide goods or services. During the certification evaluation process, certifiers will scrutinize the daily operations of the applicant by reviewing several factors, including its personnel, facilities, equipment, finances, bonding support, employment history, and its relationships with non-DBE firms. Relationships that an applicant have with non-DBE firms must be consistent with normal industry practices to be deemed acceptable for certification eligibility.

A DBE applicant must not be subject to any formal or informal restrictions which limit the disadvantaged owners from making any business decision of the firm without the cooperation or vote of any non-disadvantaged individual. For instance, the disadvantaged owners cannot be subject to restrictions through corporate charter provisions, by-laws, contracts, or voting trusts. Disadvantaged owners must possess the power to direct or cause the direction of the management and policies of the firm, and make the daily and long-term decisions on matters of management, policy, and operations.

Specifically, the disadvantaged owner must hold the highest officer position in the company (i.e., president or chief executive officer). If the applicant is a corporate entity, the disadvantaged owners must control the board of directors. If the applicant is a partnership, one or more disadvantaged owners

must serve as general partners with control over the partnership decisions. Disadvantaged owners must have an overall understanding of, and managerial and technical competence and experience directly related to, the type of business in which the firm is engaged and the firm's operations.

Examples of insufficient expertise include office management, administration, and secretarial or bookkeeping functions. If the state or local law requires persons to have a particular license to own and/or control a certain type of firm, the disadvantaged persons who own and control the firm must possess the required license. In addition, certifiers typically scrutinize the compensation or income of the owners of the applicant to determine whether it is commensurate with their ownership interests and responsibilities. Disadvantaged owners must work full-time for the applicant and cannot engage in outside employment or other business interests. Notwithstanding the federal DBE requirements, some certifiers will allow disadvantaged owners to own and operate more than one business, as long as they control the applicant's daily operations.

It should be noted that the federal DBE regulations have additional rules governing control that we do not discuss because they are not generally required by certifiers that do not implement DBE programs. These rules, for example, govern the certification of franchises or licensees, partnerships, firms that use an employee leasing company, regular dealers, newly formed firms, not-for-profits, Indian tribes or Native Hawaiian organizations, and Alaska Native Corporations (ANCs).

## **WHAT IS THE ATTORNEY'S ROLE IN THE CERTIFICATION PROCESS?**

Certification has proven to be one of the best tools for small businesses to get their foot in the door of major corporations and government agencies that have MBE/WBE or supplier diversity programs. One of the best ways that attorneys can help their small business clients achieve their business goals in the public and private marketplaces is by encouraging those that qualify to obtain certification eligibility

from the right certifying entity, and by helping them to successfully navigate the certification process. Also, attorneys can help those that don't initially qualify by identifying and addressing their certification eligibility issues prior to their application submittal.

Although most attorneys with small business clients do not regularly practice in this specialized area of law, many nonetheless believe they can easily help their clients apply for and obtain certification eligibility. Depending on the circumstances, inexperienced and/or uninformed attorneys can prolong and complicate the certification application process for their clients, resulting in a denial of their certification eligibility, refusal to pay related legal fees, and possible termination of the attorney/client relationship. As we discussed in our first article of this series, there are three important ways an attorney can help small business clients seeking certification eligibility achieve their business goals and avoid unintended consequences that may negatively impact their business or the attorney/client relationship.

### **Determine whether the business qualifies for certification eligibility**

There are many governmental and nonprofit certifying agencies nationwide. Most of them have a number of certification requirements, as previously discussed, that must be met in order to certify a small business applicant. Before you complete and submit a certification application for your client or approve their application for submittal, you should conduct a comprehensive certification eligibility analysis to determine whether there are any eligibility issues that should be addressed before the application is filed. You should: (i) review the applicable certification requirements of the entity from which your client is seeking certification; (ii) review a draft application and all of the required supporting documents to identify certification eligibility issues; (iii) propose a legal strategy to address each eligibility issue; and (iv) develop an action plan with the client to execute the legal strategy to facilitate its certification. Do not submit the application until all eligibility issues have been fully addressed and properly

documented. Applicants can be denied certification based on only one certification issue which may not be disclosed by the certifier in its certification denial letter. A denial of certification eligibility by one certifier often results in subsequent denials by other certifiers.

### **Avoid common certification application pitfalls**

There are common mistakes that certification applicants make that may prevent their certification eligibility. Some of these pitfalls include: (i) the submittal of incomplete or inaccurate certification applications; (ii) failure to submit each of the required documents on the certification checklist; (iii) failure to provide an explanation for documents that do not apply to the applicant; (iv) failure to submit current documents; and (v) failure to submit copies of legible, complete and/or executed documents. Your client should provide you all of the documents on the applicable certification checklist to review. You should make sure that each certification document is complete, accurate, current, and legible. You may also need to draft missing documents and/or recommend the submittal of other business documents to meet the submittal requirements. You can significantly increase the likelihood of your client obtaining certification eligibility by making sure that it submits a complete certification application with all required supporting documents, pursuant to the specified instructions. This will also decrease the amount of time it takes the certifier to complete its evaluation process and for your client to receive certification. Incomplete applications can significantly prolong the certification process which could prevent an applicant from fulfilling a DBE/MBE/WBE contract participation goal on a contract.

### **Properly respond to certification inquiries and denial decisions**

After a certification application is submitted, it is initially reviewed by the certifying entity for completeness. If the application is incomplete or if the certifier has questions about any of the certification documents, it will request additional information or documents from the applicant. You should advise

your client to inform you of all inquiries by the certifier for additional information. You should prepare or review and approve all responses by your client to the certifier prior to their submittal to ensure that the responses do not compromise your client's certification eligibility. You should also prepare your client for a site visit or interview that may be conducted by the certifier during the certification evaluation process. Applicants can be denied certification eligibility based on their responses to questions during a site visit or interview, regardless of the information provided in their certification application and supporting documents which may support their eligibility. If your client is denied certification eligibility, you should consider referring them to a law firm or attorney who has significant legal experience in successfully responding to certification denial decisions. Most certification denial decisions are upheld on appeal by the certifier or appellate agency.

## CONCLUSION

Certification is a no-brainer for eligible small businesses if they want to take advantage of the available benefits in the public and private marketplaces to help them grow, expand, and achieve their business goals. It is the stamp of approval that allows them to participate in DBE/MBE/WBE programs of Fortune 500 companies, other large businesses, and governmental agencies. Certification is one of the best tools that a small business can obtain to achieve and sustain their success. In addition to securing major contract or subcontract opportunities, there are many other benefits to being certified that we discussed in our first article. Because of these benefits, there is a lot of fraud by ineligible applicants or front companies that seek to obtain certification eligibility. The purpose of certification eligibility requirements is to prevent and reduce fraud in

DBE/MBE/WBE programs by preventing ineligible companies from receiving certification and fulfilling contract participation goals that are intended for DBE/MBE/WBEs.

Each certifying entity has its own certification eligibility requirements, certification application, and certification application process. If your client is certified by one agency, it does not mean that it will be certified by another agency. Unfortunately, if your client is denied certification by a certifying entity, it increases the likelihood that it will be denied by another certifier. Before you provide small businesses with legal consultation in this specialized area of the law, make sure that you have fully reviewed and understand the applicable certification eligibility requirements. When in doubt, consider referring your client to a small business organization or government agency that provides certification assistance or, alternatively, to an experienced government contracts attorney in private practice.

During these economically challenging times, certification eligibility can help your small business clients to significantly increase their revenues, grow their business, and achieve their business goals. Helping your clients to successfully navigate the certification process will also help you grow and expand your client base and give you opportunities to provide them additional legal services. The next two articles in our Government Contracts and Diversity series will discuss: (i) certifiers in the public and private sector which certify businesses that seek contract opportunities with government agencies and/or Fortune 500 companies that have DBE/MBE/WBE programs; and (ii) the certification application process, including the application form and required supporting documents. 📌

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### Notes

- 1 Anita Ponder, *The Certification Eligibility of Small Businesses: What Your Clients Need to Know*, *The Practical Lawyer*, Vol. 68, No. 1 pg. 38 (ALI CLE Feb. 2022).
- 2 Pub. L. No. 114-94, 23 USC § 101 (Dec. 4, 2015).
- 3 49 C.F.R. § 23.1 et seq.; 49 C.F.R. § 26.1 et seq.