2.0 LEGAL BACKGROUND

2.1 Introduction

This chapter provides legal background for the study. The material that follows does not constitute legal advice to the State of Oregon on minority business programs, disadvantaged business enterprise (DBE) programs, affirmative action, or any other matter. Instead, it provides a context for the statistical and anecdotal analysis that appears in subsequent chapters of this report.[1]

The Supreme Court decision in *City of Richmond v. J.A. Croson Company*[2] and later cases have established and applied the constitutional standards for an affirmative action program. This chapter identifies and discusses those decisions, summarizing how courts evaluate the constitutionality of race-specific and gender-specific programs. Decisions of the Ninth Circuit, which includes the State of Oregon, offer the most directly binding authority, but where those decisions leave issues unsettled, the review considers decisions from other circuits.

By way of a preliminary outline, the courts have determined that an affirmative action program involving governmental procurement of goods or services must meet the following standards:

- A remedial race-conscious program is subject to strict judicial scrutiny under the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.
  - Strict scrutiny has two basic components: a compelling governmental interest in the program and narrow tailoring of the program.
  - To survive the strict scrutiny standard, a remedial race-conscious program must be based on a compelling governmental interest.

[1] Pursuant to ORS § 180.060 only the Office of the Attorney General, Oregon Department of Justice, may provide legal advice to ODOT.
[2] *Richmond v. Croson*, 488 U.S. 469 (1989).

- "Compelling interest" means the government must prove past or present racial discrimination requiring remedial attention.
- There must be a specific "strong basis in the evidence" for the compelling governmental interest.
- Statistical evidence is preferred and possibly necessary as a practical matter; anecdotal evidence is permissible and can offer substantial support, but it probably cannot stand on its own.

- Program(s) designed to address the compelling governmental interest must be narrowly tailored to remedy the identified discrimination.
  - "Narrow tailoring" means the remedy must fit the findings.
  - The evidence showing compelling interest must guide the tailoring very closely.
  - Race-neutral alternatives must be considered first.
- A lesser standard, intermediate judicial scrutiny, applies to programs that establish gender preferences.
  - To survive the intermediate scrutiny standard, the remedial gender-conscious program must serve important governmental objectives and be substantially related to the achievement of those objectives.
  - The evidence does not need to be as strong and the tailoring does not need to be as specific under the lesser standard.

2.2 An Overview of the Applicable Case Law

The discussion in this review will attend closely to the most relevant decisions in the area of government contracting. Justice O'Connor, distinguishing her majority opinion on affirmative action in law school admissions from her opinions in government contracting cases, wrote:

> *Context matters when reviewing race-based governmental action under the Equal Protection Clause. . . . Not every decision influenced by race is equally objectionable and strict scrutiny is designed to provide a framework for carefully examining the importance and the sincerity of the reasons advanced by the governmental decision-maker for the use of race in that particular context.*[3]

[3] *Grutter v. Bollinger*, 539 U.S. at 327

Further, some caution must be exercised in relying upon opinions of the federal district courts, which make both findings of fact and holdings of law. As to holdings of law, the federal district courts are ultimately subject to rulings by their circuit courts. As to matters of fact, their decisions depend heavily on the precise record before them, in these cases frequently including matters such as evaluations of the credibility and expertise of witnesses. Such findings are not binding precedents outside their districts, even if they may indicate the kind of evidence and arguments that might succeed elsewhere.

Finally, the ways in which state and local governments participate in federal DBE programs is a specialized issue distinct from that of supporting municipal programs, even if the same kinds of evidence and same levels of review apply. In *Adarand Constructors, Inc. v. Peña,*[4] the Supreme Court did decide that federal DBE programs should be examined by the same strict scrutiny standard that *Croson* mandated for state and local programs. Nevertheless, cases considering federal DBE programs have many important distinctions from cases considering municipal programs, particularly when it comes to finding a compelling governmental interest.

Thus, the majority of this review will be based on decisions of the federal circuit courts applying *Croson* and *Adarand* to state and local programs designed to increase participation by DBEs in government contracting. That is not a large body of case law. While other cases are useful as to particular points, only a handful of circuit court cases have given clear, specific, and binding guidance on the adequacy of a complete factual record including thorough, local disparity studies.

[4] *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200 (1995).

2.3 Standards of Review for Race-Specific and Gender-Specific Programs

2.3.1 Race-Specific Programs: The Croson *Decision*

Croson established the framework for testing the validity of programs based on racial discrimination. In 1983, the Richmond City Council adopted a Minority Business Utilization Plan (the Plan) following a public hearing in which seven citizens testified about historical societal discrimination. In adopting the Plan, the Council also relied on a study indicating that "while the general population of Richmond was 50 percent African American, only 0.67 percent of the city's prime construction contracts had been awarded to minority businesses in the five-year period from 1978 to 1983."[5]

The evidence before the Council also established that a variety of state and local contractor associations had little or no minority business membership. The Council relied on statements by a Council member whose opinion was that "the general conduct of the construction industry in this area, the state, and around the nation, is one in which race discrimination and exclusion on the basis of race is widespread."[6] There was, however, no direct evidence of racial discrimination on the part of the city in its contracting activities, and no evidence that the city's prime contractors had discriminated against minority-owned subcontractors.[7]

The Plan required the city's prime contractors to subcontract at least 30 percent of the dollar amount of each contract to one or more minority-owned business enterprises (MBEs). The Plan did not establish any geographic limits for eligibility. Therefore, an otherwise qualified MBE from anywhere in the United States could benefit from the 30 percent set-aside.

[5] *Croson*, 488 U.S. at 479-80.
[6] Id. at 480.
[7] Id.

J.A. Croson Company, a non-MBE mechanical plumbing and heating contractor, filed a lawsuit against the City of Richmond, alleging that the Plan was unconstitutional because it violated the Equal Protection Clause of the Fourteenth Amendment. After a considerable record of litigation and appeals, the Fourth Circuit struck down the Richmond Plan and the Supreme Court affirmed this decision.[8] The Supreme Court determined that strict scrutiny was the appropriate standard of judicial review for MBE programs, so that a race-conscious program must be based on a compelling governmental interest and be narrowly tailored to achieve its objectives.[9] This standard requires a firm evidentiary basis for concluding that the under-utilization of minorities is a product of past discrimination.

2.3.2 Gender-Specific Programs

The Supreme Court has not addressed the specific issue of a gender-based classification in the context of a woman-owned business enterprise (WBE) program. *Croson* was limited to the review of an MBE program. In evaluating gender-based classifications, the Court has used what some call "intermediate scrutiny," a less stringent standard of review than the "strict scrutiny" applied to race-based classifications. Intermediate scrutiny requires that classifying persons on the basis of sex "must carry the burden of showing an 'exceedingly persuasive justification' for the classification."[10] The classification meets this burden "only by showing at least that the classification serves 'important governmental

[8] Id. at 511.

[9] For government contracting programs, courts have yet to find a compelling governmental interest for affirmative action other than remedying discrimination in the relevant marketplace. In other arenas diversity has served as a compelling government interest for affirmative action. For example, the Ninth circuit upheld race-based admission standards at an experimental elementary school in order to provide a more real world education experience. *Hunter v. Regents of Univ. of California,* 190 F.3d 1061 (9th Cir. 1999). The Ninth Circuit in *Western States Paving* did not consider any other compelling interests for the DBE program outside of remedying discrimination and its effects. *Western State Paving v. Washington DOT,* 407 F.3d 983 (9th Cir. 2005).

[10] *Mississippi University for Women v. Hogan*, 458 U.S. 718, 724 (1982) (quoting *Kirchberg* v. *Feenstra,* 446 U.S. 142, 150 (1981)); see also *United States v. Virginia,* 518 U.S. 515, 531 (1996), *Nguyen v. U.S*., 533 U.S. 53, 60 (2001).

objectives and that the discriminatory means employed; are 'substantially related to the achievement of those objectives.'"[11]

Several federal circuit courts have applied intermediate scrutiny to WBE programs and yet have found the programs to be unconstitutional.[12] Indeed, one court has questioned the concept that it might be easier to establish a WBE program than it is to establish an MBE program.[13] Nevertheless, in *Coral Construction v. King County*, the Ninth Circuit upheld a WBE program under the intermediate scrutiny standard.[14] Even using intermediate scrutiny, the court in *Coral Construction* noted that some degree of discrimination must be demonstrated in a particular industry before a gender-specific remedy may be instituted in that industry. As the court stated, "The mere recitation of a benign, compensatory purpose will not automatically shield a gender-specific program from constitutional scrutiny."[15] In *Monterrey Mechanical* the Ninth Circuit also cited the "exceedingly persuasive" standard in striking down a university contracting goals program for minorities and women.[16] In *Western States Paving* the Ninth Circuit stated that although the gender-conscious elements of the DBE regulations were subject to intermediate scrutiny, the race-conscious element met the standard of strict scrutiny; therefore, both race and gender elements of the program were discussed under the same strict scrutiny standard.[17]

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[11] *Mississippi Univ. for Women, supra,* at 724 (quoting *Wengler v. Druggists Mut. Ins. Co.* (1980)); see also *Virginia, supra,* at 533, *Nguyen, supra,* at 60.
[12] *See,* e.g., *Engineering Contractors Ass'n of South Florida, Inc. v. Dade County*, 122 F.3d 895 (11th Cir. 1997); *Builders Ass'n of Greater Chicago v. County of Cook*, 256 F.3d 642 (7th Cir. 2001).
[13] *Builders Ass'n of Greater Chicago*, 256 F.3d at 644.
[14] *Coral Construction v. King County*, 941 F.2d 910 (9th Cir. 1991), cert. denied, 502 U.S. 1033 (1992). The Tenth Circuit, on the second appeal in *Concrete Works of Colorado v. City of Denver* (*Concrete Works IV*), approved the constitutionality of a WBE program based on evidence comparable to that supporting an MBE program that the court also upheld in the same decision. Unlike *Coral Construction*, however, *Concrete Works IV* offered no independent guidance on the level of evidence required to support a WBE program.
[15] *Coral Construction*, 941 F.2d at 932.
[16] *Monterrey Mechanical v. Wilson*, 125 F.3d 702, 712 (9th Cir. 1997); see also *AGCC v. City and County of San Francisco*, 813 F.2d 922, 940 (9th Cir. 1987).
[17] *Western State Paving v. Washington DOT,* 407 F.3d at n.4.

2.3.3 Adarand and Federally Funded Projects

As noted above, federal DBE programs are now governed by the constitutional standards set in the 1995 Supreme Court case of *Adarand Constructors, Inc. v. Peña (Adarand III).*[18] *Adarand III* involved a challenge to the United States Department of Transportation (USDOT) DBE program under which prime contractors could be awarded financial bonuses for subcontracting with DBEs. Without ruling on the merits of the case, the Court overturned its prior decision in *Fullilove v. Klutznick,*[19] in which the Court had adopted intermediate scrutiny standard for congressionally mandated race-conscious programs. The Supreme Court in *Adarand* decided that federal DBE programs should be examined by the same strict scrutiny standard used for state and local programs.[20] At the same time, the Court restated the principal that "strict in theory" is not "fatal in fact."

In January 1999, USDOT published its final DBE rule in Title 49, Code of Federal Regulations, Part 26 (49 CFR 26) that addressed the *Adarand* decisions. In the last round of the *Adarand* litigation, the Court of Appeals in the Tenth Circuit upheld the revised USDOT DBE program as modified by the new regulations in 49 CFR 26 in *Adarand v. Slater*. The Court reaffirmed that Congress had found a compelling interest for the DBE program. *Adarand v. Slater* was appealed to the U.S. Supreme Court which in turn dismissed the writ of certiorari as improperly granted.[21] More significantly, the Tenth Circuit ultimately found the new DBE regulations to be narrowly tailored.

[18] *Adarand v. Peña,* 790 F.Supp. 240, 16 F.3d 1537 (10th Cir. 1996), *cert. granted*, 63 U.S.L.W. 3213 (U.S. Oct. 4, 1996) (No. 63-12), 115 S.Ct. 2097 (1995).
[19] 448 U.S. 448 (1980).
[20] Upon remand the District Court ruled in favor of *Adarand*. The District Court found that while there was a compelling government interest for the program, the program was not narrowly tailored. In March of 1999, the Tenth Circuit vacated the District Court ruling as moot because *Adarand* had become certified as a DBE. In January of 2000, the U.S. Supreme Court vacated the Appeals Court decision on mootness and remanded the case for a ruling on the merits of *Adarand v. Slater,* 120 S.Ct. 722 (2000).
[21] *Adarand v. Mineta*, U.S. Supreme Court, *per curiam*, November 27, 2001.

These results are still standing after four cases upholding the federal DBE program. In *Sherbrooke Sodding v. Minnesota Department of Transportation,*[22] (combined with *Gross Seed v. Nebraska Department of Roads*[23]*), Western States Paving v. Washington Department of Transportation*,[24] and *Northern Contracting v. Illinois Department of Transportation*,[25] federal appeals courts in the Eighth, Ninth, and Seventh Circuits have found the current DBE regulations to be narrowly tailored to serve a compelling governmental interest.

2.4 To Withstand Strict Scrutiny, an MBE/DBE Program Must Be Based on Evidence Showing a Compelling Governmental Interest

Croson identified two necessary factors for establishing racial discrimination sufficiently to demonstrate a compelling governmental interest in establishing an M/WBE program. First, there needs to be identified discrimination in the relevant market.[26] Second, "the governmental actor enacting the set-aside program must have somehow perpetuated the discrimination to be remedied by the program,"[27] either actively or at least passively with the "infusion of tax dollars into a discriminatory industry."[28]

Although the Supreme Court in *Croson* and *Adarand* did not specifically define the methodology that should be used to establish the evidentiary basis required by strict scrutiny, the Court did outline governing principles. Lower courts have expanded the Supreme Court's *Croson* guidelines and have applied or distinguished these principles when asked to decide the constitutionality of state, county, and city programs that seek to enhance opportunities for minorities and women.

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[22] *Sherbrooke Sodding v. MDOT,* 345 F.3d 964 (8th Cir. 2003).
[23] *Gross Seed v. Nebraska Department of Roads,* 345 F.3d 968 (8th Cir. 2003); *cert denied*, 158 L.Ed. 2d 729 (2004).
[24] *Western States Paving v. Washington DOT*, 407 F. 3d 983 (9th Cir. 2005).
[25] *Northern Contracting v. Illinois DOT,* Case No. 05-3981 (7th Cir. 2007).
[26] *Croson*, 488 U.S. at 492, 509-10.
[27] *Coral Construction*, 941 F.2d at 918.
[28] Id. at 922.

The Ninth Circuit in *Western States Paving* cited the following evidence that Congress considered in finding a factual predicate supporting the federal DBE program:

- Minority business ownership percentage does not reflect the percentage of the population.
- MBEs have gross receipts that are on average approximately one-third those of firms owned by non-minorities.
- MBEs own 9 percent of all businesses, but receive only 4.1 percent of federal contracting dollars.
- WBEs constitute almost a third of all small businesses but receive less than 3 percent of federal contracting dollars.
- Majority-owned construction firms receive more than 50 times as many loan dollars per dollar of equity capital as Black firms with the same borrowing characteristics.
- After many state and local governments stopped their M/WBE programs there was a significant drop in M/WBE utilization in the construction industry.
- The U.S. Department of Justice study *The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey* found discrimination by trade unions, financial lenders, prime contractors, business networks, suppliers, bonding companies, and an "old boys network."[29]

The Ninth Circuit also concurred with the ruling of the federal circuit in *Rothe Development Corporation v. United States Department of Defense* (as well as the Eighth Circuit in *Sherbrooke Sodding)* that Congress did not need to possess evidence of discrimination in every state to enact the federalDBE program.[30]

2.5 To Withstand Strict Scrutiny, an MBE Program Must Be Narrowly Tailored to Remedy Identified Discrimination

The discussion of compelling interest in the court cases has been extensive, but narrow tailoring may be the more critical issue. Many courts have held that even if a

[29] *Western States Paving*, 407 F. 3d at 992.
[30] Id. (citing *Rothe Dev. Corp. v. United States Dep't of Def.*, 262 F.3d 1306, 1329 (Fed. Cir. 2001)).

compelling interest for the D/M/WBE program can be found, the program has not been narrowly tailored.[31] Nevertheless, the federal courts in general and the Ninth Circuit in particular have found that the DBE program established pursuant to the current federal regulations (49 CFR, Part 26) issued under the Transportation Equity Act (TEA-21) (1998) has been narrowly tailored to serve a compelling interest.[32] The Ninth Circuit in particular has identified the following elements of narrow tailoring: "the efficacy of alternative remedies; the flexibility and duration of the relief, including the availability of waiver provisions; the relationship of the numerical goals to the relevant labor market; and the impact of the relief on the rights of third parties."[33] Each of these elements will be considered in turn.

2.5.1 Race-Neutral Alternatives

Concerning race-neutral alternatives, the Supreme Court in *Croson* concluded that a governmental entity must demonstrate that it has evaluated the use of race-neutral means to increase minority business participation in contracting or purchasing activities.[34] As the Ninth Circuit stated in *Coral Construction*, "Among the various narrow tailoring requirements, there is no doubt that consideration of race-neutral alternatives is among the most important."[35] There is little if any chance for a plan to succeed without addressing this requirement.

Strict scrutiny does not mandate that every race-neutral measure be considered and found wanting, but does "require serious, good faith consideration of workable race-neutral

[31] See, e.g., *Contractors Ass'n of Eastern Pennsylvania, Inc.*, 91 F.3d at 605; *Engineering Contractors Ass'n of South Florida, Inc*., 122 F.3d at 926-929; *Verdi v. DeKalb County School District*, 135 Fed. Appx 262 , 2005 WL 38942 (11th Cir. 2005).
[32] *Adarand v. Slater*, 228 F.3d 1147; *Sherbrooke Turf*, 345 F.3d 963; *Western States Paving v. Washington DOT*, 407 F.3d 983 (9th Cir. 2005); *Northern Contracting v. Illinois DOT,* Case No. 05-3981 (7th Cir. 2007).
[33] *Western States Paving*, 407 F. 3d at 993 (citing *U.S. v. Paradise*, 480 U.S. 149, 171 (1987)).
[34] *Croson*, 488 U.S 507.
[35] *Coral Construction*, 941 F.2d at 922.

alternatives."[36] In applying this principle in the *Coral Construction* case, the Ninth Circuit did not require King County to challenge state laws restricting its ability to alter bonding requirements. Nevertheless, the Ninth Circuit found it important that King County had adopted a number of race-neutral measures to help overcome discrimination.[37]

In *Western States Paving* the Ninth Circuit found that this prong of narrow tailoring was satisfied for two reasons. First, race-conscious remedies are only to be used in those jurisdictions where "discrimination or its effects are a problem."[38] The Ninth Circuit found this result in the two-step goal-setting process in the federal DBE regulations. Second, race-conscious remedies are only to be used when race-neutral means have proven inadequate.[39]

2.5.2 Flexibility and Duration of the Remedy

The Ninth Circuit found flexibility in the new DBE rules because: (1) "TEA-21 regulations explicitly prohibit the use of quotas"; (2) when race-conscious contracting goals are employed, "prime contractors can meet that goal either by subcontracting the requisite amount of work to DBEs or by demonstrating good faith efforts to do so"; and (3) a state "cannot be penalized by the federal government for failing to attain its DBE utilization goal as long as it undertakes good faith compliance efforts."[40]

Other factors that have impressed other circuits as to the flexibility of the federal DBE program include: (1) setting aspirational, not mandatory, goals; and (2) using overall aspirational goals as simply a framework for setting local contract goals, if any, based on local data. [41]

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[36] *Grutter v. Bollinger*, 539 U.S. 306, 339 (2003); *see also Adarand III*, 515 U.S. at 237-38, *Coral Construction*, 941 F.2d at 923
[37] *Coral Construction*, 941 F.2d at 923.
[38] *Western States Paving*, 407 F. 3d at 995.
[39] Id. at 990 (citing 49 CFR 26.51(a).
[40] *Western States Paving*, 407 F. 3d at 994 (citing 49 C.F.R. § 26.43(a), § 26.53(a) and § 26.47(a)). See also *Sherbrooke Turf, Inc.*, 345 F.3d at 972 ("the DBE program has substantial flexibility").
[41] *Sherbrooke Turf, Inc.*, 345 F.3d at 972.

With respect to program duration, the Supreme Court wrote in *Adarand v. Peña* that a program should be "appropriately limited such that it will not last longer than the discriminatory effects it is designed to eliminate."[42] The Ninth Circuit noted the limits in the revised DBE program, stating that "TEA-21 comports with this [durational] requirement because it is subject to periodic reauthorization by Congress."[43]

Other appellate courts have noted several possible mechanisms for limiting program duration in the revised DBE regulations: (1) the decertification of DBEs that achieve certain levels of success, or mandatory review of DBE certification at regular, relatively brief periods; and (2) a state "may terminate its DBE program if it meets its annual overall goal through race-neutral means for two consecutive years."[44] Governments thus have some duty to ensure that they update their evidence of discrimination regularly enough to review the need for their programs and to revise programs by narrowly tailoring them to fit the fresh evidence.[45]

2.5.3 Relationship of Goals to Availability

Narrow tailoring under the *Croson* standard requires that remedial goals be in line with measured availability. Merely setting percentages without a carefully selected basis in statistical studies, as the City of Richmond did in *Croson* itself, has played a strong part in decisions finding other programs unconstitutional.[46]

By contrast, the Ninth Circuit in *Coral Construction* noted with approval that King County set project goal percentages individually on large contracts according to the number of available MBEs and had chosen a relatively low percentage (5 %) for contracts of under $10,000—which percentage in turn was not absolute, but subject to further fact-specific

[42] *Sherbrooke Turf, Inc.*, *Adarand*, 345 F.3d at 972, 515 U.S. at 238 (internal quotations and citations omitted); see also *Grutter*, 123 S. Ct. at 2346.
[43] *Western States Paving*, 407 F. 3d at 994.
[44] *Adarand v. Slater*, 228 F.3d at 1179, 1180. *Sherbrooke Turf*, at 972 (citing 49 C.F.R. § 26.51(f)(3)).
[45] *Rothe,* 262 F.3d at 1324 (commenting on the possible staleness of information after 7, 12, and 17 years).

considerations under a "bid preference" plan. Further, King County had carefully limited preferences for instances where it had evidence of discrimination against particular racial groups.[47]

More significantly, the Seventh, Eighth, Ninth, and Tenth Circuits have approved the goal-setting process for the USDOT DBE program, as revised in 1999.[48] The approved USDOT DBE regulations require that goals be based on one of several methods for measuring DBE availability. The Ninth Circuit noted that:

> *The [TEA-21] regulations do not establish a mandatory nationwide standard for minority participation in transportation contracting…The TEA-21 regulations instead provide for each State to establish a DBE utilization goal that is based upon the proportion of ready, willing, and able DBEs in the State's transportation contracting industry. This provision ensures that each State sets a minority utilization goal that reflects the realities of its own labor market.*[49]

Moreover, the approved DBE regulations use built-in mechanisms to ensure that DBE goals are not set excessively high relative to DBE availability. For example, the approved DBE goals are to be set aside if the overall goal has been met for two consecutive years by race-neutral means. The approved DBE project goals also must be reduced if overall aspirational goals have been exceeded with race-conscious means for two consecutive years. The Seventh and Eighth Circuit courts found these provisions to be narrowly tailored, particularly when implemented according to local disparity studies that carefully calculate the applicable goals.[50]

[46] See, e.g., *Builders Ass'n of Greater Chicago*, 256 F.3d at 647.
[47] *Coral Construction*, 941 F.2d at 924.
[48] *Adarand v. Slater*, 228 F.3d at 1182; *Sherbrooke Turf*, 345 F.3d at 972. *Western States,* 407 F.3d at 995. In *Northern Contractors* the plaintiff forfeited its right to challenge the narrow tailoring the federal regulations themselves on appeal. *Northern Contractors*, at 720.
[49] *Western States Paving*, 407 F. 3d at 994 (citing 49 C.F.R. § 26.41(b)-(c), § 26.45(b)). See also *Sherbrooke Turf, Inc.*, 345 F.3d at 972 ("DOT has tied the goals for DBE participation to the relevant labor markets.").
[50] *Sherbrooke Turf, Inc.*, 345 F.3d at 973, 974.

2.5.4 Burden on Third Parties

Narrow tailoring also requires specific efforts to minimize the burden of the program on third parties. The Ninth Circuit found that while rejecting bids of nonminority males in favor of higher bids by DBEs was a burden, such a burden sharing by innocent parties was permissible.[51] Moreover, the new DBE regulations limited the burden on third parties by allowing the certification of nonminority males and by excluding minorities and women with a high personal net worth.[52] The USDOT DBE regulations have also sought to reduce the program burden on non-DBEs by avoiding DBE concentration in certain specialty areas.[53]

2.5.5 Overinclusion

Narrow tailoring also involves limiting the number and type of beneficiaries of the program. As noted above, there has to be evidence of discrimination to justify a group-based remedy, and over-inclusion of uninjured individuals or groups can endanger the entire program.[54] Federal DBE programs have succeeded in part because regulations covering DBE certification do not provide blanket protection to minorities.[55]

In *Croson*, the Supreme Court criticized the City of Richmond's inclusion of "Spanish-speaking, Oriental, Indian, Eskimo, or Aleut persons" in its affirmative action program.[56] These groups had not previously participated in City contracting, and "the random inclusion of racial groups that, as a practical matter, may never have suffered from discrimination in the construction industry in Richmond suggests that perhaps the city's purpose was not in fact to remedy past discrimination."[57] To evaluate availability properly, data must be gathered for each racial group in the marketplace.

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[51] *Western States Paving,* 407 F. 3d at 995.
[52] *Sherbrooke Turf, Inc.*, 345 F.3d at 974 (citing 49 C.F.R. § 26.67(d), (b).
[53] 49 CFR, Section 26, Part 33.
[54] See, e.g., *Builders Ass'n of Greater Chicago*, 256 F.3d at 647.
[55] *Sherbrooke Turf*, 345 F.3d 963, 972-73.
[56] Id., 488 U.S. at 506.
[57] Id.

The Ninth Circuit also made this point in *Western States Paving*, stating that, "even when discrimination is present within a State, a remedial program is only narrowly tailored if its application is limited to those minority groups that have actually suffered discrimination."[58] The Ninth Circuit also cited the observation of the Seventh Circuit in *Builders Association v. Cook County* that a program was not narrowly tailored if "afforded preferences to a 'laundry list' of minorities, not all of whom had suffered discrimination."[59] The Ninth Circuit went on to quote the DC Circuit in *O'Donnell v. District of Columbia* to the effect that, "the random inclusion of racial groups for which there is no evidence of past discrimination in the construction industry raises doubts about the remedial nature of [a minority set-aside] program."[60] Hitherto, state DBE programs, in line with the federal regulations, had set overall aspirational and project goals for all DBEs, across ethnic and gender lines. These goals were based on data involving all DBEs and were not delineated by ethnic and gender group.

2.6 "As Applied" Challenge in Western States Paving

The Washington DOT DBE program was struck down not in *Western States Paving* because the federal DBE program had no factual program and not because the federal DBE program lacked narrow tailored program features. Instead, the Ninth Circuit ruled that the Washington DOT DBE program was not narrowly tailored "as applied."[61] While a state does not have to independently provide a factual predicate for its DBE program the Ninth Circuit found that, "it cannot be said that TEA-21 is a narrowly tailored remedial measure unless its application is limited to those States in which the effects of discrimination are actually

[58] *Western States Paving*, 407 F. 3d at 998. see also *Monterey Mechanical Co. v. Wilson*, 125 F.3d at 704.
[59] Id. (citing *Builders Ass'n of Greater Chi. v. County of Cook*, 256 F.3d 642, 647 (7th Cir. 2001)).
[60] Id. (citing *O'Donnell Constr. Co. v. District of Columbia*, 295 U.S. App. D.C. 317, 963 F.2d 420, 427 (D.C. Cir. 1992)).
[61] The Ninth Circuit distinguished a previous case which did not involve an "as applied" challenge to the federal DBE program. *Milwaukee County Pavers Ass'n v. Fiedler*, 922 F.2d 419 (7th Cir. 1991). The Seventh Circuit disagreed with the Ninth Circuit's reading of *Milwaukee County Pavers*. See *Northern Contracting,* at fn 4.

present."[62] In effect, while Washington DOT was not required to produce a separate factual predicate for a DBE program, it was still required to produce a factual predicate (of sorts) to justify race-conscious elements in the local implementation of its DBE program.

While Washington DOT conceded that it had no studies of discrimination in highway contracting, it argued that there was evidence of discrimination in the fact that DBEs received 9 percent of subcontracting dollars on state-funded projects where there were no DBE goals and 18 percent of federal funded projects where there were DBE goals. But the Ninth Circuit stated that, "even in States in which there has never been discrimination, the proportion of work that DBEs receive on contracts that lack affirmative action requirements will be lower than the share that they obtain on contracts that include such measures because minority preferences afford DBEs a competitive advantage."[63]

In contrast, the Eighth Circuit in *Sherbrooke Turf* and the Tenth Circuit in *Adarand v. Slater* found that a decline in DBE utilization following a change in or termination of a DBE program was relevant evidence of discrimination in subcontracting.[64] The Tenth Circuit stated that while this evidence "standing alone is not dispositive, it strongly supports the government's claim that there are significant barriers to minority competition in the public subcontracting."[65]

The Ninth Circuit also dismissed the disparity between the proportion of DBE subcontractors and the proportion of DBE dollars on state-funded contracts, because "DBE firms may be smaller and less experienced than non-DBE firms (especially if they are new businesses started by recent immigrants) or they may be concentrated in certain geographic

[62] *Western States Paving*, 407 F. 3d at 998.
[63] Western *States Paving*, 407 F. 3d at 1000.
[64] *Sherbrooke Turf*, 345 F.3d at 973.
[65] *Adarand v. Slater,* 228 F.3d at 1174; see also *Concrete Works IV*, 321 F.3d at 985.

areas of the State, rendering them unavailable for a disproportionate amount of work."[66] The Ninth Circuit quoted the DC Circuit in *O'Donnell* to the effect that:

> *Minority firms may not have bid on . . . construction contracts because they were generally small companies incapable of taking on large projects; or they may have been fully occupied on other projects; or the District's contracts may not have been as lucrative as others available in the Washington metropolitan area; or they may not have had the expertise needed to perform the contracts; or they may have bid but were rejected because others came in with a lower price.*[67]

The Ninth Circuit noted further that "if this small disparity has any probative value, it is insufficient, standing alone, to establish the existence of discrimination against DBEs." The Ninth Circuit contrasted this minor disparity with the Ninth Circuit's decision in *Associated General Contractors of California, Inc. v. Coalition for Economic Equity (AGCCII)* where "discrimination was likely to exist where minority availability for prime contracts was 49.5 percent but minority dollar participation was only 11.1 percent."[68]

2.7 The Governmental Entity or Agency Enacting an MBE Program Must Be Shown to Have Actively or Passively Perpetuated the Discrimination

In *Croson*, the Supreme Court stated, "It is beyond dispute that any public entity, state or federal, has a compelling interest in assuring that *public* dollars, drawn from the tax contributions of all citizens, do not serve to finance the evil of *private* prejudice."[69] *Croson* provided that the government "can use its spending powers to remedy private discrimination, if it identifies that discrimination with the particularity required by the Fourteenth Amendment."[70] The government agency's active or passive participation in discriminatory practices in the marketplace may show the compelling interest. Defining passive

[66] *Western States Paving*, at 1001.
[67] Id. (quoting *O'Donnell Constr. Co.*, 963 F.2d at 426).
[68] *Western States Paving*, at 1001. (Quoting *Associated Gen. Contractors of Cal., Inc. v. Coalition for Econ. Equity*, 950 F.2d 1401, 1414 (9th Cir. 1991).
[69] *Coral Construction*, 941 F.2d at 922 (citing *Croson*, 488 U.S. at 492) (emphasis added).

participation, *Croson* stated, "Thus, if the city could show that it had essentially become a 'passive participant' in a system of racial exclusion practiced by elements of the local construction industry, we think it clear that the city could take affirmative steps to dismantle such a system."[71]

In *Western States Paving* the Ninth Circuit affirmed that "The federal government has a compelling interest in ensuring that its funding is not distributed in a manner that perpetuates the effects of either public *or private discrimination within the transportation contracting industry*."[72] The Ninth Circuit quoted the Tenth Circuit's assertion in *Adarand v. Slater* that "The Constitution does not obligate Congress to stand idly by and continue to pour money into an industry so shaped by the effects of discrimination that the profits to be derived from congressional appropriations accrue exclusively to the beneficiaries, *however personally innocent*, of the effects of racial prejudice." [73] However, the Ninth Circuit did not have before it any evidence of private sector discrimination in *Western States Paving*.

The Tenth Circuit's ruling in *Adarand*, however, noted two barriers that demonstrated a link between "public funds for construction contracts and the channeling of those funds due to private discrimination": (1) discriminatory barriers to the formation of DBE subcontractors, and (2) barriers to fair competition between minority and nonminority subcontractors.[74] The first barrier was supported by evidence of behavior by prime contractors, unions, lenders, and bonding companies. Evidence for the second barrier showed that "informal, racially exclusionary business networks dominate the subcontracting construction industry," exemplified by family-run firms with long-standing relationships with majority subcontractors. In *Adarand v. Slater* the Tenth Circuit also favorably cited evidence

[70] See *Croson*; see generally I. Ayres and F. Vars, "When Does Private Discrimination Justify Public Affirmative Action?" 98 *Columbia Law Review* 1577 (1998).
[71] *Croson*, 488 U.S. at 492.
[72] *Western States Paving*, 407 F. 3d at 991 (emphasis added).
[73] 228 F.3d at 1176 (emphasis added).

of capital market discrimination as relevant in establishing the factual predicate for the federal DBE program.[75] The same circuit court, in *Concrete Works IV,* also found that barriers to business formation were relevant insofar as this evidence demonstrated that M/WBEs were "precluded from the outset from competing for public construction contracts."[76] Along related lines, the court also found a regression analysis of census data to be relevant evidence showing barriers to M/WBE formation.[77]

2.8 Anecdotal Evidence of Discrimination in Disparity Studies

Most disparity studies present anecdotal evidence along with statistical data. The Supreme Court in *Croson* discussed the relevance of anecdotal evidence and explained, "Evidence of a pattern of individual discriminatory acts can, if supported by appropriate statistical proof, lend support to a local government's determination that broader remedial relief is justified."[78] Washington DOT introduced no anecdotal evidence of discrimination in *Western States Paving.* Washington DOT did have the DBE affidavits required by 49 CFR 26.67(a) attesting to the social and economic disadvantage of the DBE owners, but the Ninth Circuit ruled that those affidavits spoke to general societal discrimination and not discrimination within the transportation construction industry in the state of Washington.

Although *Croson* did not expressly consider the form or level of specificity required for anecdotal evidence, the Ninth Circuit has addressed both issues in earlier cases. In *Coral Construction*, the Ninth Circuit addressed the use of anecdotal evidence alone to prove discrimination. Although King County's anecdotal evidence was extensive, the court noted the absence in the record of any statistical data in support of the program. Additionally, the

[74] *Adarand v. Slater,* 228 F.3d at 1169.
[75] Id. at 1169-70.
[76] *Concrete Works IV*, 321 F.2d at 977. The district court had rejected evidence of credit market discrimination as adequate to provide a factual predicate for an M/WBE program. *Concrete Works v. Denver*, 86 F.Supp. 2d 1042 (D Co. 2000) (*Concrete Works I*).
[77] *Concrete Works IV*, 321 F.2d. at 977.
[78] *Croson*, 488 U.S. at 509.

court stated, "While anecdotal evidence may suffice to prove individual claims of discrimination, rarely, if ever, can such evidence show a *systemic pattern of discrimination necessary for the adoption of an affirmative action plan*."[79] The court concluded, by contrast, that "the combination of convincing anecdotal and statistical evidence is potent."[80]

Regarding the appropriate form of anecdotal evidence, the Ninth Circuit in *Coral Construction* noted that the record provided by King County was "considerably more extensive than that compiled by the Richmond City Council in *Croson*."[81] The King County record contained affidavits of at least 57 minority or female contractors, each of whom complained in varying degrees of specificity about discrimination within the local construction industry, including the inability to obtain contracts for private sector work. The *Coral Construction* court stated that the M/WBE affidavits "reflected a broad spectrum of the contracting community" and the affidavits "certainly suggested that ongoing discrimination may be occurring in much of the King County business community."[82]

In *AGCC II*, the Ninth Circuit discussed the specificity of anecdotal evidence required by *Croson*.[83] Seeking a preliminary injunction, the contractors contended that the evidence presented by the City of San Francisco lacked the specificity required by both an earlier appeal in that case[84] and by *Croson*. The court held that the city's findings were based on substantially more evidence than the anecdotes in the two prior cases, and "they [were] clearly based upon dozens of specific instances of discrimination that are laid out with particularity in the record, as well as significant statistical disparities in the award of contracts."[85] The anecdotal evidence included evidence of harassment of M/WBEs by entity

[79] *Coral Construction*, 941 F.2d at 919 (emphasis added).
[80] Id. See also *AGCC II*, 950 F.2d at 1414.
[81] *Coral Construction*, 941 F.2d at 917.
[82] Id. at 917-18.
[83] *AGCC II*, 950 F.2d at 1414
[84] *AGCC I*, 813 F.2d 922.
[85] *AGCC II,* 950 F.2d. at 1416. This evidence came from 10 public hearings and "numerous written submissions from the public."

personnel and of M/WBEs being told they were unqualified when they were later found to be qualified by third parties.

The court also ruled that the city was under no burden to identify specific practices or policies that were discriminatory.[86] Reiterating the city's perspective, the court stated that the city "must simply demonstrate the existence of past discrimination with specificity; there is no requirement that the legislative findings specifically detail each and every instance that the legislative body had relied upon in support of its decision that affirmative action is necessary."[87]

2.9 Small Business Procurement Preferences

Small business procurement preferences have existed since the 1940s. The first small business program had its origins in the Smaller War Plants Corporation (SWPC), established during World War II.[88] The SWPC was created to channel war contracts to small business. In 1947, Congress passed the Armed Forces Procurement Act, declaring that "it is the policy of Congress that a fair proportion of the purchases and contracts under this chapter be placed with small business concerns."[89] Continuing this policy, the 1958 Small Business Act requires that government agencies award a "fair proportion" of procurement contracts to small business concerns.[90] The regulations are designed to implement this general policy.[91]

Section 8(b)(11) of the Small Business Act authorizes the Small Business Administration (SBA) to set aside contracts for placement with small business concerns. The SBA has the power:

[86] Id. at 1410.
[87] Id. at 1416.
[88] See, generally, Thomas J. Hasty III, "Minority Business Enterprise Development and the Small Business Administration's 8(a) Program: Past, Present, and (Is There a) Future?" *Military Law Review* 145 (Summer 1994): 1-112.
[89] 10 U.S.C. § 2301 (1976).
[90] 15 USC 631(a).

> *to make studies and recommendations to the appropriate Federal agencies to insure that a fair proportion of the total purchases and contracts for property and services for the Government be placed with small-business enterprises, to insure that a fair proportion of Government contracts for research and development be placed with small-business concerns, to insure that a fair proportion of the total sales of Government property be made to small-business concerns, and to insure a fair and equitable share materials, supplies, and equipment to small-business concerns.*[92]

Every acquisition of goods and services anticipated to be between $2,500 and $100,000 is set aside exclusively for small business unless the contracting officer has a reasonable expectation of fewer than two bids by small businesses.[93]

There has been only one constitutional challenge to the long-standing federal small business enterprise (SBE) programs. In *J.H. Rutter Rex Manufacturing v. United States*,[94] a federal vendor unsuccessfully challenged the Army's small business set-aside as in violation of the due process clause of the Fifth Amendment to the U.S. Constitution, as well as the Administrative Procedures Act and the Armed Forces Procurement Act.[95] The court held that classifying businesses as small was not a "suspect classification" subject to strict scrutiny. Instead the court ruled:

> *Since no fundamental rights are implicated, we need only determine whether the contested socioeconomic legislation rationally relates to a legitimate governmental purpose… Our previous discussion adequately demonstrates that the procurement statutes and the regulations promulgated there under are rationally related to the sound legislative purpose of promoting small businesses in order to contribute to the security and economic health of this Nation.*[96]

A large number of state and local governments have maintained small business preference programs for many years.[97] No district court cases were found overturning a

[91] See 32 C.F.R. §§ 1-701.1 to 1-707.7.
[92] 15 U.S.C. § 637(b)(11).
[93] *Federal Acquisition Regulations* 19.502-2.
[94] 706 F.2d 702 (5th Cir. 1983), *cert denied*, 464 U.S. 1008 (1983).
[95] Administrative Procedures Act, 5 U.S.C. §§ 552(a)(1)(E) (1976) and the "fair proportion" language of the Armed Forces Procurement Act, 10 U.S.C. § 2301 et seq. (1976), and the Small Business Act, 15 U.S.C. § 631 et seq. (1976).
[96] *J. H. Rutter Rex Manufacturing,* at 706 F.2d at 730 (emphasis added). See also *Dandridge v. Williams*, 397 U.S. 471 (1970).
[97] For example, Florida started a small business preference program in 1985 (FL St Sec. 287); Minnesota in

state and local small business preference program. One reason for the low level of litigation in this area is that there is no significant organizational opposition to SBE programs. There are no reported cases of Associated General Construction (AGC) litigation against local SBE programs. And the legal foundations that have typically sued M/WBE programs have actually promoted SBE procurement preference programs as a race-neutral substitute for M/WBE programs.

There has been one state court case in which an SBE program was struck down as unconstitutional. The Cincinnati SBE program called for maximum practical M/WBE participation and required bidders to use good faith efforts requirements to contract with M/WBEs up to government-specified M/WBE availability. Failure to satisfy good faith effort requirements triggered an investigation of efforts to provide opportunities for M/WBE subcontractors. In *Cleveland Construction v. Cincinnati,*[98] the state court ruled that the Cincinnati SBE program had race and gender preferences and had deprived the plaintiff of constitutionally protected property interest without due process of law. The city acknowledged that it had not offered evidence to satisfy strict scrutiny, because it felt that it had been operating a race-neutral program.

2.10 Conclusions

As summarized earlier, when governments develop and implement a DBE program that is sensitive to race and gender, they must understand the case law that has developed in the federal courts. These cases establish specific requirements that must be addressed so that such programs can withstand judicial review for constitutionality and prove to be just and fair. Under the developing trends in the application of the law in the Ninth Circuit, local governments must engage in specific fact-finding processes to compile a thorough, accurate, and specific evidentiary foundation to determine whether there is in fact discrimination

1979 (Mn Stat 137.31); New Jersey, in 1993 (N.J.S.A 52:32-17).

sufficient to justify race- and gender-conscious elements of a DBE plan. Further, local governments must continue to update this information and revise their programs accordingly.

[98] *Cleveland Construction v Cincinnati*, Case No. A0402638 (Ct Comm Pleas, Hamilton County, Ohio 2005).