

Increasing Government Scrutiny Requires Robust MWBE Compliance Programs to Avoid Criminal, Civil Investigations



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New York's state contracts boast some of the most ambitious diversity goals in the nation, and are well recognized for their frequent utilization of Minority and/or Women-owned Business Enterprises, known as MWBEs,^[1] with a set "goal" of over 30% MWBE participation. Construction companies, including contractors and subcontractors vying for lucrative state and city contracts, (and even organizations operating in other industries, such as tech companies) commonly agree to meet these goals during the bidding process, only to later find themselves the targets of government investigations that focus on the way companies have complied with the requirements. These high goals can make it difficult for well-intentioned contractors to comply, particularly in less populated areas of the state.

Mitigating fraud in the MWBE program has been a law enforcement focus for some time. In 2014, a New York County Grand Jury investigated activities of several prime contractors and subcontractors in the construction industry, ultimately finding that the companies committed fraud regarding to the government imposed MWBE goal requirements specified in the contracts. The Grand Jury found these acts violated criminal laws in addition to program regulations and found evidence of criminal conduct spanning at least a decade.

State agencies now require contractors to submit detailed utilization plans [2] for achieving contract goals for MWBEs performing *commercially useful functions* in relation to State contracts, including the dollar amounts paid to an MWBE. Contractors also must submit MWBE Contractor Compliance Reports each month during the term of the contract for the preceding month's activity, documenting progress made towards achievement of the contract MWBE goals. Exemptions, waivers, or reductions in the MWBE participation goals may be granted in certain limited situations and are reviewed by a case-by-case basis by the New York State Office of General Services ("OGS") Office of MWBE.

These certifications of compliance and associated business records that are submitted to the state (if criminally false) may be used to form the basis for criminal charges, including Grand Larceny (Penal Law §155), a Scheme to Defraud (Penal Law §190.65 (1)[b]), Offering a False Instrument for Filing in the First Degree (Penal Law §175.35) and Falsifying Business Records in the First and Second Degrees (Penal Law §§ 175.05, 175.10). To criminally prosecute such claims successfully, the government needs to prove a criminal intent to thwart the requirements or deceive the state in its utilization of certified MWBEs (see, [Lippes Mathias article on Falsifying Business Records](#)).

More recently, Governor Hochul signed legislation to prevent fraud and abuse in NYS contracts by entities falsely claiming to be MWBEs, (See NY Executive Law §314-A [2022]) Creating a fund to audit, investigate and prosecute MWBE fraud.[3] The new law requires (1) a post-completion certification, under penalty of perjury, prior to the prime contractor getting paid, that the MWBE in fact performed the work, performed the services, or delivered the materials; (2) a searchable, centralized state registry containing all relevant documents relating to certification and performance of the contractor, and (3) empowers the Director of the Division to perform inspections of MWBEs to root out fraud and abuse by authorizing inspection of financial records.

Investigations can also be initiated by a multitude of aggressive regulators: a state or federal Office of Inspector General, federal prosecutors, local prosecutors from County District Attorney's Offices, the State Attorney General's Office (the Taxpayer Protection Bureau), the federal or State Department of Labor, or federal and state tax authorities. Companies are subject to fines and the imposition of independent monitors. Potential charges could also include violations of the False Claims Act, which carries treble damages.

Another issue that is ripe for fraud allegations is whether an MWBE firm was used merely as a pass-through entity while the contractor performed the work on the project. Government regulations rely on certain criteria ensuring the MWBE performs a *commercially useful function*. [4] An MWBE subcontractor or a general contractor using MWBEs can open themselves up to scrutiny if the MWBE does not perform a commercially useful function, its role adds no substantive value, and is limited to that of an extra participant in a transaction, contract, or project through which funds are passed through the MWBE entity to obtain the appearance of participation. Several factors are used in assessing a commercially useful function, which should be considered when entering into subcontracts with MWBEs.

An effective compliance program must include a thorough understanding of the policies and regulations to satisfy the state's MWBE goals, an analysis that an MWBE satisfies the commercially useful function test, and a review of the documentation submitted to the state before any post-completion certification is signed. Moreover, adopting a compliance plan, but then failing to implement the plan's components can cause difficulties for the business when the government comes calling. Having a compliance program that incorporates MWBE requirements should be an integral part of a company's risk management.

If you are utilizing subcontractors on a New York State contract to satisfy MWBE goals it is important to fully comply with the rules and regulations to avoid any missteps. For questions or concerns, contact Dennis C. Vacco (dvacco@lippes.com), Karl J. Sleight (ksleight@lippes.com) or Joan P. Sullivan (jsullivan@lippes.com) of [Lippes Mathias LLP's Government & Corporate Investigations Practice Team](#).

[1] <https://esd.ny.gov/doing-business-ny/mwbe>

[2] See 5 NYCRR §142.8.

[3] See State Finance Law §97-k established the “minority and women-owned business enterprise fund”.

[4] The regulations define a “commercially useful function” when the entity is responsible for execution of the work of the contract and is carrying out its responsibilities by actually performing, managing, and supervising the work involved (See 5 NYCRR § 140.1[f]).

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