



**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

Office of Inspector General
Washington, D.C. 20590

November 7, 2003

The Honorable Ernest J. Istook
Chairman
Subcommittee on Transportation,
Treasury, and Independent Agencies
Appropriations Committee
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

In the report accompanying the Fiscal Year 2003 Department of Transportation Appropriations Act (House Report No. 107-722), we were requested to examine firms certified under DOT Disadvantaged Business Enterprise (DBE) programs in New Orleans, LA, and report on instances in which Federal DBE regulations may have been violated. The Committee's request stemmed from concerns, initially raised by then-Subcommittee Chairman Harold Rogers and Representative David Vitter in 2001, regarding a series of articles in the New Orleans *Times-Picayune* newspaper about alleged systemic problems in local DBE programs.

While the articles discussed all DBE programs in New Orleans, only three of these programs receive DOT funding. The DOT-funded DBE programs in New Orleans consist of programs administered by the New Orleans International Airport (Airport), the Regional Transit Authority (Transit Authority), and the New Orleans Levee District (Levee District)¹.

The issues identified in the *Times-Picayune* articles included: general mismanagement of the DBE programs; political patronage in the awarding of contracts; participation in the programs by business owners who were not economically disadvantaged, including the wife of a multi-millionaire celebrity attorney; and inconsistency in DBE certification requirements between the various agencies.

¹ The New Orleans Levee District operates the Lakefront Airport, which receives Airport Improvement Program funding from DOT through the Federal Aviation Administration (FAA).

Background on New Orleans DBE Programs

In addition to the three DOT-funded DBE programs in New Orleans, there are four other DBE programs (non-DOT funded) administered by the City or local governmental agencies. These include the New Orleans Housing Authority, Orleans Parish School Board, Water and Sewage Board, and the City of New Orleans DBE program. In total, there are more than 1,200 DBE businesses in New Orleans that have been certified by one or more of the three DOT-funded agencies and the four local agencies.

Process-wise, the local agencies require prospective DBE program applicants to complete a certification application. The applicant is required to provide information on type of business, equipment owned, licenses held, past work history, financial data, and membership in a designated socially disadvantaged group. Upon receipt and review of this information, the local agency issues a certification and the DBE is added to the agency's list of DBEs qualified for participation in contracting creditable towards the agency's established DBE goals.

For DOT-funded programs, DOT authorizing statutes require that DBE firms must be *owned and controlled* by "socially and economically disadvantaged" individuals in order to qualify. The DOT statutes specify that women meet the definition of "socially and economically disadvantaged," but reference the Small Business Act for identification of other qualifying groups for which social disadvantage is to be rebuttably presumed². The Small Business Act leaves to the Department promulgation of regulations further defining the terms and conditions for DBE eligibility.

DBE eligibility requirements have been further defined by DOT regulations at Title 49 Code of Federal Regulations (CFR), Part 26, which applies to programs

² The Small Business Act defines socially disadvantaged as "...those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their individual qualities." Economically disadvantaged is defined as "...those socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same business area who are not socially disadvantaged." Further, the Small Business Act requires contractors to presume that socially disadvantaged individuals include U.S. citizens (or persons with permanent resident status) who are African American, Hispanic American, Native American, Subcontinent Asian American, and Asian-Pacific American.

involving DOT-funded contracting (e.g., for highway, transit, and airport construction), and 49 CFR Part 23, which covers airport concession³ DBEs.

A significant discrepancy exists between these two 49 CFR Parts, in that while Part 26 prescribes a \$750,000 personal net worth limit for the owner of a DBE⁴, Part 23 imposes no personal net worth limit. Although the regulations provide that presumption of economic disadvantage is rebuttable, the absence of a personal net worth limit for airport concession DBEs makes it difficult, if not impossible, for the presumption to be rebutted. As such, it is possible that *irrespective of personal wealth*, an individual otherwise qualified could attain certification as a DBE for an airport concession contract if they are a member of a designated group based on social disadvantage. The DOT DBE program and regulations are described in further detail in Appendix A.

Like airport concession DBEs, the non-DOT funded DBE programs in New Orleans presently do not limit the personal net worth of DBE owners. Eligibility for these local DBE programs is determined solely by an individual's membership in a group for which social disadvantage is presumed, as defined in the Small Business Act.

Methodology

Our investigation included an examination of those DBE certifications and contracts issued—under DOT's DBE regulations—by the Airport, Transit Authority, and Levee District between 1999 and 2002⁵. The total monetary value of all contracts we reviewed exceeded \$100 million. We interviewed 134 DBE owners, contractors, and program officials. Further, we reviewed a random sample of 100 DBE certification files (20 percent) of the 500 DBEs certified by the Airport, Transit Authority, and the Levee District. We also identified and reviewed an additional 18 certification files based on the results of our field interviews.

³ Concessions are contracts awarded by airport authorities to vendors for retail operations including newsstands, gift shops, food and beverage establishments, and duty-free shops. Concession contracts nationwide require varying levels of DBE participation.

⁴ The \$750,000 personal net worth limit excludes equity in one's personal residence and ownership in the DBE.

⁵ Our investigation did not address DBE certifications and contracts issued under other than DOT's regulations, or those which were outside the 1999-2002 scope of our review. For instance, we did not examine issues raised in the *Times-Picayune* series about Sheriff Harry Lee of Jefferson Parish, who, as a DBE owner in the 1980s into the early 1990s, voluntarily gave up his DBE certification after its legitimacy was questioned.

We conducted site visits and on-the-job interviews of current DBE contractors, and we also conducted surveillance of job sites to ascertain if DBE contractors were actually completing the work contracted for certain projects. Additionally, we investigated specific allegations reported in the *Times-Picayune* series involving the DOT-funded DBE programs, and have included the results of our review of those specific allegations in Appendix B⁶.

Summary of Findings

Our investigation substantiated many of the alleged abuses in the DBE programs reported in the *Times-Picayune* series, and we encountered many of the same problems in the DBE programs in New Orleans as we have seen in other DBE programs across the country⁷. In fact, it would be inaccurate to say that the problems we found in New Orleans are unique to that locale.

In brief, our investigation disclosed instances of significant programmatic deficiencies and violations in key areas within the DBE programs of the Airport, Transit Authority, and Levee District. For instance, we found that the DBE program managers at the Transit Authority and Levee District did not conduct site visits (required under DOT's DBE regulations) with 50 percent and 30 percent, respectively, of their certified DBEs. Further, we found DBE firms that were controlled by non-minorities, and, in some cases, we uncovered potential DBE fraud—namely “fronts”⁸. We are continuing to investigate the instances of suspected fraud identified in this report.

⁶ Some of the *Times-Picayune* articles concerning DOT-funded DBEs included allegations that were not pertinent to the DBE program itself and thus were not within the scope of our investigation (e.g., allegations about an individual's failed business and financial insolvency). Where applicable, we have noted this in Appendix A.

⁷ As of November 1, 2003, we have 40 ongoing DBE investigations in 19 states involving contractors allegedly engaged in defrauding DOT's DBE program. From Fiscal Year 1999 to present, our DBE fraud investigations have resulted in 40 indictments, 29 convictions, and \$10.7 million in fines and other monetary recoveries. In addition to criminal prosecutions nationwide, we have identified and reported to the Department areas where the DOT DBE regulations need strengthening, especially those applicable to airport concession DBEs.

⁸ The term “front” refers to a DBE which does not perform work to fulfill DBE participation requirements under prime contracts. Instead, a prime or subcontractor pays the DBE a relatively small amount for use of their DBE status to falsely represent that the DBE is performing the specified work. The prime contractor, or another non-DBE contractor, then actually performs the work and receives the bulk of the payments. Typically, payments are funneled through the DBE's bank account to make it appear that the DBE in fact performed the required work. This type of crime defrauds the integrity of the DBE program and harms legitimate DBEs who abide by the law.

Additionally, over 60 percent of DBE owners we interviewed expressed their belief that political patronage affected the awarding of DBE contracts in the New Orleans DBE programs during the 1999-2002 period we examined. One DBE owner even told us he received a contract after yielding to what he perceived was pressure from local campaign officials to make monetary contributions to, and work on, a local candidate's campaign; the DBE owner said the campaign officials had implied that the way to obtain DBE contracts was through supporting this candidate. These specific allegations remain under investigation. Our investigation also disclosed program mismanagement; inadequate oversight—at both the local and DOT level; participation by individuals not meeting eligibility requirements; and inconsistency in DBE certification procedures.

Despite these and other troubling findings, we have also noted that since the *Times-Picayune* series and the initiation of our investigation, the local agencies have taken steps to ensure that such programmatic deficiencies do not remain pervasive. More specifically, we found the following:

- **DBE Owners Exceeded Personal Net Worth Limits**

We identified several DBE owners who exceeded the personal net worth limit of \$750,000 prescribed in the DOT DBE regulations at 49 CFR Part 26. For instance, one DBE owner, certified by the Levee District, was a multi-millionaire and one of the largest contractors in the Southeastern U.S. This DBE owner has since been decertified.

- **Businesses Controlled by Non-Minorities**

We identified multiple DBE businesses that were controlled by individuals ineligible for DBE status. In one instance, we interviewed a DBE owner (qualified based on her gender) who admitted she knew little about the operation of her business, which was being run by her son, who was not eligible for DBE status. This individual was decertified during our investigation.

- **Illegal DBE Fronts**

Our investigation disclosed three suspected DBE fronts. In one instance, a DBE owner, when asked generally whether he was aware of any “fronts,” admitted to us that a non-DBE firm had paid him \$1,000 to allow the non-DBE to perform contract work and falsely represent that the work had been done, as required, by his DBE firm. After making this admission, the DBE owner refused to cooperate in providing further information. This case, which we are

continuing to investigate, highlights the critical importance of oversight in preventing and detecting such illegal arrangements.

- **Annual Affidavits not Submitted; Required for Continued Participation**

The agencies did not enforce the DOT DBE regulations requiring DBE owners to submit annual affidavits certifying there have been no changes in circumstances affecting the DBE's ability to meet program qualification criteria, to include personal net worth. The affidavits are required for the purpose of determining continued program eligibility. In the case of the Levee District, over half of the certification files we reviewed (randomly sampled) did not contain the required affidavits. Similarly, we found 30 percent of Airport and 25 percent of Transit Authority certification files reviewed lacked affidavits. The regulations provide for decertification of persons failing to submit the required affidavits.

Moreover, we found that two of the three agencies had no system in place for identifying and responding to persons delinquent in filing, and that the third agency's system was inadequate. At our recommendation, the agencies instituted an automated tracking process that includes generating notification letters to participating DBE owners 30 days in advance of their affidavit filing deadline.

- **Mandatory Site Visits Not Conducted or Inadequate**

We found that the DBE program managers at the Transit Authority and Levee District did not conduct site visits (required under the DOT DBE regulations) with 50 percent and 30 percent, respectively, of their certified DBEs. We further found that site visits which were conducted during the certification process were not thorough enough to detect eligibility violations or false statements and DBE fraud.

- **Political Patronage**

We found a widespread perception that political patronage was prevalent in the DBE programs in New Orleans during the 1999-2002 period we examined. More than 60 percent of the DBEs we interviewed expressed their belief that political patronage affected the awarding of DBE contracts. One DBE owner even told us he received a contract after yielding to what he perceived was pressure from local campaign officials to make monetary contributions to, and work on, a local candidate's campaign; the DBE owner said the campaign officials had implied that the way to obtain DBE contracts was through

supporting this candidate. We have corroborated certain details of this DBE owner's admission and are continuing to investigate the facts and circumstances.

Some DBE business owners expressed frustration over what they characterized as constant solicitation to contribute to local political campaigns. They advised that they made political contributions they could not afford because they were afraid they would be labeled as "not on the team" if they failed to contribute.

- **Questioned Spending on Airport DBE Consultant**

The Airport expended more than 80 percent of its DBE program administration budget, or \$640,000 annually, for a private DBE consultant. This consultant billed the Airport professional rates ranging from \$65 to \$125 per hour for many tasks that could readily have been accomplished by non-professionals at lower cost. As part of our investigation, we raised questions about this consultant contract, and, subsequently, the Airport selected a new DBE consultant, to be paid \$250,000 per year, whose primary duties will entail reporting DBE participation to the Airport Board and the FAA. The Airport has utilized this cost savings to increase staffing in its DBE Compliance Office by four additional personnel.

- **Transit Authority Procurement Procedures Circumvented**

Standard procurement procedures were not followed in the awarding of four DBE contracts by the Transit Authority. Procurement procedures and the recommendations of evaluation teams were ignored to facilitate the awarding of contracts to two DBE owners who were political contributors. We are continuing to investigate these circumstances.

- **Reported DBE Ownership by Spouse of Multi-millionaire**

The *Times-Picayune* series reported that the wife of a multi-millionaire celebrity attorney owned an Airport concession DBE. We found that while she had been an Airport concession DBE owner in the late 1990s, and could still qualify given the lack of a personal net worth limit under the current DOT DBE regulations for airport concessions, she has not been operating this concession under the rubric of a DBE. For this concession, she has functioned as a non-DBE joint venture partner with a major retail contractor.

This is not the first time we have reviewed assertions that millionaires have owned DBEs. As referenced in further detail below, we recently reported the

results of our investigation into allegations about airport concession DBEs involving the Metropolitan Washington Airports Authority (MWAA). In that case, a similar assertion had been raised about the reported affluence of a DBE owner.

In light of the absence of a personal net worth limit, situations such as this and the MWAA example foster perceptions that very wealthy individuals can take advantage of the DBE program, in contradiction to its intended purpose of aiding those who are both socially and economically disadvantaged. Accordingly, as addressed below, our report in the MWAA case included a recommendation that the Department prescribe a personal net worth limit for owners of airport concession DBEs.

- **Remedial Actions Taken by the Agencies**

As part of our investigation, we briefed the Airport, Transit Authority, and Levee District on our findings and discussed best practices and recommendations for improving the management and oversight of their DBE programs. These three agencies have already effected a number of improvements. Each agency has instituted policy and procedural changes, to include more thorough site visits and tracking recertification and annual reporting requirements for program participants.

Following the publication of the March 2001 *Times-Picayune* series, the DBE program managers at the Airport, Transit Authority, and Levee District began a comprehensive program to review their DBE certification files and personal net worth information previously submitted by program participants. As a result of their reviews, many DBE owners were found to have exceeded the \$750,000 personal net worth limit and were subsequently decertified.

We are recommending that the Federal Aviation Administration (FAA) and Federal Transit Administration (FTA) conduct appropriate follow-up to ensure that these local agency improvements are sustained, and that the programs operate in full conformance with all applicable DBE statutes and regulations.

- **Federal Oversight Requires Strengthening, Particularly FAA's**

We are concerned about the current level of DOT oversight of local DBE programs, particularly that provided by the FAA. Prior to our review, FAA and FTA were requested to investigate the New Orleans DBE programs following the *Times-Picayune* series. In response, FAA's regional office performed an internal review and issued a three-page report, while, in

comparison, FTA contracted a private auditing firm, which produced a 24-page report. FTA's review included interviews with DBE owners and prime contractors, as well as detailed review of certification files.

FAA's review, which we concluded was cursory in nature, did not include such substantive activities as site visits, interviews with DBE and prime contractors, comprehensive review of certification files, and work-site surveillance. We incorporated each of these elements in the methodology for our investigation and believe such activities represent the kind of attention needed for FAA to fulfill its oversight responsibilities in a robust, effective manner. We spoke with current and former FAA DBE program officials, who related that, historically, FAA's DBE oversight nationwide has been limited, which they attributed to lack of staffing.

Based on our observations in this and other cases, DOT's Operating Administrations, FAA in particular, need to strengthen the effectiveness of their stewardship of the DBE program beyond the status quo, which largely consists of limited, historical documentary reviews conducted periodically within local agency DBE program offices. Specifically, we are recommending that FAA and FTA oversight include aspects of the methodology we utilized for this investigation, e.g., site visits, DBE and prime contractor interviews, detailed certification file reviews, and work-site surveillance. We are also recommending that FAA and FTA perform their own up-front examination of DBE certification application packages (i.e., those pending approval by local agencies).

Even if applied on a selective basis, such an approach—considerably more hands-on in nature—would enable FAA and FTA not only to better assess the compliance actions of local agency DBE program managers, but also to directly gauge the extent of regulatory compliance by participating DBEs and applicants for certification. This type of model would also facilitate the identification of best practices program-wide.

- **DOT Regulations and Current Rulemaking for Airport Concession DBEs**

The current DOT DBE regulations contained in 49 CFR Part 26 (applicable to all DOT-funded programs *except* airport concessions) were promulgated in March 1999⁹. These new regulations instituted significant changes in eligibility requirements for DOT DBE program participants, including the establishment of a \$750,000 personal net worth limit, an increase in the gross

⁹ The 49 CFR Part 26 regulations were revised pursuant to the landmark Supreme Court case of *Adarand Constructors v. Federico Peña, Secretary of Transportation*, 515 U.S. 200 (1995)

revenue limitation for DBE firms to \$17.4 million, and the requirement for DBE owners to submit an annual affidavit certifying that there have been no changes in circumstances affecting the DBE's ability to meet program qualification criteria, to include personal net worth.

Regarding personal net worth considerations and the requirement for eligibility affidavits, Department commentary¹⁰ preceding its March 1999 issuance of the revision to 49 CFR Part 26 included the following:

“As has been the case since the beginning of the DBE program, the presumptions of social and economic disadvantage are rebuttable. . . [Certifying agencies'] comments unanimously said that [agencies] should collect financial information, such as statements of personal net worth (PNW) and income tax returns, in order to determine whether the presumption of economic disadvantage really applies to individual applicants. Particularly in the context of a narrowly tailored program, in which it is important to ensure that benefits are focused on genuinely disadvantaged people (not just anyone who is a member of a designated group), we believe that these comments have merit. . . [I]t is appropriate to give [certifying agencies] this [PNW affidavit] tool to make sure that non-disadvantaged persons do not participate.”

In 2000, the Department initiated the rulemaking process to revise the DOT DBE regulations applicable to airport concessions (49 CFR Part 23). In the rulemaking, which remains ongoing at present, the Department proposed to institute a personal net worth limit for airport concession DBEs. The Department is currently considering comments on what the amount of the cap should be.

We recently completed an investigation concerning airport concession DBEs, involving the Metropolitan Washington Airports Authority (MWAA)¹¹, in which we made observations related to ones reported in this investigation. In short, based on our investigative findings in that case, we made several recommendations to the Department, which are summarized as follows:

- The DBE regulations covering airport concessions need to prescribe a personal net worth limit for the owner of a DBE. While we are not proposing any specific cap, a limitation on personal net worth would serve

¹⁰ Federal Register, Vol. 64, No. 21, February 2, 1999, Page 511.

¹¹ On September 5, 2003, we issued our report to Representatives Joseph Pitts and Peter Deusch, as well as to the Secretary, Federal Aviation Administrator, and MWAA's Board of Directors.

as an appropriate threshold determinant in establishing whether an individual is economically disadvantaged.

- The regulations should set forth clear, objective, and tangible criteria for rebutting the presumption of economic disadvantage.
- Consideration should be given to establishing terms for DBE firms, and their owners, to ultimately graduate from DBE eligibility.

While we believe personal net worth limits promote fairness of opportunity for those persons who, per statute, are considered both “socially and economically disadvantaged,” and thus have recommended that the Department set a cap for the owners of airport concession DBEs, it is not our role to assess the applicability of such a requirement for non-DOT funded state and local DBE programs. However, as long as incongruity regarding DBE eligibility exists between (a) the DOT DBE regulations at 49 CFR Part 23 and Part 26, and (b) DOT and state/local standards, the potential for perceptions that certain programs are disparate in treatment, or otherwise unfair, will continue.

Details

Additional details from our investigation of the DOT-funded DBE programs at the Airport, Transit Authority and the Levee District are presented as follows:

DBE Owners Exceeded \$750,000 Personal Net Worth Limit

We identified eight DBE owners certified by the Airport whose certification files indicated they exceeded the \$750,000 personal net worth limit prescribed in the DOT DBE regulations. The contracts awarded to these eight DBEs, ranging from \$10,000 to \$1.4 million, were for services such as security, transportation, engineering, and construction.

The Airport’s DBE program managers had not identified these individuals as being ineligible and thus had not taken decertification action. Two of these same individuals had also been certified by the Transit Authority and two additional business owners exceeding the personal net worth limit had been certified by the Levee District.

Businesses Controlled by Non-minorities

Three DBE businesses certified by the Airport and Transit Authority were found to be controlled by individuals who were not disadvantaged minorities as defined

in 49 CFR 26. The regulations allow a non-minority to own up to 49 percent of the DBE business, but the minority owner must control the business and make the key business decisions.

- In the first instance, the DBE business owner was an elderly woman who owned a construction company. When we interviewed her, we learned she had limited knowledge of the business, no construction experience or licenses, and did not know what equipment her company owned or where their current projects were located. We learned her son actually controlled the business and made all the business decisions. We concluded that the owner was an owner in name only and should not have been certified as a DBE. This individual has since been decertified.
- The owner of an Airport DBE told us when interviewed that he only worked at his DBE business part-time because he had another job. This DBE owner told us that his non-minority business partner actually ran the business and made all key decisions. He further advised us that his firm was created after his non-minority partner approached him offering to form a company, for the purpose of obtaining DBE contracts, based on his status as a minority. We have requested that the Airport review the legitimacy of this DBE operation.
- Finally, we identified a DBE electrical company in which the non-minority business partner owned the majority of stock in the company and completed most of the projects. The two DBE partners had a minor role in the company. One of the DBE partners was out of the country working on projects for another company for most of the year. Regulations require full-time participation and control of the business by the DBE owner. This DBE has been decertified.

Illegal DBE Fronts

Three suspected DBE fronts were identified during our investigation. The term “DBE front” has generally been applied to businesses that obtain DBE contracts but do not complete the contracted work to fulfill stated goals for DBE participation. Instead, under such illegal schemes, they are paid a small amount for the use of their DBE status by a non-DBE contractor who actually completes the work and receives the bulk of the payments. Typically, payments are funneled through the DBE’s bank account to make it appear he has been paid for the work.

For example, we identified a DBE contractor who acted as a DBE front on a recent elevator project. In one instance, a DBE owner, when asked generally whether he was aware of any “fronts,” admitted to us that a non-DBE firm had paid him

\$1,000 to allow the non-DBE to perform contract work on an elevator project and falsely represent that the work had been done, as required, by his DBE firm. The DBE allowed the non-DBE to use his company name and DBE status to obtain the contract. After the contract was awarded to the DBE, the owner of the DBE allowed the non-DBE to complete all the work and receive full payment for the contract because, as he explained, he was “too busy” with other work and would not have been able to complete this particular contract. Nonetheless, he received \$1,000 but performed none of the required work. After making this admission, the DBE owner refused to cooperate in providing further information.

Through record reviews and interviews with contractors, we identified two other businesses suspected of operating as DBE fronts. We are continuing our investigation of these three suspected DBE fronts.

Annual Affidavits not Submitted; Required for Continued Participation

The agencies did not enforce the DOT DBE regulations requiring DBE owners to submit annual affidavits certifying there have been no changes in circumstances affecting the DBE’s ability to meet program qualification criteria, to include personal net worth. The affidavits are required for the purpose of determining continued program eligibility. In the case of the Levee District, over half of the certification files we reviewed (randomly sampled) did not contain the required affidavits. Similarly, we found 30 percent of Airport and 25 percent of Transit Authority certification files reviewed lacked affidavits. The regulations provide for decertification of persons failing to submit the required affidavits.

Moreover, we found that two of the three agencies had no system in place for identifying and responding to persons delinquent in filing, and that the third agency’s system was inadequate. At our recommendation, the agencies instituted an automated tracking process that includes generating notification letters to participating DBE owners 30 days in advance of their affidavit filing deadline.

Based on our review, a large number of DBEs did not submit the required affidavits and thus were subject to decertification. In our view, the DBE program should function such that, as a DBE grows and becomes successful, the personal net worth of its owner increases and the owner should graduate from the program, no longer in need of assistance afforded by the DBE program¹². The affidavit serves as the DBE owner’s sworn statement of continued eligibility. If a DBE owner does not submit the annual affidavit of no change in personal net worth in a

¹² This view is supported by 49 CFR Part 26.1(f), which states that an objective of the program is to “assist the development of firms that can compete successfully in the marketplace outside the DBE program.”

timely manner, the regulations provide that decertification proceedings can be initiated by the program manager.

Site Visits

Site visits conducted by the DBE compliance staffs at all three agencies during the certification process were, in many instances, not conducted in accordance with the regulations. The DBE program managers at the Transit Authority and Levee District did not conduct site visits with 50 percent and 30 percent, respectively, of their certified DBEs. While record reviews indicate that Airport DBE compliance personnel conducted site visits with all of the certified DBEs, in some cases the visits were not thorough. For example, information such as financial statements and business licenses, which should have been reviewed during the site visit, was missing from the certification files.

The site visit is one of the most important duties of DBE program managers because it provides important information that cannot be gained through the review of documents provided in the DBE's application package. The site visit provides the reviewer the opportunity to observe the DBE's business operations, interview associates and employees, verify equipment and assets, and ascertain if the applicant is the primary decision maker and manager of the business. The DBE compliance official should be able to identify businesses with the potential to act as a DBE front company or commit DBE fraud through information obtained during the site visit.

When we made site visits in connection with our review, we found indicators of fraud; specifically, minority contractors controlled by prime contractors and minority contractors who were not performing work. An illustration of the importance of site visits is found in the example, reported in the *Times-Picayune*, of the wife of the owner of Boe's Iron Works, Inc., who had applied for DBE certification with the agencies. The individual's applications were processed, but a site visit by the DBE compliance officer at the Airport determined that she would not be actively managing and controlling the business, thus the Airport, along with the other agencies, denied her requested DBE certification.

Political Patronage

The *Times-Picayune* series alleged some DBE contracts were awarded based on political patronage. We found a widespread perception that political patronage was prevalent in the DBE programs in New Orleans during the 1999-2002 period we examined.

During our interviews with DBE owners, we asked if political patronage played any role in the awarding of DBE contracts. More than 60 percent of those interviewed expressed the belief that it was necessary to make political contributions to be a successful DBE. One DBE owner even told us he received a contract after yielding to what he perceived was pressure from local campaign officials to make monetary contributions to, and work on, a local candidate's campaign; the DBE owner said the campaign officials had implied that the way to obtain DBE contracts was through supporting this candidate. These specific allegations remain under investigation. We have corroborated certain details of this DBE owner's admission and are continuing to investigate the facts and circumstances.

Some DBE business owners expressed frustration over what they characterized as constant solicitation to contribute to local political campaigns. They advised that they made political contributions they could not afford because they were afraid they would be labeled as "not on the team" if they failed to contribute.

Airport DBE Consultant

During the past few years, the Airport DBE program had utilized 80 percent of its annual budget for an external DBE consultant. The Airport's DBE program administration budgets for 2000, 2001, and 2002 averaged \$800,000 annually. Approximately \$640,000 was paid annually to this DBE consultant.

Our review of the consultant's contract with the Airport disclosed it was paid to provide such services as reviewing DBE certification applications; reviewing and maintaining DBE files; site visits to DBE applicants; assisting in the preparation of DBE reports; assisting the Airport's Legal Office in formal DBE grievance and appeal hearings; tracking and reporting of all DBE participation at the Airport; holding job fairs; and conducting mentoring programs for DBEs and minority youth programs.

We found that this consultant charged the Airport professional services rates for many tasks that could have been accomplished by personnel paid at non-professionals rates. Our review of billing records revealed that the consultant billed the Airport more than \$500,000 in 2002 for over 6000 hours at rates ranging between \$65 and \$125 per hour. The consultant also added a 10 percent charge for general and administrative expenses and charged the Airport for all additional expenses incurred, such as mileage, postage, parking, travel, etc. The consultant received more than \$1.9 million from the Airport during the past three-year period.

Additional analysis of 2002 billing records and payroll data, as well as interviews with the consultant's employees, revealed that the consultant billed the Airport at a rate of \$85 per hour for an employee who was actually paid less than \$25 per hour. The consultant also billed at the rate of \$65 per hour for an employee who was paid \$25 per hour, and at the rate of \$45 per hour for two employees who were paid less than \$15 an hour.

When compared with other similar size DBE programs in the State of Louisiana, the Airport, with a staff of three at the time, spent a considerably large proportion of its budget on the DBE consultant. For example, the Louisiana Department of Transportation and Development, which has a comparably-sized client base as that of the Airport, has a staff of 11, carries out its functions without utilizing consultants, and operates on a total budget of less than \$600,000 per year.

After we raised questions about this consultant contract during our investigation, the Airport selected a new DBE consultant, to be paid \$250,000 per year, whose primary duties will entail reporting DBE participation to the Airport Board and the FAA. The Airport has utilized this cost savings to increase staffing in its DBE Compliance Office by four additional personnel.

DBE Contract Improprieties at the Transit Authority

We found that standard operating procedures were not followed by the Transit Authority in the process of awarding and administering four contracts to DBE businesses. We are continuing to investigate the circumstances surrounding the award of these contracts. The allegations involve favoritism in awarding contracts and circumventing contract evaluation team recommendations; circumventing standard procurement procedures; and ignoring documented contract violations committed by a contractor who was a major political party contributor.

Recommendations

As noted above, based on interim advisements we have received, the Airport, Transit Authority, and Levee District have taken steps to improve their operating procedures, consulting contracts, and certification procedures, and we understand that the Airport and Transit Authority have already added additional personnel to improve their operational efficiency and oversight.

As part of our investigation, we examined a statistically significant sample of 118 of the agencies' DBE certification files. Despite this coverage, based on our findings, we believe examination of all certification files would be prudent. Accordingly, we recommend that the agencies conduct a comprehensive audit of

all of their DBE certification files. Particular attention should be paid to the following:

- (a) Compliance with the annual regulatory requirement for DBE owners to submit an affidavit attesting to no change in personal net worth. We found that a large percentage of the certification files at all three agencies were missing required annual affidavits. Business owners who have not submitted an affidavit within the past year should be notified, given a reasonable time to respond, and then decertified if the affidavit is not submitted in a timely manner.
- (b) DBE program managers should identify each DBE certified without a site visit having been performed, and immediately conduct a site visit. The site visit is an important tool for managing DBE programs and preventing DBE fraud. It is imperative that site visits be conducted at all DBE applicant firms before certification is granted, and then periodically thereafter to help guard against DBE “fronts.”

We are recommending that FAA and FTA, pursuant to their DBE program oversight responsibilities, conduct appropriate follow-up to ensure that these local agency improvements are sustained, and that the programs operate in full conformance with all applicable DBE statutes and regulations. Moreover, as noted earlier in this report, both FAA and FTA need to strengthen the effectiveness of their stewardship of the DBE program, beyond their current protocols, which largely consist of limited documentary reviews.

Specifically, we are recommending that FAA and FTA oversight include key aspects of the methodology we utilized for this investigation, e.g., site visits, DBE and prime contractor interviews, detailed certification file reviews, and work-site surveillance. We are also recommending that FAA and FTA perform their own up-front examination of DBE certification application packages (i.e., those pending approval by local agencies).

Even if applied on a selective basis, such an approach—considerably more hands-on in nature—would enable FAA and FTA not only to better assess the compliance actions of local agency DBE program managers, but also to directly gauge the extent of regulatory compliance by participating DBEs and applicants for certification. This type of model would also facilitate the identification of best practices program-wide.

We are transmitting our recommendations under separate cover to the Secretary, Federal Aviation Administrator, and Federal Transit Administrator, and we will be

providing the local agencies with our recommendations for enhancing the effectiveness of their programs. In addition, we have addressed an identical letter to the Ranking Minority Member of the Subcommittee and the Senate Transportation Appropriations Subcommittee.

If I can answer any questions or be of further assistance in this or any other matter, please feel free to contact me at 202-366-1959, or my Deputy, Todd J. Zinser, at 202-366-6767.

Sincerely,

A handwritten signature in blue ink, appearing to read "Kenneth M. Mead".

Kenneth M. Mead
Inspector General

Enclosures (2)
Appendices

APPENDIX A

General Background on the DOT DBE Program

The U.S. Department of Transportation established a Disadvantaged Business Enterprise (DBE) Program for minorities in the early 1980s. The program was designed to remedy the effects of past discrimination against small businesses owned by socially and economically disadvantaged individuals and to foster equal opportunity in transportation contracting.

DOT authorizing statutes contain provisions for DOT-funded highway and transit programs requiring that a minimum of 10 percent of DOT funding be expended on DBE businesses. The original DBE program did not include women in its definition of socially or economically disadvantaged individuals. Women were first included among disadvantaged groups in the Surface Transportation and Uniform Relocation Assistance Act of 1987¹.

The DBE regulations applicable to DOT-funded programs such as highway, transit, and airport construction projects are at Title 49 Code of Federal Regulations (CFR), Part 26. 49 CFR Part 26 prescribes a \$750,000 personal net worth limit for the owner of a DBE (excluding equity in his/her primary residence and ownership in the DBE. Additionally, Part 26 caps the annual gross revenue of a DBE firm at \$17.4 million per year (averaged over the preceding three years).

In contrast to the Part 26 regulations, the regulations covering airport concession DBEs (49 CFR Part 23) impose no personal net worth limit for the owner of a DBE. Although the regulations provide that presumption of economic disadvantage is rebuttable, the absence of a personal net worth limit for airport concession DBEs makes it difficult, if not impossible, for the presumption to be rebutted. As such, it is possible that *irrespective of personal wealth*, an individual otherwise qualified could attain certification as a DBE for an airport concession contract if they are a member of a designated group based on social disadvantage. In addition, Part 23 allows airport concession DBE firms to remain qualified with up to \$30 million in gross revenues (averaged over the preceding three years).

DOT administers its DBE program through its Operating Administrations, such as the Federal Highway Administration (FHWA), the Federal Aviation

¹ This Act contained provisions to include women in the previously designated groups of disadvantaged minorities. The Transportation Equity Act for the 21st Century (1998) continued to identify women as disadvantaged individuals for DOT DBE programs.

Administration (FAA), and the Federal Transit Administration (FTA). DOT Operating Administrations develop program policies, instructions, and procedures; reviews and approves states' and transit authorities' DBE program plans; provides technical assistance and training; and carry out oversight of local agencies.

New Orleans local agencies such as the Airport, Transit Authority and the Levee District must maintain DOT-approved DBE programs in order to receive financial assistance from the Federal Government on certain public works, transportation and airport improvements projects. These three local agencies established individual DBE programs, but are all bound by the DOT regulations for the certification of DBE contractors, vendors, and suppliers. Each agency maintains a list of certified DBEs by category of expertise such as paving contractors, engineers, and management consultants. Each agency sets annual DBE participation goals in accordance with goal-setting procedures prescribed in 49 CFR Part 26.

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APPENDIX B

Times-Picayune Newspaper Articles

In March 2001, the *Times-Picayune* published a series of articles on DBE programs in the City of New Orleans. The articles featured personal interviews with individual DBE owners who alleged numerous problems and abuses in the programs. Many of the DBE owners mentioned in the articles were not, at the time, certified under DOT DBE programs. Many of the allegations of program abuse or DBE fraud noted in the newspaper articles involved DBE programs operated by the City of New Orleans or other local agencies.

We investigated the specific allegations of abuse involving seven businesses cited by the *Times-Picayune* as having received DBE contracts under DOT DBE programs. In most cases, the DBE owners and program officials were interviewed. However, some DBE owners refused to be interviewed. Of the 1,224 DBEs certified in the City of New Orleans, approximately 500 were certified under U.S. DOT DBE programs.

Our general findings concerning the anecdotes in the *Times-Picayune* series are presented as follows:

Payless Car Rental

One *Times-Picayune* article cited problems the Airport has experienced in locating DBEs to participate as owners of car rental agencies at the airport. The article criticized the Airport's selection, for a car rental concession, of a DBE owner having a poor history of financial dealings.

We reviewed the circumstances of the Airport's selection of this concessionaire and found that in 1997, the Airport certified this DBE owner for the purpose of operating a PAYLESS car rental franchise. The Airport agreed to give him a choice location for a rental counter within the airport, lowered his concession fee to the airport from the customary 10 percent of gross revenues to 8 percent, and assisted him in negotiating a low franchise fee from PAYLESS. The DBE was not successful and declared bankruptcy. The Airport advised us that it was unaware that this businessman had previously been involved in a failed credit union and was the target of several lawsuits. Airport officials conceded that they may have exercised poor judgment in attempting to assist a DBE in a concession area controlled by large national firms. The Airport noted the difficulties small

businesses have in competing with large national companies such as HERTZ, AVIS, and BUDGET.

We did not investigate the circumstances surrounding the owner's previous involvement in a failed credit union and unpaid loans, as this was beyond the scope of our investigation. We did interview the owner concerning his political contributions. He told us he had made a personal contribution of \$10,000 to a mayoral candidate. He denied that his contribution had any influence in the extent of assistance he had received from Airport officials in operating his rental car business.

Edgar Ford

The newspaper articles questioned the eligibility of a large Ford automobile dealership, EDGAR FORD (EDGAR), to participate in the DBE program at the Airport. HERTZ CAR RENTAL, INC. (HERTZ) made more than \$90 million in fleet purchases from EDGAR between 1995 and 2001. HERTZ counted the entire purchase price of these vehicles toward DBE participation goals since they were purchasing them from a DBE certified by the Airport.

Through interviews with Airport officials and the owner of the auto dealership, we determined these vehicles were not actually being purchased from EDGAR. HERTZ purchased the vehicles directly from FORD MOTOR CO. Originally, EDGAR was paid between \$40 and \$100 per vehicle to take physical delivery of the vehicles and assist in recording the titles. (EDGAR was a certified DBE, but because the business was classified as an Airport concessionaire, there were no limits on the owner's personal net worth.) This arrangement with HERTZ lasted for approximately two years, after which HERTZ began having the cars shipped from FORD directly to their locations and EDGAR was no longer involved in preparing any paperwork. Notwithstanding this, HERTZ continued to pay EDGAR between \$5 and \$25 per vehicle from HERTZ, in order for HERTZ to continue applying the purchases toward DBE participation goals, even though EDGAR had no involvement in the transactions.

HERTZ has not counted the purchase of these fleet vehicles toward DBE participation goals in New Orleans since the end of 2001. In September 2002, the Airport decertified EDGAR as a DBE after it failed to provide information necessary for recertification.

Wealthy Airport Concessionaire

The news articles cited that the wife of a multi-millionaire celebrity attorney was reportedly a current DBE at the Airport. We found that while she had been an Airport concession DBE owner in the late 1990s, and could still qualify under the current DOT DBE regulations for airport concessionaires, she was actually a non-DBE joint venture partner with a major retail contractor. The articles correctly noted that there are no personal net worth limitations on airport concession DBEs, and individuals with unlimited assets may be able to meet DBE eligibility requirements.

In 1997, the Airport solicited contract proposals for new major retail and beverage concession managers. The Airport required 35 percent participation in these contracts by minority-owned firms. The minority individual mentioned above submitted a proposal and was selected as the minority joint venture partner by the major retail contractor, but was not operating as a DBE.

A.M.E. Janitorial Service

The newspaper articles reported that the owner of a janitorial company certified as a DBE by the City of New Orleans, A.M.E., Inc., (AME), had obtained several lucrative contracts at the Airport through political influence. A review of the DBE's business records and interviews with the DBE owner and Airport DBE compliance officials revealed he was never certified as a DBE by the Airport. His business was considered a services company, not a concessionaire, and would have had to meet standard certification regulations under 49 CFR Part 26 to qualify as a DBE. The company's gross revenues exceeded \$20 million annually and, therefore, the owner could not meet the \$17.4 million gross revenue limitation. AME operated at the Airport as a regular contractor, not as a DBE. However, AME was certified by the City of New Orleans as a DBE because its DBE program (non-DOT funded) has no limitations on personal net worth or gross revenues.

The owner told us he made political contributions to several local politicians, but denied these contributions had any affect on the awarding of the Airport contracts. He advised he had obtained his airport contracts through competitive bidding. We verified through the Airport Contracting Office that AME's contracts were competitively awarded¹.

Allegations were made that the owner of AME also operated another business at the Airport identified as ETI. The owner stated he made a loan to a former

¹ Not all Airport concession contracts are competitively awarded.

employee to assist him in setting up a new personnel business, Exceptional Temporaries, Inc. (ETI) which was a DBE. We verified that ETI had been certified by the Airport as a DBE. The owner of AME denied he owned any part of this business; he merely made a personal loan to the owner of ETI as a friend and the loan has since been repaid. Our review of ETI's certification records indicated no ownership by the owner of AME.

The newspaper articles also reported that AME had failed to provide assistance to other DBEs in accordance with a clause in its Airport contract to make a good-faith effort to place 35 percent of its work with DBE firms. We did not investigate these allegations due to the fact the contracts in question extended from the early 1990s through 1998, which was beyond the scope of our investigation.

Carlo Ditta, Inc.

The *Times-Picayune* questioned the DBE status of a large cement contractor, CARLO DITTA, INC. (CDI). Our review of records and interviews with Airport DBE personnel and the owner and managers of the company revealed the business was no longer a certified DBE. The business had originally been certified as a DBE by the Airport and Transit Authority in 1993. In March 1999, changes to the DOT regulations at 49 CFR Part 26 instituted a personal net worth limitation for DBE owners and an annual gross revenue limitation for DBE firms (presently \$17.4 million, averaged over the three preceding years). Under these new regulations, CDI no longer qualified because its annual gross revenues exceeded the prescribed limit. However, DOT guidance for implementing the new regulatory standards afforded agencies some discretion for when to apply the provisions. As such, the Airport and Transit Authority DBE Compliance Offices allowed CDI to remain a program participant until September 2001, when it was decertified.

Boe's Iron Works Inc.

The owner of Boe's Iron Works Inc. (BIW), described in the *Times-Picayune* as "a white man with a net worth of more than \$4.2 million", was alleged to have received DBE contracts. It was determined that BIW has never been certified by the Airport, the Transit Authority or the Levee District. The company applied for DBE certification at these agencies under the Woman-owned Disadvantaged Business Enterprise (WBE) program with the wife of the owner as the proposed WBE. The applications were processed, but site visits performed by the Airport Authority determined the wife would not be actively managing and controlling the business, thus the DBE certification was denied. BIW did obtain DBE certification by the Orleans Parish School Board, which is not part of DOT's DBE program, and received a \$1 million contract. While our overall finding about the

agencies' DBE programs is that site visits were inadequate, this specific example serves to underscore the utility and value of thorough site visits.

Bayou State Security, Inc.

The *Times-Picayune* reported that the owner of one of the largest security companies in the state, Bayou State Security, Inc., was a DBE with annual revenue of \$5 million. We determined Bayou had several large security contracts with the Airport and various local agencies. We interviewed the owner who advised he met all eligibility requirements for the DOT DBE program. We reviewed the firm's business records and the owners personal net worth records contained in his certification file at the Airport DBE Compliance Office. In reviewing certification file documentation, we determined that the owner's personal net worth was below \$750,000 (excluding his personal residence and his investment in the company.) Even though his firm had annual gross revenues of \$5 million, this was well below the amount allowed by the DOT DBE regulations—a three-year average of \$17.4 million or less per year. We determined the owner met all DBE eligibility requirements and was properly certified.

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