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April 27, 2006

Construction Information Memorandum No. 2-2006

TO: Division Engineers

ATTN: Division Construction and Division County Transportation Engineers

FROM: Terry McDuffie
Construction Engineer

RE: Guidelines for Payments to DBE Subcontractors and Material Vendors using Joint Checks

Recently, the USDOT/FHWA has been made aware of the use of joint (two-party) checks by prime contractors for payment to DBE subcontractors and regular dealers of materials/supplies. The attached memorandum titled **Information: Guidance on Use of Joint Checks Under the DBE Program** from Mr. Fredrick Isler, Associate Administrator for Civil Rights for the U.S. Department of Transportation is their response and is their policy concerning the use of joint checks for DBE payments on Federal-aid highway projects.

As outlined in the memorandum, the primary concern with this practice is that it may be difficult to determine whether the DBE is performing a commercially useful function as outlined in 49 CFR Part 26.55(c), which is restated in the Credit Toward Participation section of ALDOT Special Provision No. 02-0106(2). The regulations require that the DBE must be responsible for *"negotiating price, determining quality and quantity, ordering the materials, and installing (where applicable) and paying for the material itself."* When joint checks are used, it is more difficult to gauge the extent in which the DBE is controlling its operations independent of the prime contractor and the regular dealer, and it raises questions as to whether the transaction complies with these regulatory requirements because of the involvement of another party (i.e. prime contractor) other than the DBE in the issuance of the check for payment to the dealer/supplier.

However, FHWA will not object to the use of joint checks when the following conditions are met:

1. the second party (typically the prime contractor) acts solely as a guarantor
2. the DBE must release the check to the dealer/supplier
3. the use of joint checks is a commonly recognized business practice in the industry
4. the State Transportation Agency (STA) approves the practice before it is used
5. the STA monitors its use closely to avoid abuse

Joint checks, as ALDOT understands, are commonly used in the steel reinforcement and stay-in-place metal decking industry. From our past experiences, the manufacturers and dealers for these materials require prime contractors to act as the guarantor of payment of the materials to be furnished to the subcontractor (whether DBE or not) through joint checks. The prime sends the check to the subcontractor for review and endorsement, and then the sub releases the check to the dealer for final payment. Therefore, the practice of joint checks for these materials satisfies the first three conditions listed.

We also understand that the concrete industry utilizes joint checks for payment, but it seems that this practice is dictated more by a particular subcontractor's payment history rather than an industry practice. Our experience seems to indicate that this is the case for both DBE and non-DBE subcontractors, and that most of the time, it is the prime contractor's method of payment to protect the *Bond for Payment of Labor, Materials, Feed-Stuffs or Supplies* from a vendor claim. The claim, of course, is the result of the subcontractor's delinquent payment.

In order to satisfy the remaining two conditions required by USDOT/FHWA, the Department is developing an approval practice and a monitoring process. To assist us in this development process, USDOT/FHWA has provided some general circumstances and conditions to consider for allowing the use of joint check payments for DBE credit. Based on this information, the following guidelines will be used in the approval practice:

1. Regular communication and correspondence with the various contractor associations in order to determine the different material industries that use the joint checks as a standard practice for dealer payment.
2. The material industries in which joint check payments are deemed by the Department to be standard will be posted on the ALDOT Internet website to aid contractors in preparation of U-Plans and DBE-10 submittals.
3. Prime contractors should include notes on DBE Utilization Plan submittals (original and revised, if applicable) requesting that joint check payments be used for a particular DBE sub. These notes may be included on the U-Plan sheet (Form OE-110), an attached worksheet indicating the subcontractor's items of work and unit prices, or the DBE subcontractor's quote sheet. Regardless of the type of materials, the proposed DBE subcontractor, or the method of U-Plan notation, each U-Plan request will still be reviewed and approved on a case-by-case basis prior to the proposed work.
4. Formalized agreements, if applicable, between all parties indicating the joint check payment to the DBE subcontractor and the dealer for a particular project will need to be provided to the Department. These agreements should be included with the U-Plan, but if they are not, the U-Plan may still be approved with the stipulation that the agreement be furnished to the Department for review prior to the DBE beginning work. Failure to do so may result in a loss of credit for the proposed materials.
5. Documentation from the prime contractor and/or DBE to the Department outlining any changes in the joint check agreement or payments for this contract.

In addition, the following criteria will be considered as standards for this practice:

1. The use of joint checks must be available to all subcontractors, and not be limited to only DBEs.
2. No exclusive arrangement between one prime and one DBE in the use of joint checks that might bring independence into question.
3. The DBE subcontractor is still responsible for both furnishing and installing the materials paid by joint check.
4. DBE still must perform all other elements of a commercially useful function as outlined in 49 CFR Part 26.55(c) and the Credit Toward Participation section of ALDOT Special Provision No. 02-0106(2).
5. The Department will continue to use the check/audit of subcontractor payments as outlined in CIM 2-2004 to review the payment documentation for the DBE subcontractor. This may include copies of the cancelled joint checks.
6. The Prime contractor cannot require a DBE to use a specific supplier nor his negotiated unit price.

ALDOT will use these measures and criteria listed above on each affected project in order to monitor the joint check payment practice as required by USDOT/FHWA and to determine the amount of credit that may be allowed towards fulfilling the contract DBE goal. Prime contractors and DBE subcontractors are encouraged to maintain open and regular communication with all levels of ALDOT Construction personnel in order to satisfy these requirements.

This CIM is effective with all projects let on or after June 30, 2006. Should you have questions concerning this memorandum, please contact this office.

TM/GMB/WJP/wjp

Attachments

pc: Mr. D. W. Vaughn
Mr. G. M. Harper
Mr. Lamar Woodham
Mr. Ronnie Baldwin
Ms. Alvena Williams
Mr. Alton Treadway
Ms. Catherine A. Batey, FHWA
Alabama Roadbuilders Association
Alabama Asphalt Paving Association
Alabama Bridge Construction Association
Alabama DBE Contractors Association
American Concrete Pavement Association
DBE Issues File
File



U.S. Department
of Transportation

Federal Highway
Administration

Memorandum

INFORMATION: Guidance on Use of Joint Checks
Under the DBE Program

Date AUG 30 2005

Frederick D. Isler
From: Frederick D. Isler
Associate Administrator for Civil Rights

Reply to
App. of HCR

To: Division Administrators

Recently, several concerns have been raised about the use of joint checks under the Disadvantaged Business Enterprises (DBE) program. We have observed that a number of State Transportation Agencies (STA) have allowed the use of joint checks. From our experience a joint check is a two-party check between a DBE, a prime contractor and the regular dealer of material/supplies. Typically, the prime contractor issues the check as payor to the DBE and the supplier jointly (to guarantee payment to the supplier) in payment for the material/supplies used by the DBE. Due to the issues and concerns brought to our attention and requests for guidance, this memorandum sets forth FHWA's policy on the use of joint checks on Federal-aid highway projects.

A primary concern with allowing joint checks is that such a practice may make it difficult to determine whether the DBE is performing a commercially useful function. It also makes it much more difficult to gauge the extent to which the DBE is controlling its operations (independent of the other party involved in the joint check arrangement). The cost of material and supplies purchased by the DBE is part of the value of work performed by the DBE to be counted toward the goal. To receive credit, the DBE must be responsible for "negotiating price, determining quality and quantity, ordering the materials, and installing (where applicable) and **paying for the material itself.**" See 49 CFR 26.55(c)(1). When joint checks are used, a question is raised as to whether the transaction being carried out complies with regulatory requirements because of the involvement of another party other than the DBE in the issuance of the check for payment to the supplier.

In light of these concerns, FHWA will not object to the use of joint checks when the following conditions are met: (1) the second party (typically the prime contractor) acts solely as a guarantor, (2) the DBE must release the check to the supplier, (3) the use of joint checks is a commonly recognized business practice in the industry, (4) the STA approves the practice before it is used, and (5) the STA monitors its use closely to avoid abuse.

As part of its approval process (programmatically or on a case-by-case basis), the STA should analyze industry practice. Standard industry practice is one of several factors to consider in approving the use of joint checks. However, using joint checks should not be approved if doing so conflicts with other aspects of the DBE regulations regarding commercially useful function

(CUF). For example, the practice of joint checks might be standard industry practice in a State, but the regulations do not allow the DBE to be used as an "extra participant in a transaction, contract, or project through which funds are passed in order to obtain the appearance of DBE participation. In determining whether a DBE is such an extra participant, [the STA] **must** examine similar transactions, particularly those in which DBEs do not participate." See 49 CFR 26.55 (c)(2). Thus, standard industry practice cannot be shown unless the practice is commonly employed outside of the DBE program for non-DBE subcontractors on both federal and state funded contracts.

A STA that approves the use of joint checks in their DBE program should have a well defined monitoring process that ensures its use comports with agreed upon conditions and that such practice is not in conflict with the requirements of the DBE program. Furthermore, the STA should incorporate its policies and procedures for handling joint checks in its DBE program. This will ensure that all parties (internally and externally) are informed of the STA's process and that the DBE staff, field project engineers, and others implement it consistently statewide. A method for monitoring the use of joint checks used by some STAs is to require the prime contractor/DBE furnish the cancelled check used for the payment of materials/supplies under the contract.

The attached document lists a set of circumstances and conditions that should be considered in approving the use of joint checks. This guidance has been coordinated with the FHWA Office of Chief Counsel. We trust this information is helpful to you and your respective STA. Should you have any questions, comments or additional concerns regarding this subject, please contact Charles Klemstine (202-366-6753).

DBE Program – Joint Checks

The practice of using joint checks in the DBE program is not a new phenomenon. In fact FHWA addressed the use of joint checks as far back as the mid 1980s. The FHWA has always maintained that joint checks could be allowed but needs to be closely monitored to ensure that such a practice did not erode the independence of the DBE firm. Close monitoring also ensures that the use of joint checks does not inhibit the DBE's ability to control its work and perform a commercially useful function (CUF). The STA should establish a solid basis for the use of joint checks that strikes a reasonable balance between the benefit to the DBE and the potential for abuse. Joint checks should not be allowed simply for the convenience of the prime contractor. .

General circumstances to be present to support joint checks:

- Standard Industry practice applies to all contractors (federal and state contracts)
- Use of joint checks must be available to all subcontractors
- Material industry sets the standard industry practice, not prime contractors
- Short term not to exceed reasonable time (i.e., one year, two years) to establish/increase a credit line with the material supplier
- No exclusive arrangement between one prime and one DBE in the use of joint checks that might bring independence into question
- Non-proportionate ratio of DBE's normal capacity to size of contract and quantity of material to be provided under the contract
- DBE is normally responsible for both to install and furnish the work item
- DBE must be more than an extra participant in releasing the check to the material supplier

General conditions for allowance:

- DBE submits request to STA for action
- Subject of formalized agreement between all parties that specify the conditions under which the arrangement will be permitted
- Full and prompt disclosure of the expected use of joint checks
- Require prior approval
- Even with joint checks, DBE remains responsible for all other elements of 26.55(c)(1)
- State clearly determines that independence is not threaten because the DBE retains final decision making responsibility
- State clearly determines that request is not an attempt to artificially inflate DBE participation.
- Standard industry practice is only one factor
- State is to have a well-established monitoring process that has oversight mechanisms such as, for example, receipt of cancelled checks and/or certification statement of payment
- No requirement by prime contractor that DBE is to use a specific supplier nor the prime contractor's negotiated unit price