

DISADVANTAGED AND MINORITY BUSINESS CERTIFICATION IN SOUTHCAROLINA



By Jack Pringle

Introduction

In South Carolina there are several programs designed to benefit those businesses owned and controlled by “disadvantaged” individuals. The key to obtaining certification or designation under all these programs is a demonstration that a qualified individual “owns” and “controls” the business. While those terms certainly appear straightforward, there are pitfalls for those businesses who do not understand the application process, the applicable rules, and their purposes.

Background and Benefits of Certification

Both federal and state law encourage the participation of businesses owned by certain groups in government contracts. On the federal level, these businesses are called Disadvantaged Business Enterprises (DBEs), and on the state level they are called Minority Business Enterprises (MBEs). (There are other flavors of certification as well, but this post addresses the most common).

Federal Law and DBEs: Participation in Federal Projects

The DBE Rules, found beginning at [49 C.F.R. § 26.1](#), provide that no less than 10% of the federal funds spent in connection with South Carolina projects receiving federal funding from the Federal Aviation Administration (FAA), the Federal Highway Administration (FHWA), or the Federal Transit Administration (FTA) should be spent with DBE firms. In practical terms, this means that the DBE Rules encourage DBE participation in highway contracts, airport improvement projects,

The South Carolina Department of Transportation (SCDOT) administers a [Unified Certification Program \(UCP\)](#) on behalf of all agencies who implement these projects, and makes certification decisions according to the criteria set out in the DBE Rules. SCDOT also maintains a [Unified DBE Directory](#) listing all businesses certified as DBEs in South Carolina.

State Law and MBEs: Procurement, Tax Credits, and Tie-Breaking Bid Preference

The [South Carolina Consolidated Procurement Code](#) references a “socially and economically disadvantaged small business,” a term used interchangeably with “MBE.”

Each state agency must develop a MBE Utilization Plan, which includes goals to spend 10% of expended funds with MBEs certified by the [South Carolina Office of Small and Minority Business Assistance \(OSMBA\)](#), and to solicit certified MBEs in each category of goods or services for which those MBEs are qualified. OSMBA maintains a [list of certified minority vendors](#) for use by state agencies.

Per [S.C. Code Ann. Section 12-6-3350](#), firms with state contracts subcontracting with MBEs are eligible for a state income tax credit equal to 4% of the payments to MBE subcontractors on a state contract (up to \$50,000 in any one year). Additionally, any tie bids involving a MBE under the competitive sealed bidding provisions of the South Carolina Procurement Code must be awarded to the MBE.

OSMBA applies the DBE Rules in its determinations, as well as the provisions of [S.C. Code Ann. Regs. 19-445.2160](#).

Certification Requirements

Under the DBE Rules and South Carolina law, a firm must demonstrate several things in order to obtain certification.

Small Business. The firm must be a “small business,” with average annual gross receipts over the previous three fiscal years of no more than \$22.41 million (as of the date of this post- the figure is adjusted from time to time).

Ownership by a Disadvantaged

Individual. Second, the owner must be a socially and economically disadvantaged individual. The members of a number of minority groups, including women, Black Americans, Hispanic Americans, Native Americans, Asian-Pacific Americans, and Subcontinent Asian Americans enjoy a rebuttable presumption of social and economic disadvantage under the DBE Rules. Under the South Carolina Consolidated Procurement Code, social disadvantage is established by membership in a particular minority group, but economic disadvantage is made on a case-by-case basis. In addition, the disadvantaged individual's personal net worth cannot exceed \$1.32 million.

Real, Substantial and Continuing

Ownership. Third, the disadvantaged individual must own at least 51% of the firm. While that proposition appears completely objective, in practice the rules require that ownership be shown by substance as opposed to mere form. Because the DBE Rules are designed to root out “fronts” where one or more non-disadvantaged individuals really own the firm, the SCDOT will seek support for the ownership proposition beyond the bare language in a shareholder or operating agreement. Accordingly, certain facts and arrangements may raise “red flags” with respect to ownership:

- The disadvantaged individual does not share in the risks and profits of the firm commensurate with her ownership interest;
- The disadvantaged individual obtains her interest in the firm by means of a gift or a transfer without adequate consideration, especially when the donor is non-disadvantaged and involved in the same business or a similar line of business as the firm;
- The disadvantaged individual obtains her ownership interest through a “sweetheart” deal, such as a promise to contribute capital, an unsecured note payable to the firm, or mere participation in the firm as an employee.

The DBE Rules also have some specific provisions addressing marital assets used to purchase ownership by a disadvantaged individual, so particular attention must be given to how that acquisition takes place.

Control. Fourth, the disadvantaged individual must demonstrate control of the firm. Several “red flags” may demonstrate a lack of control by the disadvantaged individual, including:

- The firm relies on one or more other businesses for its resources (e.g. personnel, facilities, equipment, financial and/or bonding support), such that its independence is compromised. If a non-DBE firm is in the position to exercise influence over the firm, then the disadvantaged individual may not truly control the firm.
- The disadvantaged individual lacks the power to direct the management and policies of the firm, and to make day-to-day and long-term decisions.
- The disadvantaged individual has outside interests or other employment that compromises her ability to manage the firm.
- The disadvantaged individual lacks an overall understanding of the firm’s business.
- The disadvantaged individual lacks the absolute right to hire and fire;
- A non-disadvantaged individual who previously controlled the firm remains involved in the firm in some capacity;
- The non-disadvantaged partners of the firm have the right to bind the firm contractually without the concurrence of the disadvantaged individual.

Conclusion

An applicant seeking designation as a DBE or an MBE must demonstrate to the SCDOT or the OSMBA that the disadvantaged individual truly owns and controls the firm. Moreover, the applicable rules make clear that these programs are to be “narrowly tailored” to ensure that only those firms that fully meet eligibility standards can participate. As a result, an applicant needs to make sure that it meets the letter and the spirit of each such requirement.