SAN FRANCISCO BAY AREA RAPID TRANSIT DISTRICT
INDEPENDENT OFFICE OF THE INSPECTOR GENERAL

PROCEDURAL LAPSES PROMPTED CLAIM OF DBE FRAUD

INVESTIGATION RESULTS

A change to a $19.9 million federally funded contract led to noncompliance with contract terms and the District's contracting procedures. The contractor awarded the contract submitted a project bid that included two bid items totaling $2.3 million for hazardous materials trucking and disposal, which the contractor awarded to a DBE subcontractor to satisfy its DBE participation goal. When differing site conditions led to a request to change the two bid items, the contractor continued to provide work to the DBE, but not under the same conditions cited in the contract. This led to the use of subhaulers and non-DBE trucking firms in a manner that did not conform to contract terms, thus creating a perception of DBE fraud.

Per a BART executive, the contractor did ask about the impact of the change on its DBE goal at the time the change was proposed, but the BART project manager said that would be addressed later, thereby bypassing established procedures. The BART project manager also did not process the requisite change order when the changes were approved, which would have provided the opportunity to document and obtain formal approval for the scope change's impact to the contract terms and DBE goals.

While we did conclude contract noncompliance, our review of available evidence supported that the contractor did receive approval of its proposal to remove bid items 25 and 26, thus, removing $2.3 million from its DBE goal.

RECOMMENDATION

There are no recommendations associated with this report. Our forthcoming construction contract change order audit will provide recommendations to improve the change order process. Also, the project manager who circumvented BART's practices has left District service. There is no indication that the resignation was associated with this investigation.

WHY THIS INVESTIGATION MATTERS

A fundamental goal of the DBE program in place during the period of this investigation was to create equitable opportunities for small businesses owned by socially and economically disadvantaged persons. Violations of this program harm these businesses.

Ensuring adherence to established procedures is essential for preventing waste, safeguarding against fraud, and promoting efficiency. Compliance monitoring is vital to accountability within federally funded projects.

Our findings underscore the need for enhanced compliance practices to ensure transparency and uphold the integrity of the DBE program and foster equal opportunities for all stakeholders in BART contracts.

RELEVANT LAW

Title 49, Part 26 of the Code of Federal Regulations has strict guidelines regarding DBE participation on federally funded projects. Engaging non-DBE subcontractors for work intended for DBE subcontractors could be a violation of these regulations and the Federal False Claims Act.

OIG Reporting Requirement & Disclosure Practices

We are providing this report to comply with California Public Utilities Code § 28841, which requires that we keep BART administration, the Board of Directors, and the public informed of our fraud, waste, or abuse investigative findings and recommendations.

We identify those involved in our investigations in only limited circumstances. This avoids violating privacy and confidentiality rights granted by law and creating unwarranted actions against those involved with our investigation. The decision to provide names is made on a case-by-case basis and considers all elements of an investigation. This practice does not prevent individuals from requesting documents under the California Public Records Act (CPRA). However, such disclosures may be restricted or limited by law. The case described in this report is associated with case number 199-2024.

DBE Fraud Fast Fact

DBE fraud generally takes on one of two forms: a "front" company or a "pass-through" company.

In the front company scheme, a non-DBE firm creates a DBE company as a front to bid on projects, while ultimately diverting all the work (and profits) to the non-DBE contractor.

In the pass-through company scheme, a legitimate DBE acts as an intermediary, passing most of the work on to a non-DBE firm while invoicing the general contractor for the non-DBE's work, plus a small percentage fee.

Background

On February 16, 2022, BART awarded a $19.9 million contract for civil grading work at a BART maintenance facility, funded by federal sources. As part of this federally assisted project, the contractor was obligated to follow Title 49, Part 26 of the Code of Federal Regulations (CFR 26), which mandates good-faith efforts to engage Disadvantaged Business Enterprises (DBEs) and obligates the contractor to use DBE subcontractors as outlined in its bid. The District's Office of Civil Rights' (OCR) DBE program ensures compliance with CFR 26 and aims to promote nondiscrimination based on race, color, sex, or national origin.

The OCR set a DBE participation goal of 30% for this contract. The contractor committed to 36.2% in its bid and designated specific bid items to all but one DBE subcontractor to achieve this target. Among these were bid items 25 and 26 related to Class I and Class II hazardous materials trucking and disposal, specifically for contaminated soil that poses fire and explosion risks if mishandled. The contractor awarded this work to a DBE subcontractor, and that DBE agreed in writing not to subcontract the trucking tasks. Under CFR 26, the contractor was to ensure that the DBE firm performed the work outlined in the contract. Specific to the DBE's award, the contractor estimated the cost of the hazardous materials disposal at $2.3 million. Hazardous materials are generally more expensive to handle than non-hazardous materials due to the specialized procedures and regulations involved. In California, businesses must possess a Hazardous Materials Transportation License and a Hazardous Waste Transporter Registration to legally transport hazardous materials, further increasing costs. Per the contractor, the DBE selected for bid items 25 and 26 had the requisite licensure and registration.

INVESTIGATION

We concluded that non-DBE subcontractors performed work billed under bid items 25 and 26, which was not in accordance with the original contract bid. However, we determined that this use of non-DBE firms resulted from Change Notice 7 (CN7), which altered bid items 25 and 26 and was approved by BART in August 2022. Consequently, our investigation focused on the events prior to September 2022 and whether the DBE awarded bid items 25 and 26 subcontracted work under those items before the approval of CN7.

June 2022: Site preparation began, which included demolition, clearing, and hauling debris through at least August 2022. Per the contractor, they also stabilized the site with riprap and set up K-rail for traffic control, which required trucking services. During this period, the DBE awarded bid items 25 and 26 performed other work under the contract, such as hauling and disposing of treated wood, sometimes using sub-haulers.

July 13, 2022: The contractor informed BART of differing site conditions, specifically, an additional 30,000 cubic yards of soil that needed to be removed from the construction site. An amount beyond the quantities identified in BART's engineer's estimate. The contractor had relied on these estimated quantities when submitting its bid for the project.

July 21, 2022: BART instructed the contractor to obtain additional soil sampling and testing of the 30,000 cubic yards of excess soil.

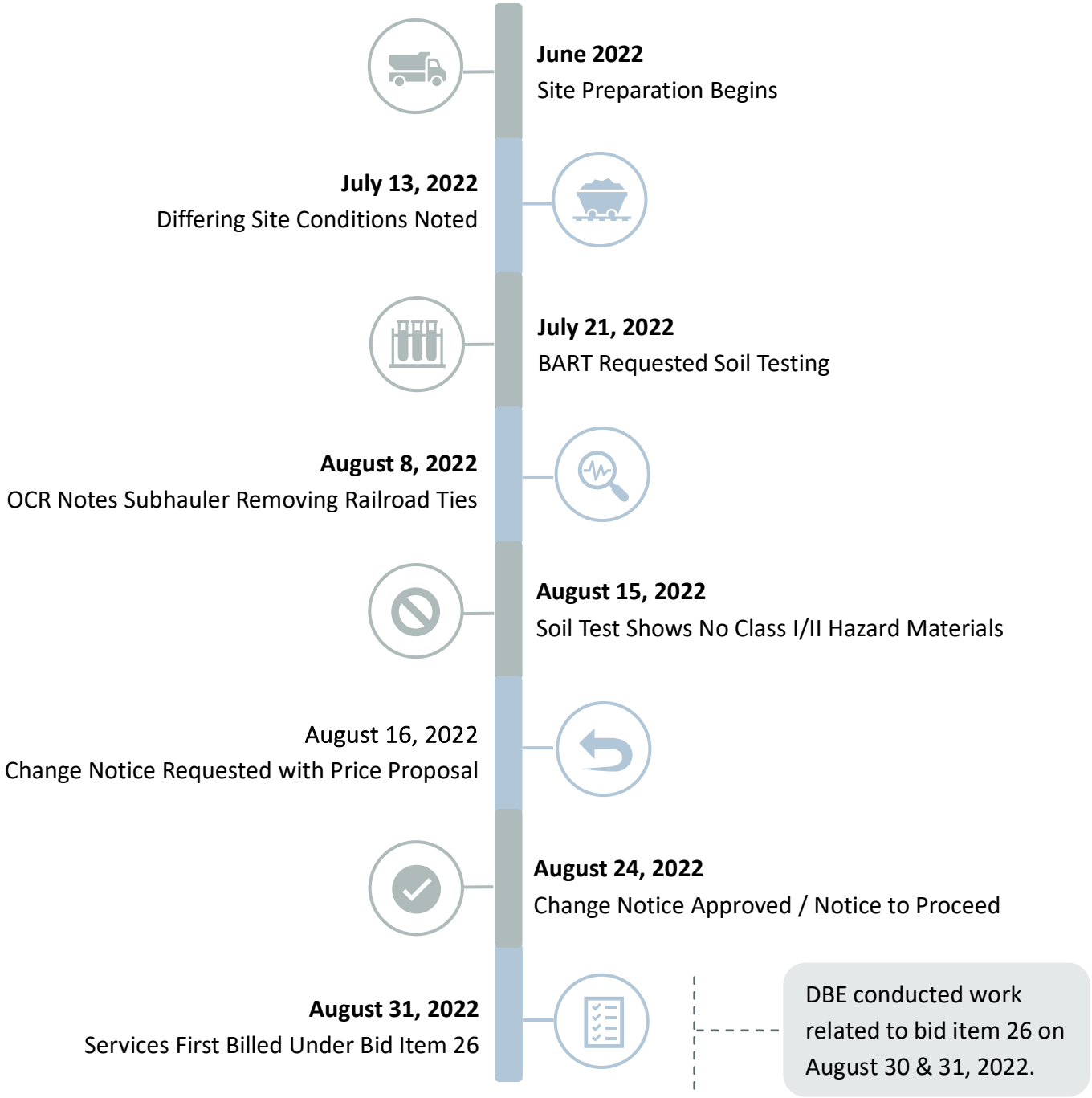
August 8, 2022: The OCR conducted a site review, finding that a subhauler working for the DBE subcontractor in question was off-loading railroad ties (treated wood). The subhauler was not removing Class I and II hazardous material. OCR noted that the DBE signed an affidavit asserting it would not subcontract its work, which we confirmed, but the affidavit was specific to bid items 25 and 26, not the work observed by OCR.

August 15, 2022: The soil test results showed that the excess soil was contaminated, but not with Class I and Class II hazardous materials. Thus, the specialized hauling procedures and regulations required for Class I and II materials were not applicable.

August 16, 2022: The contractor submitted a letter to BART to account for "differing site conditions." Attached to the contractor's letter was "PCO3," a price proposal showing that the contractor proposed eliminating bid items 25 and 26 for the removal of Class I and II hazardous material and replacing them with "Contaminated Waste/Material Alternative Disposal." The contractor did not associate this work with bid items 25 and 26.

August 24, 2022: BART formally approved and issued CN7 with a "notice to proceed" on the work identified in the contractor's letter and, thus, PCO3. Per CN7, "Payment for the work will be billed against bid items for soil off haul (Bid Items 25 and 26)".

August 31, 2022: The date of the first contractor invoice with services billed to bid item 26. When compared to the DBE's invoices, the services related to bid item 26 took place on August 30 and August 31, six days after BART approved CN7. Nothing was billed to BART under bid item 25 in August 2022.



Considering the sequence of events and the allegation that subcontracting the DBE awarded work constituted a violation of CFR 26 and potential DBE fraud, we concluded that there was no clear evidence of fraudulent activity. However, we also determined that there were procedural failures that likely contributed to the appearance of fraud and presented weaknesses that would allow for fraud to occur.

Adherence to Procedures is Critical to Fighting Fraud
Proper procedures ensure that records are accurate, transactions are transparent, and responsibilities are clearly assigned. When procedures are not followed, it becomes more difficult to track financial activities, verify claims, and identify wrongdoing, allowing fraud to go undetected or making investigations more time-consuming and inconclusive.

The contractor asserted that CN7 eliminated bid items 25 and 26 from its DBE participation goal, which we found to be consistent with our review of CN7 and PCO3. We also considered the contractor's assertion consistent with federal DBE regulations in effect at the time, that said, in part, that bidders must provide "a description of the work that each DBE will perform" and "the dollar amount of the participation for each DBE firm."[1] While consistent with regulations, a good-faith effort was still required to meet DBE participation goals.

Per the District contract, the contractor was required to "make good faith efforts to meet the DBE goal offered in the Bid in the performance of work under any Change Orders that may be issued under this Contract." Approval of CN7 should have prompted the BART project team to issue a change order, thus, also prompting an effort to formally address the change to the DBE goal. The project manager working for BART at the time did not process the change order, removing that critical procedure. According to a BART executive, the contractor raised the topic of CN7's impact on their DBE goal, but the BART project manager said that they would address that later. There is no documentation to support this assertion. Moreover, the BART project manager's decision to delay addressing the impact to the DBE goal undermined the integrity of the DBE compliance process and eliminated the opportunity to formally document and evaluate the necessary goal modification in a timely and proper manner.

Although the change to the DBE participation goal was not formally addressed, the contractor continued to use the DBE's services to off haul the contaminated soil and billed for those services under bid items 25 and 26, per BART's instructions. Additionally, the DBE used subhaulers, some of which were not DBEs, to assist in this work. The combination of these events—along with the absence of a proper change order and the failure to reassess DBE goals—suggested a potential pattern of DBE fraud, which understandably concerned the OCR.

[1] Title 49 CFR § 26.53 (b)(2)(ii)(iii) and (v)

The omissions also limited our ability to investigate for fraud by creating documentation gaps and obscuring accountability. However, based on a preponderance of the available evidence, we determined that CN7 constituted a BART approved change to the contract that removed the bid items awarded to the DBE in question and allowed for alternative methods to execute the contract work. Our conclusions are based on a thorough analysis of the contract, change notices, email, serial letters, invoices, and trucking slips, as well as interviews with OCR staff, the BART project team, and the contractor. We also gained an understanding of CFR 26, hazardous waste removal requirements, and the soil test results prompting CN7.

As previously noted, our investigation focused on events that took place before September 2022. Once we satisfied ourselves that fraud was not evident in relation to the incident prompting the fraud allegation, we concluded our investigative efforts. However, we are aware that from August 2022 through April 2024, the BART project team and executive leadership, the OCR, and the contractor were engaged in deliberations regarding contract compliance and DBE regulations. We are further aware that during this period, OCR halted payments and, subsequently, the contractor stopped work. Ultimately, on April 5, 2024, BART approved Change Order 10 (CO10), which the OCR initially declined to approve. CO10 incorporated CN7 and formally changed the contractor's DBE participation goal to 20–24%.

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