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Inspector General

Office of the Inspector General

Metropolitan Transportation Authority

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212-878-0000

June 11, 2018

Mr. Patrick Foye
President
Metropolitan Transportation Authority
2 Broadway, 20th Floor
New York, NY 10004

Re: **Small Business Mentoring Program
MTA/OIG #2017-11**

Dear Mr. Foye:

During an ongoing investigation, the Office of the Metropolitan Transportation Authority (MTA) Inspector General (OIG) identified weaknesses in the MTA's process for assessing whether small construction companies are eligible to participate in its Small Business Mentoring Program (SBMP). Having preliminarily identified weaknesses in SBMP's eligibility determinations, OIG undertook a more formal review of selected aspects of program eligibility. SBMP is one of the two programs established by MTA to help enlarge the pool of qualified construction contractors who can successfully compete as prime and subcontractors for MTA capital projects.¹

This letter shall serve as the OIG's final report on the matter that was previously presented to MTA in a draft letter dated November 28, 2017. In MTA's June 6, 2018 response the agency indicated that it agreed with the recommendations contained in our draft letter.

SBMP offers firms training in the fundamentals of the construction business, as well as the opportunity to compete with other SBMP contractors for small construction projects that are specifically designed for the program. MTA awarded its first SBMP project in July 2011. As of October 2017, MTA had awarded 238 SBMP contracts valued at \$188.2 million to 219 participating firms.

MTA has established financial thresholds for firms that apply to SBMP to help ensure that SBMP training and contract opportunities target the small businesses that need the assistance. For example, to be eligible for the SBMP Tier 1, defined by MTA as its basic mentoring program, a firm's annual gross revenues cannot exceed \$3 million, averaged over the three calendar or fiscal years' that preceded its application.

¹ The other program is named the Small Business Federal Program.

However, we found that the owner(s) of some of the firms accepted into SBMP also owned or were affiliated with other construction firms, but were not required by MTA to disclose these other businesses when applying to SBMP. Since such other ownership and affiliations may bear heavily on an applicant's need for the program, we believe that the failure to require such disclosure is a flaw in the MTA's process for determining SBMP eligibility.

For example, the owner of one SBMP-approved firm also owned another, much larger construction company that had demonstrated proficiency as a prime contractor on MTA projects before the smaller firm had applied to SBMP. Clearly, the smaller firm did not need the mentoring and other assistance provided by the program.

We also found that the background evaluations performed by MTA for SBMP eligibility are incomplete. For example, while the MTA evaluates the background of the applicant firm, the Authority does *not* currently conduct background checks on the firm's owner(s) and key persons.² In this respect, we believe the MTA can do more. Specifically, by also including checks of such individuals in its background reviews, the MTA will help ensure that firms accepted into SBMP meet its requirements for integrity.

Going forward, MTA should revise its SBMP application to ensure that a firm's owners are required to disclose all construction-related businesses that they own. Further, when MTA is deciding whether a firm's owner(s) actually need SBMP's assistance, revenues from all of the construction related businesses that they control (defined below) should be considered in aggregate. Finally, MTA should tighten controls on SBMP's application process so that an applicant, its owner(s), and key persons are thoroughly vetted for integrity. This letter informs you of the results of our review.

About the Small Business Mentoring Program

SBMP's purpose is to "develop [the] business capabilities of small construction firms, so that they become capable of successfully competing for larger projects, ultimately widening the prospective pool of construction firms competing for authority public works projects."³

SBMP is comprised of two tiers; Mentor (Tier 1) and Graduate Mentor (Tier 2). Firms participate in Tier 1 for a maximum period of 4 years. Tier 1 firms receive mandatory training in project estimating and scheduling, business marketing, and cash flow and financial management, among other subjects. Tier 1 firms also have the opportunity to compete with other Tier 1 firms for small projects (up to \$ 1 million) that are specifically designed for the program.

² MTA defines a "key person" to include a director, officer, or member; any person in a position to significantly control and direct the firm's overall operation, financial decisions, or its performance of any project; signatories to bank accounts; and holders of licenses necessary for the Applicant Firm to engage in a building trade.

³ Senate Sponsor's Memorandum in Support, Bill Jacket L. 2010, ch. 206 at 7.

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Upon successful completion of Tier 1, a company is eligible to apply for Tier 2, which is a more advanced program that helps prepare the firm to transition to active and independent contract work with the MTA.

Organization and Eligibility Review

SBMP is overseen jointly by the MTA Office of Construction Oversight (OCO) and the MTA Department of Diversity and Civil Rights. The TDX Construction Corporation (TDX) was hired by MTA “to mentor the small businesses with advice and technical assistance in competing for and managing authority construction contracts.”

Under OCO’s direction, TDX is also responsible for screening applications from prospective SBMP participants, a process known as a pre-qualification review. TDX reviews each SBMP application and supporting documentation, and then provides a written recommendation to OCO as to whether the company should be approved for the program. The OCO Deputy Director in charge of the program is responsible for making the final decision regarding a firm’s eligibility for the program, subject to the right of appeal.

As documented below, weaknesses in the SBMP eligibility process have allowed owners and firms that were not suitable for SBMP to participate nonetheless in the program and take part in the training and contract opportunities offered by it.

Revenue Limitation Criteria

New York State Public Authorities Law Section 1265-b, which enabled the MTA to establish the SBMP, defines a small business to mean an independently owned business in the construction trades which “has annual revenues not exceeding a fiscal limitation of five million dollars or such lesser amount as established by the authority....”

As noted, for Tier 1, MTA set an applicant firm’s revenue limit at \$3 million, averaged over the three calendar or fiscal years’ that preceded its application, which is a more stringent financial threshold than established by state law. To demonstrate that it meets these guidelines, the applicant must attach the firm’s financial statements and tax returns for the three-year period that preceded its SBMP application. In effect, the financial threshold is an indicator of the firm’s experience and, conversely, its need for the training and opportunities to bid on contracts offered by SBMP.

Notably, OIG has found that the MTA requires the applicant to provide financial information only on the firm itself that is applying to SBMP. Yet, it is not uncommon for small construction business owners to control two or more construction firms. Nevertheless, when assessing whether a firm meets the revenue limitation criteria, MTA does not consider revenue from other construction companies controlled by the applicant’s owner(s). As the case study of Firm A

below demonstrates, this flaw allowed an owner with substantial experience as prime contractor on MTA projects to participate in a program designed for less experienced firms that need assistance in competing for and managing MTA construction contracts.

Firm A Case Study

Firm A was accepted into SBMP Tier 1 in June 2012. OIG found that Firm A's owner, who submitted and signed Firm A's SBMP application, is also the sole owner of another, well established construction firm (Firm B). From 2009 to 2011, Firm A averaged \$1.18 million in revenues, well under MTA's threshold. Firm B, however, averaged more than \$7.1 million in revenue for the two-year period 2010 to 2011, and by itself, would have been ineligible for SBMP. When aggregated, A & B's combined revenues were nearly triple SBMP's Tier 1 threshold.

Further, before Firm A was accepted into SBMP in 2012, Firm B had already worked as a prime contractor on four New York City Transit (NYC Transit) contracts and one Metro-North Railroad contract, inviting the question of why its owner required mentoring to develop business capabilities so that his firm could "become capable of successfully competing for larger projects."

We also found that both firms are in the same line of work (electrical and general contracting) and extensively subcontract with each other. For example, SBMP applicants are required to provide at least two references for commercial work in every trade for which the applicant wishes to be qualified. Because he sought work in two trades, electrical and general contracting, Firm A's owner provided four references in its SBMP application. All four referenced projects were MTA construction contracts where Firm A was a subcontractor to Firm B which was the prime. Further, Firm A was not a prime contractor prior to its acceptance into SBMP. However, when Firm A did get work as a prime through SBMP, Firm B was a subcontractor on at least one of Firm A's SBMP contracts.

According to the company's owner, Firm B has approximately 20 permanent employees, including electricians and other skilled tradespeople. He also told OIG that Firm A does not have any permanent employees, and that he hires electricians on a temporary basis as the need arises. He further stated that if he cannot find electricians to hire he will assign Firm B electricians to work on Firm A's jobs. Thus, Firm A's use of Firm B employees, along with both firms extensive subcontracting with each other is strong evidence that, for all practical purposes, Firm A is indistinguishable from Firm B.

About a year after Firm A was accepted into the program, a TDX employee who was responsible for SBMP application reviews and training discovered that Firm A and Firm B had a common owner, and alerted the SBMP Program Manager. The manager told OIG that he discussed the matter with the then-Director of OCO, who concluded that Firm A should be allowed to continue

in the program because the SBMP eligibility criteria did not prohibit the firm from participating. Whether or not this was a correct interpretation, the Firm A situation presented a missed opportunity to revise or clarify the criteria to address the issue of common ownership.

In total, Firm A has been awarded four SBMP contracts; the last award was for approximately \$800,000 in July 2016 for a project in Queens. It should also be noted that between 2013 and 2017, Firm B was awarded 10 prime contracts by MTA agencies. Firm B's last award, in January 2017, was for \$29.7 million.

The owner of Firms A and B told OIG that he heard about SBMP from an advertisement. He attended an SBMP recruitment conference and claimed that he was encouraged by the recruiters to apply to the program. However, he acknowledged that because of his prior experience, he did not need the training and opportunities to bid on the MTA work offered by SBMP. Indeed, although the owner claimed that he had attended all but one of the 11 SBMP mandated training sessions, instead OIG found that he attended only one of the sessions, and that he had left that session early. He advised OIG that he had completed Tier 1, but claimed that he did not plan to apply to Tier 2.

During our study of Firm A, we found that the owner(s) of at least two other SBMP firms either owned, or were affiliated with other larger construction firms. For example, one of the firms, (Firm C), is affiliated with a large well established construction firm. Additionally, Firm C's primary owner is a member of the larger entity's executive team. Other factors in the relationship indicate that the Firm C benefits substantially from its affiliation with its larger corporate partner. Notably, the firms share office space, and corporate officers, and Firm C also had a \$500,000 line-of-credit from its corporate affiliate.

In sum, as the above examples demonstrate, requiring that an applicant fully disclose his or her other construction businesses is essential to ensuring that the program is targeting the firms that would likely benefit most from the opportunity and assistance that SBMP provides.

Integrity Reviews

MTA requires that firms that are accepted into SBMP possess a record of law-abiding conduct and ethical business practices. To help judge whether this standard has been met, the MTA SBMP Application form Question 39 requires that the applicant answer certain questions bearing on the integrity of, among others: itself, its key persons, and any person or entity with a 10% or more interest in the applicant firm (referred to here collectively as the Applicant). For example, one of these questions (39[c]) requires that the applicant disclose if it "is the subject of a pending investigation... in connection with the commission or alleged commission of a crime."

TDX is required to review the answers to these questions and, with some assistance from MTA, conduct a background assessment of the applicant firm. The purpose of the background

assessment is to help identify any adverse findings related to the applicant, including bankruptcies, lawsuits, liens, judgments and/or debarments or exclusions from performing public work.

However, we found that the background checks are directed only at the firm itself but not its owners, or key persons. Yet, as noted above, the scope of the integrity inquiry under Question 39 is much broader, in that it encompasses owners and key persons. Therefore, MTA's review provides no assurance that a firm's integrity has been thoroughly vetted before it is accepted into the program. As the case study of Firm D, and its owner demonstrates (see below) a thorough vetting of an owner's background is essential to ensure that an applicant has the integrity to participate in the program.

Firm D Case Study

On July 11, 2016, the owner of Firm D submitted the firm's application to SBMP Tier 1. TDX and MTA's review turned up no indication of adverse information regarding the firm. MTA accepted Firm D into Tier 1 on September 18, 2016.

Notably, though, OIG found that Firm D's owner failed to disclose a United States District Court civil judgment entered against him. MTA required that the owner of Firm D disclose the civil judgment in Firm D's SBMP application, because he owned 100% of the company, let alone the 10% disclosure threshold set forth in Question 39.

OIG discovered the civil judgment against the owner of Firm D after we examined documents pertaining to company's business address, which is located on Long Island. OIG learned that a construction company (Firm E) owned by the wife of the owner of Firm D, was also registered at the same Long Island address.

Firm E had defaulted on three public works contracts in 2009 and 2010. A surety had issued performance bonds and payment bonds on the three projects.⁴ OIG found that the surety successfully brought a civil judgment against the owner of Firm D based on his submitting materially false statements of net worth, resume, financial statements, and tax returns on behalf of Firm E.

According to the complaint in the civil action:

[Surety sought] to recover \$749,440 in damages suffered as a result of intentional misrepresentation and concealment of facts by defendant [owner of Firm D] for purposes of inducing [the surety] to issue surety bonds on behalf of [Firm E]....

⁴ A surety is an insurance company. A performance bond is a bond issued by a financial institution on behalf of a contractor, guaranteeing the contractor's fulfillment of a particular contract. A payment bond is a surety bond posted by a contractor to guarantee that its subcontractors and material suppliers on the project will be paid.

[Owner of Firm D] concealed and failed to disclose the facts that ... he alone managed every aspect of Firm Es' business affairs and construction operations and was therefore key and indispensable to Firm Es' operation, success and profitability....

[Owner of Firm D's] material misrepresentations ... were made with either actual intent to deceive or with reckless disregard for the truth or falsity of the representations

On October 9, 2013 the Court issued a Default Judgment against the owner of Firm D for "having failed to plead or otherwise defend in this action", and decreed that he owed the surety \$749,440, plus interest from the date of the judgment. According to court records, the owner of Firm D never challenged this judgment.

In Firm D's SBMP application, its owner answered "No" in response to question 39 (h) which, in relevant part, asked whether he, as a "person... with a 10% or more interest in the applicant"

Has within a ten year period preceding completion of this Application, ... had a civil judgment rendered against them for: (i) commission of a fraud ... in connection with obtaining, attempting to obtain, or performing a public (federal, state or local) transaction or contract under a public transaction;... (iv) or... falsification... of records, making false statement"

Indisputably, given the fraudulent conduct for which the owner of Firm D was sued, the civil judgment against him, and his admission on page four of Firm D's SBMP application that he has a 100% ownership interest in company, the owner of Firm D should have answered "Yes" to question 39 (h).

OIG alerted MTA to the adverse information regarding Firm D, whereupon MTA terminated Firm D from the program. The owner of Firm D appealed MTA's decision. However, MTA found no reason to alter its initial decision and denied the appeal.

In sum, as this case study demonstrates, MTA should tighten controls on SBMP's application process so that the applicant firm, its owner(s), and its key personnel, are thoroughly and equally vetted for integrity.

Improving Eligibility Screening

In order for MTA to determine if an applicant firm and its owner(s) are suitable for the program, MTA should require more information disclosure than its SBMP application currently requires. The MTA should also conduct more robust integrity reviews.

For starters, MTA should require that the owner(s) of an applicant firm disclose the names of any other active construction firm(s) in which they or the applicant firm have *any* ownership interest.

MTA should also require the disclosure of any other construction firms that the firm or its owner(s) previously owned during the 10 years preceding the firm's application to the SBMP, including construction firms that were sold during that time-frame and businesses that have ceased operations and are no longer active. Full disclosure of such key business information by the owner(s) of an SBMP applicant is an essential first step to help ensure that the applicant is suitable for the program.

Next, the MTA should ensure that a more complete assessment of an applicant owner's capability to manage a construction business is performed. When calculating revenues against the SBMP's financial limits, the MTA should aggregate the revenues from all active *construction* firms that are controlled by the applicant, and/or its owner(s).⁵ Doing so will provide a more complete picture of the owner(s) need and eligibility for the SBMP. However, MTA will need to exercise some flexibility when determining a firm's eligibility for the program. For example, if an applicant's owner can demonstrate to MTA's satisfaction that their ownership interest in another construction company (not the applicant) is a financial investment only that does not give them control of the firm, then the MTA may decide to exclude its revenues when calculating the applicant's eligibility for the program.

Finally, the MTA should ensure that integrity evaluations, including background checks and interviews, are comprehensive, and include reviews of the firm's owner(s), managers and key persons, as well as of all of the firm's owned by the applicant's owner(s).

RECOMMENDATIONS

To ensure that SBMP training and contract opportunities target the small businesses that need the assistance, and that only small construction firms with a history of ethical business practices are accepted into SBMP, we make the following recommendations:

Disclosure

1. The MTA should require that the owner(s) of SBMP applicants:
 - a. Disclose the names and addresses of all construction firms in which they, and/or the applicant firm, have had *any* ownership interest during the 10 years preceding the firm's SBMP application. The required disclosure should include their degree of ownership and all firms that ceased operations during the 10 year time-frame.

⁵ According to the MTA All-Agency Responsibility Guidelines, a "contractor controls another entity when: (1) it holds ten (10)% or more of the voting stock of the other entity; or (2) it directs or has the right to direct daily operations."

- b. Disclose all MTA construction contracts that the applicant and any and all construction firms disclosed by the applicant, were awarded as a prime contractor during the 10 years preceding the firm's SBMP application.
- c. Disclose the names and addresses of all construction firms for which the owner(s) have served as a key person within the last five years.

Agency Response: Implemented.

Eligibility and Integrity

2. When determining whether an applicant meets SBMP's financial criteria for acceptance into the program, aggregate revenues from all construction firms *controlled* by the applicant's owner(s) should be considered.

Agency Response: Accepted and in process. SBMP Prequalification procedures will be amended to require that an applicant meets SBMP's financial criteria for acceptance into the program based on the aggregate revenues from all construction firms controlled by the applicant's owner(s).

3. Re-evaluate the eligibility of firms accepted in the SBMP:
 - a. Require that the owner(s) of firms accepted in the SBMP disclose all other firms in which the owner(s) have a controlling interest.
 - b. Review the information disclosed per recommendation 2(a) above., and evaluate each firm's eligibility to participate in future SBMP training and bidding opportunities.

Agency Response: Accepted and in process. All current SBMP participants will be required to complete the new application and the applicant's eligibility will be reassessed based on these recommendations.

4. Ensure that integrity reviews are comprehensive, and include thorough background checks of the :
 - a. Applicant firm's owner(s), managers and key persons;
 - b. Other firms owned by the applicant's owner(s); and addresses

Agency Response: Accepted and in process. SBMP is in the process of engaging the services of a firm to perform the recommended comprehensive integrity reviews including thorough background checks for all participating SBMP firms and new applicants.

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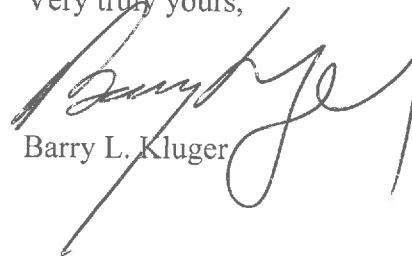
5. Ensure that Firm A is no longer eligible to bid on SBMP work.

Agency Response: Firm A will not be given any bid opportunities in the SBMP.

We are encouraged by MTA's response, and going forward, we will monitor the implementation of our recommendations as appropriate.

Should you have any questions, or need additional information, please contact me at (212) 878-0007 or Executive Deputy Inspector General Elizabeth Keating at (212) 878-0022.

Very truly yours,

A handwritten signature in black ink, appearing to read "Barry L. Kluger", written over the typed name.

Barry L. Kluger

cc: Michael Garner
Amil Patel