

Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current and previously issued FIRs are available on the NM Legislative Website ([www.nmlegis.gov](http://www.nmlegis.gov)) and may also be obtained from the LFC in Suite 101 of the State Capitol Building North.

## FISCAL IMPACT REPORT

**SPONSOR** Padilla/Maestas **ORIGINAL DATE** 1/25/17  
Barnes **LAST UPDATED** \_\_\_\_\_ **HB** \_\_\_\_\_  
**SHORT TITLE** Resident Business Set-Aside Act **SB** 18  
**ANALYST** Sánchez

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>			Indeterminate	Indeterminate	Recurring	General Fund/Other State Funds

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates HB25

### SOURCES OF INFORMATION

LFC Files

#### Responses Received

General Services Department (GSD)  
 Office of the State Auditor (OSA)  
 Department of Finance and Administration (DFA)  
 Higher Education Department (HED)  
 Administrative Office of the Courts (AOC)  
 Taxation and Revenue Department (TRD)  
 Economic Development Department (EDD)  
 New Mexico Environment Department (NMED)

#### 2016 Responses Received From

Department of Information Technology (DoIT)  
 Energy Minerals and Natural Resources Department (EMNRD)  
 Indian Affairs Department (IAD)  
 State Land Office (SLO)

### SUMMARY

#### Synopsis of Bill

Senate Bill 18 proposes to create a new section in the Procurement Code, NMSA 1978 Article 13 requiring state contracting agencies to set-aside 33 percent of its contracts for resident businesses

as an incentive to encourage businesses to grow and expand the state's economy.

Contracts included in the State Use Act awarded to resident businesses are included in the agency's 33 percent set-aside. Contracting agencies are required to submit an annual report to the General Services Department (GSD) reporting outcomes of the proposed legislation and GSD is required to analyze those reports and use the data to report to the governor and the legislature and to publish results on the sunshine portal.

State contracting agencies would be required to consult with the GSD to designate a portion of a contract as a resident business set-aside and to develop an annual plan on how to achieve the purpose of this proposed legislation. Any disagreement between the GSD and the contracting agency as to the designation of a resident business set-aside is to be sent to the State Auditor for final determination.

Businesses or contractors desiring to be certified as a resident business must submit an application and affidavit to the Taxation and Revenue Department (TRD) acknowledging that it meets the requirements proposed under this legislation. The TRD may assess a reasonable fee to issue the certificate which must not exceed the actual cost to the carry out its duties. The certification is valid for three years from the date of issuance. If the TRD denies the certification, the business has 15 days to file an objection with supporting documentation and may request a hearing. The TRD is required to review the documentation and issue a decision within 15 days of the objection being filed. Filing false information bars a business or contractor from receiving a certificate for five years and is subject to a \$50 thousand administrative penalty. The proposed legislation allows a business or contractor the right to judicial review the decision of TRD.

The GSD is required to consult with industry representative every six months and promulgate rules necessary to implement the provisions of this legislation.

The effective date of this bill is July 1, 2017.

## **FISCAL IMPLICATIONS**

GSD and the New Mexico Environment Department (NMED) consider the effects of this bill an unfunded mandate since it does not have an appropriation.

The Office of the State Auditor (OSA) opines that it might require additional resources to adequately evaluate and make a final determination regarding disputes, and auditor review issuance or the validity of resident contractor certificates.

The Taxation and Revenue Department (TRD) is concerned that there may be situations where project costs increase due to a limited pool of resident businesses or that, should the percentages be just below the required threshold, state agencies might be in the position of hiring less experienced contractors for highly specialized projects. It also reports that its taxation system, GenTax, will require modifications and that the fiscal impact is minimal. The Economic Development Department (EDD) is also concerned about cost increases.

The Department of Information Technology's (DoIT) 2016 response stated that additions or changes to the Sunshine Portal will require development which would cost about \$10,000.

The State Land Office (SLO) in 2016 supported efforts to ensure resident businesses and resident contractors to compete for contracts; however, this bill could potentially result in restricting competition for 33 percent of all its contracts which, in turn, could lead to increased prices for goods and services. These increased costs could potentially increase SLO's budgetary needs and therefore negatively impact the distributions to beneficiaries.

The Economic Development Department (EDD) reported in 2016 that it would not be able to absorb the additional workload and would require a part-time FTE.

## **SIGNIFICANT ISSUES**

GSD reports in its response that this bill would restrict competition by requiring 33 percent of all state contracts to be awarded to a defined and limited class of vendors (resident businesses); this action could result in those state contracts being awarded with higher pricing than if competition were for any and all vendors that wish to compete. Whether the pricing would be offset by increased revenue to the state is unknown, and would require more analysis.

The Department of Finance and Administration (DFA) opines that an underlying premise of the Procurement Code is that the State can obtain lower prices for goods and services from increased competition. SB18 could restrict beneficial competition for 33 percent of all State contracts to a certain class of vendors which, in turn, could lead to increased prices. This potential pricing impact on contracting agencies might be off-set somewhat by an increase in gross receipts tax revenues paid by resident contractors. Additional analysis would be required to further specify a fiscal impact. This bill could also impact the quality and availability of goods and services in an effort to reach the stipulated award percentage. It also states that it may be challenging for contracting agencies to track and meet the 33 percent of all contracts threshold since oftentimes contracting agencies may not be able to foresee necessary contracts and would not, therefore, be including such unforeseen contracts in the annual plan mandated by this bill. There is no mention in the bill of ramifications for a contracting agency failing to meet the 33 percent set-aside.

The New Mexico Education Trust Board (ETB) which is administratively attached to the Higher Education Department (HED) manages 529 college savings plans: a direct-sold plan and an advisor-sold plan. The professional services required to manage the 529 plan are highly specialized and the Educational Trust Board and HED are concerned that this bill could cause a serious inability for ETB to contract with qualified contractors that possess expertise to fulfill certain contracts because New Mexico companies do not have the expertise to fulfill the requirements of certain contracts. The bill could potentially jeopardize the ETB's ability to fulfill its fiduciary duties.

NMED expresses similar concerns about New Mexico companies having the necessary technical skills for environmental remediation or engineering projects. Although the bill does have an exemption from its provisions if participation in federal programs is jeopardized, it would have to expend additional time to comply with SB18.

The Administrative Office of the Courts (AOC) reported that business set-asides are relatively common in the United States. Many states have one or more small, resident or minority business set-aside programs. The federal government has a nationwide system of minority business set-asides. The constitutional guarantee that states must afford their privileges and immunities to

other states, together with the exclusive constitutional authority of Congress to regulate commerce among the states, have been argued to prohibit resident set-asides. To some extent, the guarantee of equal protection of the laws has been argued to prohibit set-asides as well. Yet the consensus is that set-asides that address a legitimate local interest such as business development, and that do not set aside too high of a percentage of public money exclusively for local businesses, are constitutional. There appears to be no binding legal authority for or prohibition against the 33 percent set-aside that SB18 would create. The constitutionality of the system would thus have to be definitively resolved by the courts

Since October 5, 2011, TRD has approved and certified 3,072 residential business preferences. This is not a large number of businesses for the state to contract with; however, if the 33 percent threshold is set, every state agency would be vying for services from this limited number of contractors. This could potentially have a negative impact or delay state services.

TRD further reports that it is not provided any discretion in issuing certificates to businesses or contractors that provided false information or failed to perform the contracted services to a contracting agency after waiting the requisite five (5) years delineated in Section 5 of the bill, Subsection (F)(1). A contracting agency could potentially be obligated to contract with a resident business of questionable integrity due to the preference given to resident businesses. This surely is not the bills intent. Discretion should be provided to avoid certifying businesses of questionable character.

The bill does not require agencies to report residency information to DoIT so it is possible that system development contracts may be excluded from the requirements of this bill. If the presumption is to include system development contracts, coordination among DoIT, GSD and TRD will be necessary to determine the residency requirement.

## **ADMINISTRATIVE IMPLICATIONS**

GSD questions how agencies are to report the 33 percent set-aside annually as required by the bill if agencies have no money in their budgets to comply. EDD reports that it will be difficult to comply with the requirements of the bill.

According to SLO, the additional requirements of this bill could delay the contract issuance timeframe which could hinder its ability to generate revenue or protect trust assets in a timely manner.

The Energy, Minerals and Natural Resources Department (EMNRD) reported that it may have to designate staff to track compliance and reporting of this bill and may require development of a computer application to properly account its progress in awarding contracts with resident set-asides.

A cautionary note for public entities should the bill be enacted is to examine contracting entities identifying themselves as resident contractors to ensure that the entity's staff, geographical source of revenue, and location of work performed is mostly in the state.

The effective date of the bill may not allow sufficient time to promulgate rules for implementation, which can be up to six months. Drafting the rules can take at least 60 days. Those must then be posted for 30 days to allow for public comment. All comments must be

given due consideration and if accepted included in a subsequent draft. GSD must then work closely with the Commission on Public Records to fulfill all publication requirements before the rules can be published in the New Mexico Register.

## TECHNICAL ISSUES

According to GSD, many other states do not limit competition by having resident preferences. Such states have reciprocity statutes that apply as a penalty to vendors from another state that has such a preference. Such reciprocity laws could result in New Mexico vendors enjoying a preference in New Mexico state contracting, but being penalized in procurements in other states.

There may be a conflict of interest with the OSA being required to resolve disputes and then later having to audit the contract. The Yellow Book (Generally Accepted Governmental Auditing Standards) requires auditors to be independent in mind and appearance in all matters relating to the audit work.

GSD further points out that “equipment” and “resident business subcontractor” are not defined.

DFA points out that the bill refers to "bids" in some places and "bids and proposals" in others. Bids and proposals are two distinct procurement concepts and it is unclear if the bill's intent is to include both, or only one or the other, of the concepts.

TRD recommends adding language to clarify that “number of contracts,” under no circumstances should be determined by dollar value of those contracts. TRD could not meet the 33 percent threshold if the number of contracts translated into dollar value of all contracts due to the current IT systems for tax administration.

TRD also points out that the bill does not comport with agency structural changes that occurred through 2015 legislation. Section 5 of the bill, Subsection (E) (page 10 lines 4-6) indicates that a business or contractor that was denied certification may request a hearing and indicates, “[t]he taxation and revenue department shall review the evidence and issue a decision within fifteen days of the filing of the objection.” On July 1, 2015 the Taxation and Revenue’s Hearing Bureau ceased to exist. The Administrative Hearings Office was created which functions under New Mexico Department of Finance and Administration. Any “hearing” referenced by this section would presumably be performed by the Administrative Hearings Office. TRD would therefore not issue any decision and this subsection’s language needs to be modified accordingly. Section 5 of the bill, Subsections (F) and (G) also presume a hearing would be conducted and a decision would be issued by the Taxation and Revenue Department.

According to the Indian Affairs Department (IAD), Section 3 (C) of the bill broadens the definition of “Indian nation, tribe or pueblo” from that in the State-Tribal Collaboration Act (Section 11-18-1 NMSA1978) to include: (1) a political subdivision, agency or department of an Indian nation, tribe or pueblo; (2) an incorporated or unincorporated enterprise; or, (3) a corporation considered to be an Indian nation, tribe or pueblo by the federal government or the state.

According to GSD’s response, the set-aside contract is designated as a contract with respect to which *bids or proposals* are solicited, which suggests to them that other contracts (i.e. sole source, emergency) or agreements (i.e. Intergovernmental Agreements) are not affected by the

bill. It suggests that more clarity in the definition section (Section 3) regarding *bids or proposals* (e.g. within the statewide procurement system overseen by GSD) may be useful.

The OSA suggests inserting the following language on page 5, line 5, after the period, “The non-prevailing party, as between the department and a contracting agency, shall pay all reasonable fees charged by the state auditor to resolve the dispute.”

## **OTHER SUBSTANTIVE ISSUES**

AOC states that a practical issue, for public entities that wish to contract locally, is identifying legitimate local businesses. With millions of dollars at stake, many businesses will present themselves as local, and will indeed have some local aspects to their businesses. Upon closer examination, however, the true bulk of their enterprise, as measured by staff, geographical source of revenue, and location of work performed, is elsewhere in reality. The bill's objective indicia of local presence should help contracting agencies and the TRD identify legitimate local businesses and contractors.

TRD also states that the bill may create a super-advantage for tribally owned businesses. Businesses owned by Indian Tribes, Pueblos, or Nations, depending on the nature of ownership, do not pay property taxes on real or personal property in the state and, in circumstances consistent with federal Indian law, may not pay gross receipts tax on business activities, or at least one other tax administered by the state. The businesses owned by Indian Tribes, Pueblos or Nations would receive the benefit of the one third contract mandate without the benefit to the state of paying taxes.

SB18 does not set forth penalties for agencies who do not meet either the contracting or reporting requirements. It also does not have a mechanism to revoke a license once it is issued.

## **ALTERNATIVES**

GSD suggests incorporating into procurement requirements on RFPs the inclusion of a separate rated evaluation factor for the amount of in-state subcontracting being proposed without enumerating a set percentage of the amount of such subcontracting to address the purpose of this bill, maintain competition, and attempt to place more state procured business with New Mexico “resident” vendors, both statewide and locally. Such a factor could require a showing of the fiscal impact on the state and local community where the procurement purchase is being done or performed. The greater the state or local impact by use of local businesses, the greater the points being given within the category involved, and the greater the likelihood that through this type of non-restricted competitive process the state receives the “best value” for its procurement selection.

TRD suggests the following changes to the bill Section 3:

- Subsection (E) defines New Business. Business means a business that is not a construction business that has been in existence for less than three years.
- Subsection (F), new contract means a construction business that has been in existence for less than five years.” A definition of “construction” may be necessary.
- Define “in existence” or change to “licensed in New Mexico”.
- Subsection (G), relocated business means a business that has moved to New Mexico and

employs a minimum of eighty percent of its total domestic personnel with New Mexico residents in the past five years

## **POSSIBLE QUESTIONS**

GSD posed the following questions:

- (1) While the state auditor is given authority to audit or review the issuance or validity of a Resident Business or Resident Contractor certificate, what action may be taken by that office as follow up to such audit or review? Is such action appealable?
- (2) What effect does limiting competition have on price and/or quality of items being procured under such set-asides? What impact does such pricing and quality have on the budgets of the agencies involved?
- (3) State Purchasing is required to perform procurements for Local Public Bodies (LPB) when requested (to reduce prices by having a larger amount of spend being offered thus having greater competition), and those agreements become statewide price agreements accessed by state agencies. How are those procurements to be treated under this bill? Will a state agency be required to forsake an in place procurement to do a set-aside, resulting potentially in a higher price being paid for the procurement? Conversely, if a state agency does a procurement for a statewide application accessed by a LPB, and pays a higher price as a result of such limited competition because it is done as a set-aside, how does that price affect the budgets of those LPBs that access that agreement?
- (4) How does this legislation interact with the current preference laws administered by TRD?
- (5) Is this Act to be a new section or sections of the Procurement Code? How are the two Acts to be read together?
- (6) How do emergency and sole-source procurements figure into agency annual plans?

ABS/jle/al/sb