

# Fiscal and Regulatory Impact Analysis

Prepared by

Haley Pfeiffer Haynes  
Deputy Secretary for Service Operations  
[haley.pfeifferhaynes@doa.nc.gov](mailto:haley.pfeifferhaynes@doa.nc.gov)  
(984) 236-0000

Donya Strong, General Counsel  
NC Department of Administration  
[donya.strong@doa.nc.gov](mailto:donya.strong@doa.nc.gov)  
(984) 236-0000

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**A. General Information**

Agency:

NC Department of Administration

Title and Citation of Rule:

- 01 NCAC 05E .0101 Good Faith Efforts
- 01 NCAC 05E .0102 HUB Participation Goal
- 01 NCAC 05E .0103 Office for Historically Underutilized Businesses Responsibilities
- 01 NCAC 05E .0104 Purchasing Agency Requirements
- 01 NCAC 05E .0105 Vendor Requirements
- 01 NCAC 05E .0106 Historically Underutilized Business Responsibilities

Statutory Authority:

N.C.G.S. §143-48, 143-48.4, 143-53

Impact Summary:

- State Government: Yes
- Local Government: No
- Federal Government: No
- Substantial Impact: Yes

Statement of Impact:

The impact to State government is discussed in detail below.

**B. Background and Purpose**

In recognition of the historic disadvantage that minority, women-owned, and physically handicapped contractors have faced in public procurement, G.S. § 143-48(a) states that it is the policy of the State of North Carolina to encourage and promote the use of these historically underutilized businesses (“HUBs”) when procuring goods and services for the State. The statute requires that all State agencies, institutions, and political subdivisions cooperate with the Department of Administration (“the Department”) in efforts to encourage the use of these firms in the procurement of goods and services. The proposed rules are designed to operationalize the State’s policy in the procurement of goods and services by setting an annual HUB participation goal, requiring good faith efforts be made by vendors that intend to subcontract part of a project, and establishing the responsibilities of the Department’s Office of Historically Underutilized Businesses (“HUB Office”), purchasing agencies, vendors and HUBs.

In 2020 the Department contracted with an independent organization, Griffin & Strong, P.C. (“GSPC”), to conduct a disparity study of State purchasing and contracting (“Study”). The purpose was

to determine whether there were disparities existing between HUB and non-HUB firms in state contracting. If those disparities still existed, then the Study aimed to inform the Department on the scope of the problems facing these firms so that policies and practices could be crafted to encourage and promote the use of HUBs. GSPC was tasked with conducting a study to determine the following:

- examine the extent of participation of minorities and women in the State’s procurement activities;
- collect and analyze relevant data to determine if there is a disparity between the number of minority and woman-owned businesses that are “ready, willing and able” as vendors in the areas of Construction, Architecture & Engineering (A&E), Professional Services, Other Services, and Goods;
- determine whether there are current discriminatory practices, or the present effects of past discriminatory practices in the State’s solicitation and award of contracts;
- determine if a legally justified need continues to exist for any or all the State’s remedial efforts or for new efforts regarding the awarding of contracts; and
- provide recommendations for actions to be taken by the State because of the findings of the Study, including serious consideration of race-neutral program options.

The contracting/subcontracting data of 29 state agencies and 80 colleges and universities across North Carolina were analyzed for the five-year period of fiscal years 2014-2018. The Study’s findings are published on the Department’s website and can be accessed here: [Disparity Study Report](#). The Study found that “[c]onsistent with the “narrow tailoring” aspect of the strict scrutiny analysis, the State continues to implement race- and gender-neutral measures to try to increase utilization of [minority and woman owned firms<sup>1</sup>], but the present Study shows that those measures have not been effective in ameliorating the identified disparities. Accordingly, the State has a basis to continue and/or introduce race- and gender-conscious remedies or policies toward that goal.”<sup>2</sup> (p. 12)

Furthermore, the Study found that there are statistically significant disparities across all minority and women owned business categories in prime contract utilization and total contract utilization (including sub-contracting) for the procurement of goods and services (p. 16). The Study made recommendations to address disparities that informed this rulemaking effort, including:

- Recommendation 3 to set aspirational goals for HUB utilization based on availability of HUB vendors (p. 24).
- Recommendation 4 to establish robust good faith efforts measures and provide reasonable means for vendors to demonstrate a good faith effort towards meeting the HUB aspirational goal (p. 25).

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<sup>1</sup> GSPC uses the term “minority or women owned business enterprises” or “MWBEs” in the Study. For ease of reference, this analysis uses the term “historically underutilized business” or “HUB” when referring to “MWBEs”. It should be noted that the statutory definition of HUBs includes 2 additional subgroups: disable owned and economically disadvantaged owned businesses.

<sup>2</sup> City of Richmond v. J.A. Croson Co., 488 U.S. 469 (1989), the leading US Supreme Court case on permissible government action to remedy the underutilization of minority- and women-owned businesses in public contracts, states that race- and gender-conscious policies are subject to the strict scrutiny standard of review. The strict scrutiny standard requires that the race-based policy must advance compelling governmental interests and must be a narrowly tailored remedy.

- Recommendation 7 to urge the State to provide robust and expansive supporting services to HUBs (p. 28).

### **C. Summary of Proposed Rules**

The proposed rules, attached as Appendix A, provide the requirements to be met when purchasing goods and services on behalf of the State of North Carolina. These rules, along with the newly adopted rules in 01 NCAC 05B, are the ways in which the Department of Administration seeks to encourage and promote the use of HUBs. Each rule is newly created and therefore has no history or previous version.

#### 01 NCAC 05E .0101 Good Faith Effort

This rule establishes that Purchasing Agencies must require vendors to make good faith efforts to recruit HUBs when the vendor plans to subcontract any part of a contract for goods or services. Vendors must establish that they have accomplished at least five of 11 potential items to show that good faith efforts have been made.

#### 01 NCAC 05E .0102 HUB Participation Goal

This rule establishes that the Secretary of Administration will set the HUB participation goal for the procurement of goods and services and provides the factors that will be used to set the percentage goal biannually. It is likely that the initial HUB participation goal will be set at 10% of the value of contracts to purchase Goods and Services. Compliance reviews of agency purchasing by the Office for Historically Underutilized Businesses will examine whether an agency/institution has met the HUB participation goal, as well as whether they have complied with laws and rules that aim to remedy the disparity between HUB and non-HUB firms. Per 01 NCAC 05E .0103, corrective action may be recommended if an agency fails to meet the HUB participation goal.

#### 01 NCAC 05E .0103 Office for Historically Underutilized Businesses Responsibilities

This rule provides the responsibilities of the HUB Office in accomplishing the HUB participation goal. This rule aligns with the HUB rules listed in 01 NCAC 44A, and expands those responsibilities to include training, technical assistance, relationship/networking building, monitoring compliance and corrective action. The proposed rule codifies activities that the HUB Office is presently performing.

#### 01 NCAC 05E .0104 Purchasing Agency Requirements

This proposed rule provides the requirements of the Purchasing Agency to comply with these rules and the HUB participation goal. This rule requires the Purchasing Agency to create and implement an agency HUB participation plan. Additionally, this rule provides steps the Purchasing Agency must take before and after awarding a contract. [Executive Order 25](#), concerning HUB related matters, has been in effect for Cabinet Agencies since November 2017; therefore, it is expected that these rules will have greater effect on present day activities for non-Cabinet agencies and institutions.

Pre-award requirements for Purchasing Agencies include:

- Attending any pre-bid conference and explaining the HUB participation goals and objectives;
- Notifying HUBs from the Agency's HUB vendor list or HUBs that have otherwise indicated interest in the type of work in the Solicitation at least 10 calendar days before the opportunity to respond to the Solicitation ends by electronic means;
- Using media likely to inform potential HUBs of the Solicitation being sought;
- Maintaining documentation of any contacts, correspondence, or conversation with HUB firms;
- Evaluating documentation to determine that good faith efforts pursuant to 01 NCAC 05E .0101 has been achieved prior to recommendation of award; and
- Notifying Vendors of the Agency's annual HUB participation goal or project specific participation goal.

Post-award requirements for Purchasing Agencies include:

- Reviewing Vendors' pay applications for compliance with HUB utilization commitments prior to payment; and
- Submitting a report electronically to the HUB Office regarding payments made to HUBs.

The proposed rule also requires Purchasing Agencies to provide documentation of compliance with the rule to the HUB Office upon request, such as for a compliance review, complaint, investigation, or other inquiry.

#### 01 NCAC 05E .0105 Vendor Requirements

This rule provides the actions vendors who intend to use subcontractors to do the following for their bid to be deemed responsive:

- attend pre-bid conferences;
- identify opportunities where HUBs may have an interest in providing goods or services;
- identify whether any HUBs are used in the bid response, and include the total dollar value of the HUB's subcontract; and
- provide one of the following:
  - an affidavit that they are meeting the HUB goal by subcontracting with a HUB/HUBs and include a description of the work to be completed by the HUB and the percentage of the total contract price that the HUB subcontract is worth; OR
  - an affidavit that they have made good faith efforts to include HUBs, pursuant to Rule .0101 if their bid does not meet the HUB participation goal.

Vendors who win awards that include HUB subcontractor(s) are required to notify the Purchasing Agency and HUB Office if any HUB named in their proposal needs to be replaced. They must make good faith efforts to replace a participating HUB with another HUB. Finally, the rule requires the vendor to make good faith efforts to solicit from HUBs for additional opportunities that arise after the contract is awarded.

#### 01 NCAC 05E .0106 Historically Underutilized Business Responsibilities

This rule provides the responsibilities of certified HUBs seeking to do business with the State. Businesses that are minority-, women-, economically disadvantaged- or disabled-owned may be certified as a HUB by the HUB Office and must make a good faith effort to participate in the Solicitation process.

These good faith efforts include the following: attending pre-bid conferences; responding to Purchasing Agencies; attending training and outreach sessions and other business development programs; and negotiating in good faith with Purchasing Agencies.

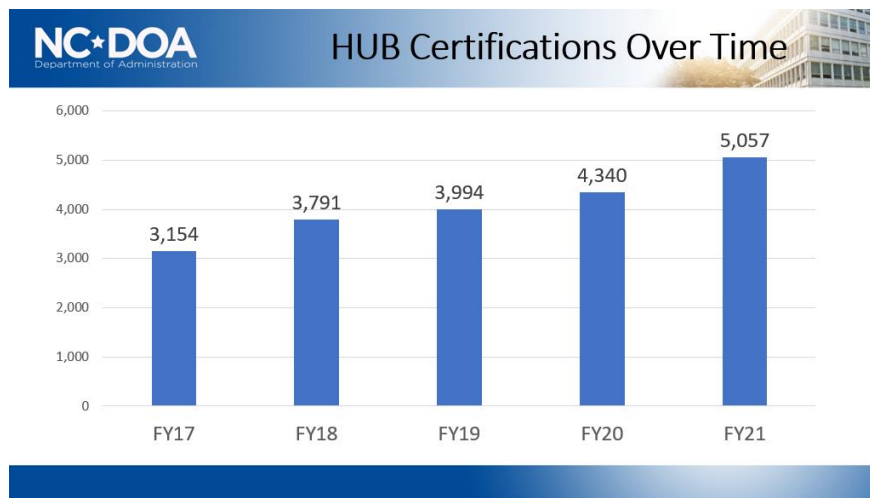
**D. Background on HUB Participation**

The goal of the proposed rules is to increase HUB participation in the state procurement of goods and services. The rules proposed here are based upon the rules that have existed for State Construction for 18 years. HUB utilization in State Construction has far exceeded the statutorily set participation rate of 10%, with the most recent year for which there is data, FY 2021, showing a 19.62% HUB utilization rate across State Construction projects.

Disparity in Contracts Awarded to HUBs

The HUB Office is charged with certifying minority-, women-, disadvantaged, and disabled-owned businesses that seek to do business with the state as Historically Underutilized Businesses. As of June 24, 2022, there were 5,943 HUBs certified by the HUB Office. The graph below shows the number of HUB certifications increasing steadily over the past five fiscal years.

*Table 1*



The Study analyzed procurement and contracting information in five industry categories: Construction, Architectural and Engineering, Professional Services, Other Services, and Goods. The conclusion of the Study was that there was a significant underutilization of minority and woman-owned firms across all industry categories. The referenced rules and this fiscal analysis focus on the categories of Professional Services, Other Services and Goods; therefore, those findings discussed below focus on those categories to the extent possible.

The Study found from 2014 to 2018, 29.02% of Professional Services vendors, 12.29% of Other Services vendors and 7.93% of Goods vendors met the study’s criteria of HUBs available to do business

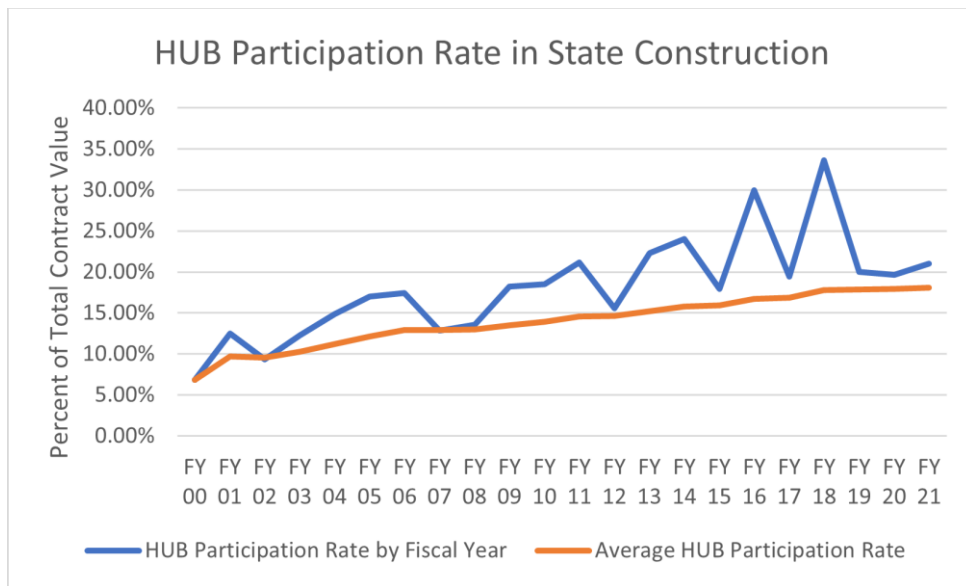
with the State<sup>3</sup>. In contrast, the average Goods and Services HUB utilization rate for the same period was 5.28%. These rates do not include the rates for subcontracted HUBs, as the Department has not collected this information to date. The proposed rules mandate that agencies shall require Vendors subcontracting all or part of a contract for the purchase of goods or services to undertake and document their good faith efforts to recruit HUB participation.

HUB Participation in State Construction

In December 2001, N.C.G.S. § 143-128.2 was enacted establishing a 10% HUB participation goal and included specific requirements centered on making “good faith efforts” for the use of HUB contractors and subcontractors within state construction projects (See [S.L. 2001-496, s. 3.1](#)). As a result of this statutory change, the Department’s State Construction Division adopted temporary rules in August 2002 under Title 01, Subchapter 301 of the Administrative Code, Minority Business Participation Goal; these rules were permanently adopted effective August 1, 2004.

Table 2 demonstrates HUB participation in construction projects for the period of FY 2000 through FY 2021 as a percent of total contract dollar value. Prior to the statutory mandate, the HUB participation rate was below 10% (FY 00 at 6.86%). Since the passage of S.L. 2001-496, the HUB participation rate has trended upward as indicated by the orange line, i.e. Average HUB Participation Rate. Acknowledging that there could be multiple factors causing this increase, it should also be acknowledged that the correlation between the requirements in S.L. 2001-496 and resulting rules is suggestive of a positive effect from their requirements.

Table 2



HUB Participation in Goods and Services

<sup>3</sup> HUBs deemed to be “available to do business with the state” have been certified as a HUB.

Table 3 below shows HUB participation as a percent of total contract dollar value in the procurement of goods and services for the same period covered as the construction table above. In contrast to construction participation, HUB participation in goods and services has declined over time from the peak of 9% in FY 99-00 and has fluctuated between 5-7% in recent years. As noted earlier, these participation rates do not include the HUB participation rates of subcontractors because the data is not available.

Table 3

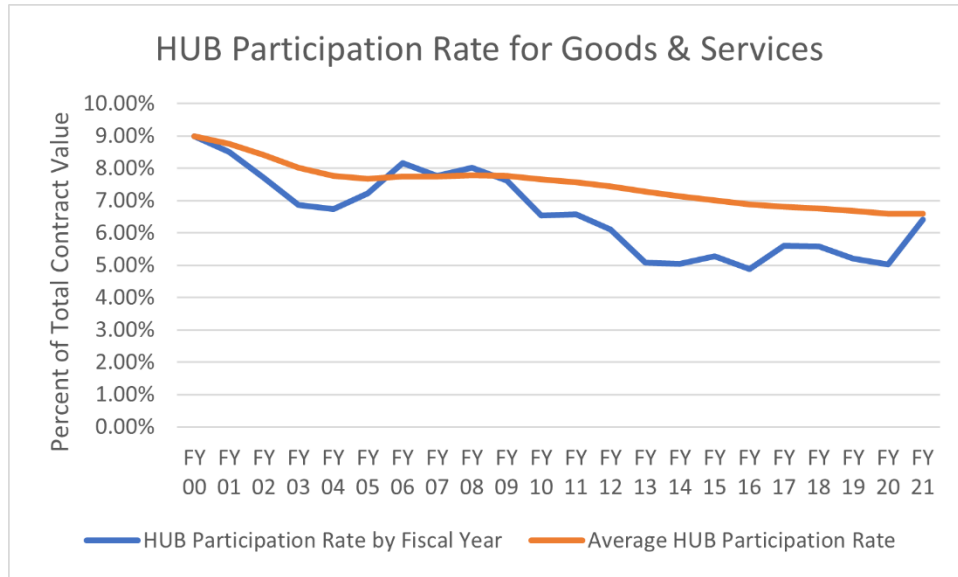


Table 4 gives an overview of the value of contracts associated with the HUB participation percentages for the four most recent fiscal years with data from the [HUB Annual Report – Goods and Services](#):

Table 4

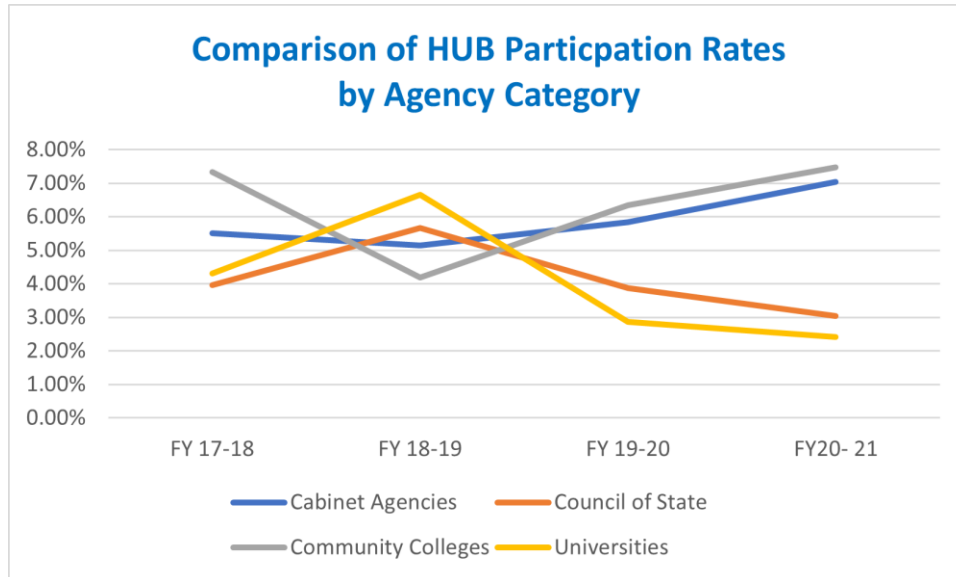
Fiscal Year	Value of Goods & Service Contracts	HUB Participation Rate	Value of Contracts Awarded to HUB Vendors
18-19	\$7,046,348,667	5.21%	\$367,220,821
19-20	\$8,020,759,684	5.02%	\$402,565,778
20-21	\$9,941,836,415	6.42%	\$638,546,538
21-22 <sup>4</sup>	\$5,340,612,740	6.71%	\$358,407,178

However, when the composite data are teased out by agency categories, a different picture emerges. Table 5 below provides comparison of HUB participation trends between Cabinet, Council of State, Community Colleges, and Universitie

<sup>4</sup> Data for FY 21-22 are for the first three quarters of the fiscal year since the 4<sup>th</sup> quarter data was not available at the time of this writing. It should be noted that the General Assembly’s delay in passing a budget to November 2021 has likely suppressed the amount of spending that agencies engaged in through the first 3 quarter of FY 21-22. Because it is expected that there will be a disproportionately large amount of procurement in the 4<sup>th</sup> quarter, the HUB Participation Rate could be affected to a greater extent than would occur in regular budgetary year.



Table 5



Many factors may affect HUB participation rates; however, it should be noted that Cabinet agencies have seen increases in HUB participation since FY 18-19, indicating that there is a positive relationship between HUB participation rates and the provisions of EO 25 being implemented.<sup>5</sup> Community colleges have seen improving HUB participation rates during the same period. It should be noted the State Board of Community Colleges has resolution that states their intent for each college to achieve 10% HUB participation in the purchase of goods and services. The HUB participation rates for Universities and Council of State agencies stand in stark contrast to the other categories. While the UNC system has policies regarding HUB participation in construction, it does not have a corresponding policy or stated goal for the purchase of goods and services.

**E. Impact Analysis**

Expected Economic Benefits to HUBs

The General Assembly enacted the policy to promote and encourage the use of HUBs in [Session Law 1983-692](#), stating in the preamble:

“Whereas, the most basic and important element of the American economic system of free enterprise is free and vigorous competition; and  
 Whereas, such free and vigorous competition increases personal initiative and individual achievement; and  
 Whereas, the majority of businesses in North Carolina are small in size or are owned by minorities, the physically handicapped or by women; and

<sup>5</sup> EO 25 became effective in November 2021. It took time to implement the requirements of EO 25, including the requirement that each Cabinet agency develop a HUB Plan to be used as a guide to help the agency to achieve the required HUB participation rate of 10% in the purchase of goods and services.

Whereas, many small, minority, physically handicapped and women contractors able to perform the work and supply the materials specified in public contracts are unable to obtain such contracts; and

Whereas, encouraging and promoting the use of small, minority, physically handicapped and women contractors in performing the work or supplying the materials specified in public contracts would serve to stimulate free and vigorous competition in North Carolina and is therefore in the best interest of the State and its citizens; and

Whereas, the effective encouragement and promotion of the use of small, minority, physically handicapped and women contractors in State purchases and construction projects necessitates active cooperation among State agencies, institutions and political subdivisions in efforts to accomplish this purpose. . .”<sup>6</sup>

As recognized in the foregoing quote, the State’s economy is made stronger and more competitive when minority businesses can fully participate in economic opportunities, including those provided by State contracts. The State of North Carolina is a major force in the economy, as demonstrated in Table 4, with billions of dollars spending happening each year. The descriptor “historically underutilized” for minority owned businesses is self-evident – businesses owned by Black, Hispanic, Asian American, American Indian, female, disabled, and disadvantaged people have been selected for state contracts at disproportionately low levels compared to the percentage of available firms that they constitute. The measures required in the proposed rules aim to correct that underutilization through various strategies, all of which have in common the element of intentional inclusion of HUBs in the competitive process of state procurement.

If these rules have their intended effect of increasing HUB utilization in state contracting for Goods and Services, the value of contracts awarded to HUB firms would be positively affected. The actual effect of the proposed rules cannot be projected with certainty. The Department’s experience with similar requirements in State Construction suggest that these measures will have a positive effect on HUB participation rates when applied in the Goods and Services context. With those qualifiers in mind, if the Department establishes – and the state achieves -- a 10% HUB participation rate for state spending on Goods and Services, HUB firms could be awarded between 3.3% and 5% more in State contracts (by dollar value), which may translate into as much as \$350M in value.<sup>7</sup>

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<sup>6</sup> The preamble quoted includes small businesses in the types of businesses that the State should be encouraging and promoting in State procurement activity. The proposed rules are directed to affect those businesses defined as historically underutilized, as defined in G.S. § 143-128.4, due to the Department’s clearly established statutory mandate to promote minority businesses. (See G.S. §§ 143-48.4, 143-128.3, 143-128.4). G.S. § 143-128.3(d) establishes the HUB Advisory Board under the Secretary of Administration to “develop recommendations to improve the recruitment and utilization of minority businesses.” It should also be noted that HUBs are predominantly small businesses.

<sup>7</sup> The calculation of \$350M in additional value to contracts for Good and Services is based upon FY 20-21, which is the last full fiscal year for which figures were available at the time of this writing. As can be seen from the data provided in Table 4, state spending has varied widely in the last three fiscal years, largely due to pandemic-related spending. It is difficult to know what state spending levels will be in the future since there are many variables that go into that projection. The American Rescue Plan Act funding, which are federal funds flowing to the state, will impact state spending through the end of 2026. In addition, the spending level can not be projected with certainty when the utilization of HUBs as subcontractors is included, as the Department does not have the data to create a baseline for comparison.

## Cost Estimates for Implementation of Rules

### *HUBs*

Proposed Rule 01 NCAC 05E .0106 makes clear that HUBs must be certified by the HUB Office to be counted toward HUB participation in state contracting. The proposed rule also sets out the good faith efforts they must undertake to engage with state purchasing activities. The items included in HUB good faith efforts are sound business practices aimed at getting HUBs prepared to provide goods and services to state agencies. It is unknown how many HUBs are engaging some or all these good faith efforts presently, so it is difficult to estimate the cost to HUBs. It is estimated that it takes 2 to 5 hours for a HUB to apply for certification. The HUB Office also offers non-mandatory training that is approximately 1.5 hours long. Attending pre-bid conferences takes one to two hours; these pre-bid conferences have largely moved to virtual conferences since the pandemic, making it easier and less time consuming to participate. Responding to Purchasing Agencies when contacted could take from as little as 10 minutes to several hours, depending on the size and complexity of the bid or quote being sought. Likewise, negotiating in good faith with a Purchasing Agency could take widely varying amounts of time.

### *Purchasing Agencies*

These rules' impact on Cabinet agencies is expected to be low because these agencies have been subject to Executive Order No. 25 ("EO 25"), titled the Governor's Advisory Council on Historically Underutilized Businesses since November 2017. In addition to establishing the HUB Advisory Council, EO 25 required each Cabinet agency to increase HUB participation in the procurement of goods and services and set an expectation for each agency to "endeavor to obtain ten percent (10%) of the State's purchases of goods and services... from HUBs."

The new impact of these rules is expected to be on non-Cabinet agencies and institutions since they were not required to conform to EO 25. Based on feedback from Cabinet agency HUB liaisons<sup>8</sup>, it is estimated that 40 hours of work per week would be required in large agencies performing a high number of procurements. High volume agencies<sup>9</sup> have multi-member teams of procurement professionals into which HUB related duties could be woven. This model has been successful in agencies that have multiple procurement team members, with the Procurement Director assuming the coordination of HUB related efforts and reporting. For medium<sup>10</sup> volume agencies, 5 to 20 hours per week would be required and low<sup>11</sup> volume agencies would require from 1 to 5 hours per week on average; very low volume<sup>12</sup> agencies would require an average of 0 to 1 hours per week to conduct HUB-related activities. According to procurement data there are 13 high volume, 20 medium volume, 22 low volume and 29 very low volume non-Cabinet agencies.

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<sup>8</sup> HUB liaisons are designated state agency employees assigned duties to promote and encourage increased utilization of HUBs in state contracting. The university and community college systems refer to these employees as HUB coordinators.

<sup>9</sup> High volume institutions are defined as those that average 10 or more procurements per month.

<sup>10</sup> Medium volume institutions are defined as those that average 2.25 to 10 procurements per month.

<sup>11</sup> Low volume institutions are defined as those that average 1 to 2 procurements per month.

<sup>12</sup> Very low volume institutions are defined as those that average 0 to less than 1 procurement per month.

Assuming the average position needed to perform these duties is graded at NC12 and paid at midpoint, an agency could expect to pay approximately \$77,800 for salary and benefits; this is the amount that large agencies would have to accommodate per year. For medium volume institutions, their cost would range from approximately \$9,725 to \$38,900 per year. Low volume agencies' cost would be from approximately \$1,945 to \$9,725 per year. Very low volume agencies could have no cost to \$1,945 required per year. In total, DOA estimates the implementation cost to non-cabinet agencies to range from \$1,250,000 – 2,060,000 per year.

EO 25 ordered Cabinet agencies to develop a HUB plan to “be used as a guide to help the agency to achieve the required HUB participation within its business activities, including . . . goods and services.” Additionally, EO 25 ordered agencies under the jurisdiction of the Governor to “work with the HUB Office as part of the Development Team of Solicitations prior to awarding bids on all statewide master contracts or procurements” and work with P&C and the HUB Office “as part of the Review and Selection team to select vendors, including term contract vendors.” Consequently, agencies under the jurisdiction of the Governor have been performing many of the tasks that the proposed rules require. Because cabinet agencies have HUB liaisons who already fulfill many of these duties, the rules are not expected to result in significant additions of time or cost to cabinet agencies. In FY20-21, HUB spend of cabinet agencies for goods and services increased to 7.03%, up from 5.51% in FY17-18, the year the Executive Order was signed. This is an additional indication that the efforts required by the rules have a positive relationship to improving HUB utilization. See also Table 5 above.

### *Vendors*

As stated previously, these rules are based upon the model of State Construction HUB law and rules. These proposed rules apply to vendors in the context of subcontracting since they require bidding vendors to make good faith efforts to obtain HUB participation when they are subcontracting some or all the work. While it is universally common for construction contracts to involve subcontractors, it is not presently known how many goods or services procurements will involve subcontractors, namely because that data has not been collected in the past. Therefore, it is difficult to make reliable estimates of the impact.

However, when examining the impact on vendors, it should be noted that good faith efforts requirements have been in effect for the construction industry for 18 years. Furthermore, vendors have options to choose five out of 11 potential methods to establish good faith efforts, meaning they can make decisions on the best methods that suit their business practices and economic situation. These methods, in whole or in part, may already be incorporated in vendors' regular business processes, such as attending pre-bid conferences or making HUBs aware of opportunities to participate in their master bid. Presently, data does not exist to measure the extent to which these efforts may be in use. However, by requiring that at least five good faith efforts are made by a prime contractor, it is expected that more HUBs will have the opportunity to participate in state contracting. For example, dividing a contract into economically feasible units, HUBs that are not able to handle the entire contract would have the opportunity to be a part of the larger contract. By notifying HUBs of the subcontracting opportunity, the prime contractor is providing an opportunity for HUBs to participate in the prime's bid proposal. Attending pre-bid conferences and site visits allow the prime contractor to understand the bid opportunity fully and ask questions of the Purchasing Agency that can help the prime contractor to provide subcontracting

opportunities. Likewise, providing qualifying HUBs with assistance in obtaining bonding, insurance, equipment, lines of credit and same unit pricing that the prime receives can remove obstacles to HUBs' participation, since many HUBs find these items to be challenging. Paying HUB subcontractors quickly can assist HUBs in being able to take on a contract that would ordinarily strain their cash flow capacity.

If the proposed rules have their intended effect, then a portion of state funds will be awarded to HUB firms and not to non-HUB firms. HUB firms must continue to compete for state contracts with non-HUB firms.

### *HUB Office*

The HUB Office has been performing the tasks required in the rule so there are no expected impacts to the HUB Office.

## **E. Alternatives**

One alternative to these rules would be to leave the status quo in place and continue to attempt to achieve greater HUB participation through existing mechanisms. However, as the analysis shows, the status quo is unsatisfactory in obtaining HUB participation in procurement of goods and services since HUB participation has been declining.

Another alternative to these rules would be to mandate that every agency and institution award a certain percentage of contracts to HUBs, commonly referred to as "set asides". However, this highly prescriptive approach is likely to run afoul of the "strict" or "intermediate scrutiny" legal standards that apply to race- and gender-based policies, respectively.

As stated by GSPC in the Study:

Laws that, on their face, favor one class of citizens over another, may run afoul of the Equal Protection Clause of the Fourteen Amendment. [HUB] programs and legislation are among the types of laws invoking such concerns. Depending on the nature of the differentiation (e.g., based on race, ethnicity, gender), courts evaluating the constitutionality of a minority business program will apply a particular level of judicial scrutiny. As explained at greater length below, race-based programs are evaluated under a "strict scrutiny" standard, and gender-based programs may be subject to strict scrutiny or under a less-rigorous "intermediate scrutiny" standard, depending on the federal circuit within which the entity sits.

In its Croson decision, the Supreme Court ruled that the City of Richmond's Minority Business Enterprise (hereinafter "MBE") program failed to satisfy the requirements of "strict scrutiny." "Strict scrutiny" review involves two co-equal considerations: First, the need to demonstrate a compelling governmental interest; second, implementation of a program or method narrowly tailored to achieve/remedy the compelling interest. **In**

**Crosen<sup>13</sup>, the Supreme Court concluded that the City of Richmond failed to show that its minority set-aside program was “necessary” to remedy the effects of discrimination in the marketplace. [emphasis added]**

The set aside approach is not justified because there is evidence that the more narrowly tailored approach taken in contracting for state construction projects works to increase HUB participation. Therefore, the approach contained in these proposed rules is likely to bear the fruit that is desired, namely greater HUB participation in the contracting for goods and services.

Furthermore, HUB liaisons/coordinators who have been performing these duties have given feedback that the methods used in these rules would be effective for goods and services procurement. During the disparity study conducted by GSPC, HUB Liaisons and HUB Coordinators were surveyed on the procurement process and HUB programs. Approximately 74.7% or 79 participants responded to the web-based survey. (Appendix F, p.1) Some of the suggestions from HUB Coordinators during this survey included: “stronger procurement guidelines”, “to make the 10% goal mandatory and to have Good Faith Efforts reported on Goods and Services”, “Good Faith efforts for goods and services”, “unbundling of contracts when feasible”, “firms should have to substantiate assistance (i.e. bonding) not just offering in a letter, to receive [good faith efforts] points”, “consistent enforcement on the statutes across all levels”. (Appendix, pp.10-11)

## **F. Conclusion**

The proposed HUB rules are designed to guide vendors, HUBs, and agencies toward intentionality for greater HUB participation in state contracting for goods and services. The theme that runs through these rules is inclusion of HUBs in the opportunities to compete for state contracts. The Secretary of Administration is charged with setting the statewide HUB goal and the HUB Office is tasked with supporting HUBs and Purchasing Agencies to attain the goal. Prime vendors are required to make good faith efforts to include HUBs in their bid proposals. Purchasing agencies are required to make efforts to include HUBs in their procurement activities. HUBs are required to make good faith efforts to negotiate and respond to bid opportunities.

The costs and the benefits of these rules are indefinite due to highly variable time and effort that procurements for goods and services require, and lack of data regarding subcontracting in goods and services contracts. The impact of good faith efforts on prime vendors is unknown due to lack of data and the variability in which of the 11 options vendors may employ. Based on professional experience, DOA believes vendors may already incorporate some of the required efforts in their existing business practices. The new impact of these rules is expected to be on non-Cabinet purchasing agencies and institutions since they were not required to conform to EO 25. DOA estimates implementation costs to range from \$1,250,000 – 2,060,000 per year. The HUB Office has been performing the tasks required in the rule so there are no expected impacts to the HUB Office. If the proposed rules have their intended effect, then a higher percentage of state contract funds will shift from non-HUB to HUB firms, more in line with the percentage of available firms that they constitute.

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<sup>13</sup> City of Richmond v. J.A. Croson Co., 488 U.S. 469 (1989).

However, based upon the experience with good faith effort requirements in State Construction, and the positive correlation between substantially similar requirements implemented by EO 25 and increased HUB participation among cabinet agencies, DOA believes the rules proposed to be the best solution for making substantial progress to promote and encourage the utilization of HUBs in state goods and services contracts.

## **APPENDIX A: Proposed Rule Text**

ADD DEFINITIONS TO 01 NCAC 05A .112 AS FOLLOWS:

(18) "HUB" means Historically Underutilized Business as defined in G.S. 143-128.4 and certified in accordance with G.S. 143-48.4.

(19) "HUB Office" means the North Carolina Department of Administration Office for Historically Underutilized Business.

(46) "Subcontractor" means a firm under contract with the prime contractor/vendor for supplying materials, labor, or materials and labor.

### **CHAPTER 05 – PURCHASE AND CONTRACT SUBCHAPTER 05E - HISTORICALLY UNDERUTILIZED BUSINESS PARTICIPATION SECTION .0100 - GOOD FAITH EFFORTS**

#### **01 NCAC 05E .0101 GOOD FAITH EFFORTS**

Agencies shall require Vendors subcontracting all or part of a contract for the purchase of goods or services to undertake good faith efforts to recruit HUB participation when contracting with the State. Good faith efforts shall include at least five (5) of the following:

- (1) Notify HUBs to be included in a response to a Solicitation at least 10 calendar days before the opportunity to respond to the Solicitation ends. The notification shall be made by electronic means and must include:
  - (a) a description of the Goods or Services being solicited;
  - (b) the date, time and location where Offers are to be submitted;
  - (c) the name of the individual within the company who shall be available to answer questions about the opportunity to participate in the response to the Solicitation;
  - (d) where Solicitation documents may be reviewed; and
  - (e) any special requirements that may exist, such as insurance, licenses, bonds and financial arrangements.
- (2) Making plans, Specifications and Requirements available to prospective HUBs at least 10 calendar days before the opportunity to respond to the Solicitation ends.
- (3) Dividing or combining elements of work into economically feasible units to facilitate HUB participation.



- (4) Working with minority trade, community, or similar organizations identified by the HUB Office that provide assistance in recruitment of HUBs.
- (5) Attending any pre-bid conferences or site visits provided for in the Solicitation.
- (6) Providing assistance in obtaining required bonding or insurance or providing alternatives for subcontractors.
- (7) Negotiating in good faith with interested HUBs. Any rejection of a HUB should have the reasons documented in writing.
- (8) Providing assistance to an otherwise qualified HUB in need of equipment, loan capital, lines of credit, or joint pay agreements to secure loans, supplies, or letters of credit, including waiving credit.
- (9) Assisting HUBs in obtaining the same unit pricing with the Vendor's suppliers.
- (10) Negotiating joint venture and partnership arrangements with HUBs to increase opportunities for HUB participation.
- (11) Providing quick pay agreements and policies to enable HUBs and suppliers to meet cash-flow demands.

*History Note:* Authority G.S. 143-48;  
Eff. \_\_\_\_\_

#### 01 NCAC 05E .0102 HUB PARTICIPATION GOAL

The Secretary shall set the statewide percentage goal for HUB participation biannually based upon the most recent disparity study commissioned by the HUB Office, the preceding year's HUB participation data, and the availability of HUB businesses by commodity code. The participation goal will be published on the NC Department of Administration website, [www.doa.nc.gov](http://www.doa.nc.gov), and in the yearly State of North Carolina Historically Underutilized Business Plan for Goods and Services.

*History Note:* Authority G.S. 143-48; 143-53.  
Eff. \_\_\_\_\_

#### 01 NCAC 05E .0103 OFFICE FOR HISTORICALLY UNDERUTILIZED BUSINESSES RESPONSIBILITIES

(a) Interested businesses may register as a HUB in accordance with 01 NCAC 44A, STATEWIDE UNIFORM CERTIFICATION. The information provided by the HUB shall be used by the HUB Office to:

- (1) assist public entities in developing a HUB participation plan;
- (2) identify areas of work where there are HUBs;
- (3) create and maintain a list of certified HUB vendors; and
- (4) assess the need for technical assistance for HUBs.

(b) The HUB Office shall also:

- (1) Provide training and technical assistance to HUBs on how to identify and obtain State purchasing and contract opportunities through the Division of Purchase and Contract and other public entities.
- (2) Provide training and technical assistance to public entities on how to identify and obtain HUB participation on projects or contracts.
- (3) Develop relationships with North Carolina trade and professional organizations by providing periodic meetings, such as networking and information sessions, obtaining input and feedback regarding HUB issues, legislation, and policies to improve the ability of HUBs to participate in State purchases and contracts.
- (4) Collaborate with the Division of Purchase and Contract to monitor Agencies' compliance with the State HUB Plan for Goods and Services. Compliance monitoring will be conducted by reviewing quarterly spend reports and other procurement documentation provided by the agency upon written request by the HUB office, such as contracts, purchase orders, and responses to solicitations.
- (5) Notify Agencies in writing of the outcomes of any compliance review with the State HUB Plan for Goods and Services.
- (6) Work collaboratively with Agencies found to be out of compliance to create a corrective action plan.

*History Note: Authority G.S. 143-48; 143-49;143-53;143-128.4  
Eff. \_\_\_\_\_*

#### 01 NCAC 05E .0104 AGENCY REQUIREMENTS

(a) The Agency shall develop and implement a HUB participation plan to identify HUBs that can provide Goods and Services and implement outreach efforts to encourage HUB participation. The plan shall include education, recruitment, and interaction between HUBs and non-HUBs.

(b) Before awarding a contract, the Agency shall:

- (1) Attend any pre-bid conference and explain the HUB participation goals and objectives of the State specific to the Agency.
- (2) Notify HUBs from the Agency's HUB vendor list or HUBs that have otherwise indicated interest in the type of work in the Solicitation at least 10 calendar days before the opportunity to respond to the Solicitation ends. The notification shall be made by electronic means and must include:
  - (A) a description of the work being solicited;
  - (B) the date, time, and location where Offers are to be submitted;

- (C) the name of the Purchasing Officer or individual who will be available to answer questions;
  - (D) where Solicitation requirements may be reviewed; and
  - (E) any special requirements that may exist.
- (3) Utilize media likely to inform potential HUBs of the Solicitation being sought.
  - (4) Maintain documentation of any contacts, correspondence, or conversation with HUB firms in accordance with 01 NCAC 05B .1903 and this Subchapter.
  - (5) Evaluate documentation to determine that good faith efforts pursuant to 01 NCAC 05E .0101 has been achieved prior to recommendation of award.
  - (6) Notify Vendors of the Agency's annual HUB participation goal or project specific participation goal.
- (c) After a contract has been awarded, the Agency shall:
- (1) review Vendors' pay applications for compliance with HUB utilization commitments prior to payment; and
  - (2) submit a report electronically to the HUB Office regarding payments made to HUBs.
- (d) Provide documentation of compliance with this Rule to the HUB Office upon request, such as for a compliance review, complaint, investigation, or other inquiry.

*History Note: Authority G.S. 143-48; 143-49;143-53;143-128.4;*  
*Eff. \_\_\_\_\_*

**01 NCAC 05E .0105    VENDOR REQUIREMENTS**

Vendors responding to Solicitations for the purchase of Goods and Services who intend to use a Subcontractor shall:

- (1) Attend any scheduled pre-bid conference.
- (2) Identify opportunities where HUBs may have an interest in providing Goods or Services.
- (3) Identify the HUBs that will be utilized on the project with the corresponding total dollar value of the work they will perform.
- (4) Provide one of the following to the Purchasing Agency:
  - (a) an affidavit including a description of the work by HUBs, expressed as a percentage of the total Contract price, equal to or more than the HUB participation goal; or
  - (b) an affidavit of all good faith efforts taken pursuant to Rule .0101 of this Subchapter, if the percentage is not equal to the HUB participation goal.

Failure to comply with the requirements of Item 4 shall be grounds for rejection of the Offer and shall be handled in accordance with 01 NCAC 05B .0501.

- (5) Submit notification for approval by the Purchasing Agency and the HUB Office within 5 calendar days of the replacement of a participating HUB. Notification shall be in writing to the contracted address stating the circumstances involved. The Vendor shall make good faith efforts in accordance with Rule .0101 of this Subchapter to replace a participating HUB with another HUB.
- (6) Make good faith efforts in accordance with Rule .0101 of this Subchapter to solicit bids from HUBs should additional Goods or Services opportunities become available after the Contract is awarded.

*History Note:* Authority G.S. 143-48;  
Eff. \_\_\_\_\_

#### 01 NCAC 05E .0106 HISTORICALLY UNDERUTILIZED BUSINESS RESPONSIBILITIES

- (a) HUBs shall be certified or designated as HUB by the HUB Office to be counted toward HUB participation.
- (b) HUB businesses shall make a good faith effort by:
  - (1) attending the scheduled pre-bid conference;
  - (2) responding when contacted by Purchasing Agencies;
  - (3) attending training and outreach sessions given by Purchasing Agencies;
  - (4) participating in training or other business development programs offered by Purchasing Agencies; or
  - (5) negotiating in good faith with Purchasing Agencies.

*History Note:* Authority G.S. 143-48;  
Eff. \_\_\_\_\_