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Minority and Small Disadvantaged Business Contracting: Legal and Constitutional Developments

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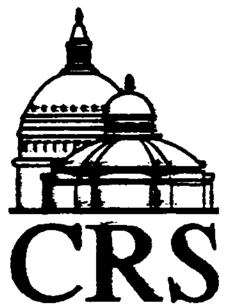

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MINORITY AND SMALL DISADVANTAGED BUSINESS CONTRACTING: LEGAL AND CONSTITUTIONAL DEVELOPMENTS

SUMMARY

Minority small business development and contracting policies of government at the federal, state, and local level continue to stir legal controversy in the wake of the U.S. Supreme Court's 1995 ruling in *Adarand Constructors v. Pena*. That case for the first time applied the constitutional rigors of "strict scrutiny," an established judicial standard for reviewing state and local affirmative action measures, to race-conscious decisionmaking by the federal government. Thus, to pass constitutional muster, the Department of Transportation (DOT) would be required to show that a federal program to "compensate" contractors on federal highway projects for the added costs of doing business with "disadvantaged" minority subcontractors furthered a "compelling governmental interest" and was "narrowly tailored" to that end. By a narrow 5 to 4 margin, the U.S. Supreme Court vacated a contrary appeals court ruling and remanded the case for reconsideration in light of these principles. On June 2, 1997, the U.S. District Court in Colorado issued its decision on remand from *Adarand* in which it determined how strict scrutiny was to be applied to federal affirmative action measures. Judge Kane determined that while the governmental interest in "reducing discriminatory barriers in federal contracting" was indeed a "compelling" one, the "almost exclusive" emphasis on race and ethnicity in the program as administered was not "narrowly tailored."

The Colorado ruling was the first of several cases pending in district courts around the nation to decide the constitutionality of the racial "presumption" used by virtually every major federal agency to allocate the benefits of federal contracts under various programs designed to increase participation by "socially and economically disadvantaged" small businesses. It largely conforms to a pattern of federal rulings which have invalidated state and local governmental programs to promote minority contracting--in Richmond, San Francisco, San Diego, Dade County, Fla., Atlanta, New Orleans, Columbus, Ohio, Louisiana and Michigan, among others--and new challenges continue to be filed. In addition, legislation to abolish minority preferences from federal law has been reintroduced in the 105th Congress, and the Clinton Administration has responded to *Adarand* by publishing a new Justice Department policy and proposed federal procurement regulations on minority contracting.

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MINORITY AND SMALL DISADVANTAGED BUSINESS CONTRACTING: LEGAL AND CONSTITUTIONAL DEVELOPMENTS

INTRODUCTION

Minority small business development and contracting policies of government at the federal, state, and local level continue to stir legal controversy in the wake of the U.S. Supreme Court's 1995 ruling in *Adarand Constructors v. Pena.*[1] That case for the first time applied the constitutional rigors of "strict scrutiny," an established judicial standard for reviewing state and local affirmative action measures, to race-conscious decisionmaking by the federal government. Thus, to pass constitutional muster, the Department of Transportation (DOT) had to show that a federal program to "compensate" contractors on federal highway projects for the added costs of doing business with "disadvantaged" minority subcontractors furthered a "compelling governmental interest" and was "narrowly tailored" to that end. By a narrow 5 to 4 margin, the U.S. Supreme Court vacated a contrary appeals court ruling and remanded the case for reconsideration in light of these principles.

The standard for judicial review of affirmative action prior to *Adarand* distinguished between racial preferences mandated by Congress and those implemented by the states or localities. In *Croson v. City of Richmond*,[2] which voided a 30% local government set-aside for minority contractors, the Court announced that state or local affirmative action measures were to be strictly scrutinized for a compelling governmental objective and had to be "narrowly tailored." This meant, in practice, that local officials had to demonstrate "specific" and "deliberate" past discrimination in public contracting--usually in the form of "disparity studies" charting minority underutilization as contractors and other anecdotal, direct or indirect evidence of minority exclusion--and a degree of remedial precision that not infrequently led to judicial invalidation of race-conscious remedies. A tradition of deference for Congress' role as "co-equal" enforcer of constitutional equal protection, however, had twice led the Court to affirm racial preferences in federal legislation to promote minority group participation in federal procurement and broadcast licensing proceedings. *Fullilove v. Klutznick*[3] and *Metro Broadcasting Inc. v. F.C.C.*[4] appeared to

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1 115 S. Ct. 2097 (1995).

2 488 U.S. 469 (1989).

3 448 U.S. 448 (1980).

4 497 U.S. 547 (1990).

permit Congress wider latitude in the formulation of race-conscious remedies based upon historical and nationwide data relative to past minority exclusion or for other important governmental purposes.

On June 2, 1997, the U.S. District Court in Colorado issued its decision on remand from *Adarand* in which it determined how strict scrutiny was to be applied to federal affirmative action measures.[5] Judge Kane determined that while the governmental interest in "reducing discriminatory barriers in federal contracting" was indeed a "compelling" one, the "almost exclusive" emphasis on race and ethnicity in the program as administered was not "narrowly tailored." The Colorado ruling was the first of several cases pending in district courts around the nation to decide the constitutionality of the racial "presumption" used by virtually every major federal agency to allocate the benefits of federal contracts under various programs designed to increase participation by "socially and economically disadvantaged" small businesses (DBEs).

The latest action in *Adarand* is in general accord with other federal decisions invalidating state and local governmental programs to promote minority contracting--in Richmond, San Francisco, San Diego, Dade County, Fla., Atlanta, New Orleans, Columbus, Ohio, Louisiana and Michigan, among others--and new challenges continue to be filed.[6] Joining this judicial chorus, the U.S. Ninth Circuit Court of Appeals recently gave its constitutional imprimatur to efforts of California voters to curtail racial preferences in state employment, education, and contracting activities when it reversed Judge Henderson's order enjoining implementation of Proposition 209 as a violation of minority rights.[7] The Clinton Administration continued its response to *Adarand* on May 8, 1997 by publishing a new Justice Department policy and proposed revisions to the federal procurement regulations.

A BRIEF HISTORY OF FEDERAL STATUTORY MINORITY CONTRACTING PROGRAMS

Present day set-aside programs authorizing preferential treatment in the award of government contracts to "socially and economically disadvantaged" small businesses originated in § 8(a) of the Small Business Act of 1958. Initially, the Small Business Administration (SBA) utilized its § 8(a) authority to obtain contracts from federal agencies and subcontract them on a noncompetitive basis to firms agreeing to locate in or near ghetto areas and provide jobs for the unemployed and underemployed. The § 8(a) contracts awarded under this program were not restricted to minority-owned firms and were offered to all small firms willing to hire and train the unemployed and

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5 *Adarand Constructors Inc. v. Pena*, 1997 WL 295363 (D.Colo.).

6 *Affirmative Action in Md. Draws Legal Challenges*, Wash. Post B1, B4 (June 5, 1997).

7 *Coalition for Economic Equity v. Wilson*, 110 F.3d 1431 (9th Cir. 1997).

underemployed in five metropolitan areas, as long as the firms met the program's other criteria.[8] As the result of a series of executive orders by President Nixon, the focus of the § 8 (a) program shifted from job-creation in low-income areas to minority small business development through increased federal contracting with firms owned and controlled by socially and economically disadvantaged persons.[9] With these executive orders, the executive branch was directed to promote minority business enterprise and many agencies looked to SBA's § 8(a) authority to accomplish this purpose.

The administrative decision to convert § 8(a) into a minority development program acquired a statutory basis in 1978 with the passage of P.L. 95-507, which broadened the range of assistance that the government--SBA, in particular--could provide to minority businesses. Section 8 (a), or the "Minority Small Business and Capital Ownership Development" program, authorizes SBA to enter into all kinds of construction, supply, and service contracts with other federal departments and agencies. The SBA acts as a prime contractor and then "subcontracts" the performance of these contracts to small business concerns owned and controlled by "socially and economically disadvantaged" individuals, Indian Tribes or Hawaiian Native Organizations.[10]

Applicants for § 8(a) certification must demonstrate "socially disadvantaged" status or that they "have been subjected to racial or ethnic prejudice or cultural bias because of their identities as members of groups without regard to their individual qualities."[11] The Small Business Administration "presumes," absent contrary evidence, that small businesses owned and operated by members of certain groups--including Blacks, Hispanics, Native Americans, and Asian Pacific Americans--are socially disadvantaged.[12] Any individual not a member of one of these groups must "establish his/her individual social disadvantage on the basis of clear and convincing evidence" in order to qualify for § 8(a) certification. The § 8(a) applicant must, in addition, show that "economic disadvantage" has diminished its capital and credit opportunities, thereby limiting its ability to

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8 *Minority Contracting: Joint Hearing Before the Senate Comm. on Small Business and the House Subcomm. on Minority Enterprise and General Oversight of the Comm. on Small Business*, 95th Cong., 2d Sess. 37 (1978).

9 E.O. 11652, 3 C.F.R. § 616 (1971), *reprinted in* 15 U.S.C. § 631 authorized the Office of Minority Business Enterprise created by preceding order, E.O. 11458, to provide financial assistance to public or private organizations that provided management or technical assistance to MBEs. It also empowered the Secretary of Commerce to coordinate and review all federal activities to assist in minority business development.

10 15 U.S.C. § 637(a).

11 15 U.S.C. § 637(a)(5).

12 13 CFR § 124.105(b).

compete with other firms in the open market.[13] Accordingly, nonminority applicants seeking to establish social and economical disadvantage must satisfy specified regulatory criteria.[14]

The "Minority Small Business Subcontracting Program" authorized by § 8(d) of the Small Business Act codified the presumption of disadvantaged status for minority group members that applied by SBA regulation under the § 8(a) program.[15] Prime contractors on major federal contracts are obliged by § 8(d) to maximize minority participation and to negotiate a "subcontracting plan" with the procuring agency which includes "percentage goals" for utilization of small socially and economically disadvantaged firms. To implement this policy, a clause required for inclusion in each such prime contract states that "[t]he contractors shall presume that socially and economically disadvantaged individuals include Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and other minorities, or any other individual found to be disadvantaged by the Administration pursuant to § 8(a). . ." All federal agencies with procurement powers were required by P.L. 95-507 to establish annual percentage goals for the award of procurement contracts and subcontracts to small disadvantaged businesses.

A decade later, Congress enacted the Business Opportunity Development Reform Act of 1988,[16] directing the President to set annual, government-wide procurement goals of at least 20% for small businesses and 5% for disadvantaged businesses, as defined by the SBA. Simultaneously, federal agencies were required to continue to adopt their own goals, compatible with the government-wide goals, in an effort to create "maximum practicable opportunity" for small disadvantaged businesses to sell their goods and services to the government. The goals may be waived where not practicable due to unavailability of DBEs

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[13] The statute, 15 U.S.C. § 637(a)(6)(A), defines economic disadvantage in terms of:

> socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others who are not socially disadvantaged, and such diminished opportunities have precluded or are likely to preclude such individuals from successfully competing in the open market.

[14] 15 U.S.C. § 637(d). Criteria set forth in the regulations permit an administrative determination of socially disadvantaged status to be predicated on "clear and convincing evidence" that an applicant has "personally suffered" disadvantage of a "chronic and substantial" nature as the result of any of a variety of causes, including "long term residence in an environment isolated from the mainstream of American society," with a negative impact "on his or her entry into the business world."13 C.F.R. § 124.105(c).

[15] 15 U.S.C. § 637(d). *See also* 13 CFR § 124.106.

[16] P.L. 100-656, § 502, 102 Stat. 3887, codified at 15 U.S.C. § 644(g)(1).

in the relevant area and other factors.[17] While the statutory definition of DBE includes a racial component, in terms of presumptive eligibility, it is not restricted to racial minorities but also includes persons subjected to "ethnic prejudice or cultural bias."[18] It also excludes businesses owned or controlled by persons who, regardless of race, are "not truly socially and/or economically disadvantaged."[19] Federal Acquisition Act amendments adopted in 1994 amended the 5% minority procurement goal, and the minority subcontracting requirements in § 8(d), to specifically include "small business concerns owned and controlled by women" in addition to "socially and economically disadvantaged individuals."[20]

Additionally, statutory "set-asides" and other forms of preference for "socially and economically disadvantaged" firms and individuals, following the Small Business Act or other minority group definition, have frequently been added to specific grant or contract authorization programs. For example, Congress early on established goals for participation of small disadvantaged businesses in procurement for the Department of Defense, NASA, and the Coast Guard. It also enacted the Surface Transportation Assistance Act of 1982, the Surface Transportation and Uniform Relocation Assistance Act of 1987, and the Intermodal Surface Transportation Efficiency Act of 1991, each of which contained a minority or disadvantaged business participation goal. Similar provisions were included in the Airport and Airway Improvement Act of 1982 in regard to procurements for airport development and concessions.[21] Finally, in 1994, Congress enacted the Federal Acquisition Streamlining Act, permitting federal agency heads to adopt restricted competition and a 10% "price evaluation preference" in favor of "socially and economically disadvantaged individuals" to achieve government-wide and agency contracting goal requirements.[22]

BACKGROUND PROCEEDINGS IN *ADARAND*

The statutory predicate for the affirmative action program in *Adarand* was the Small Business Act and § 106(c) of the Surface Transportation and Uniform Relocation Assistance Act of 1987 (STURRA). As noted, § 8(d) of the Small

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17 *See e.g.* 49 C.F.R. §§ 23.64(e), 23.65 (setting forth waiver criteria for the Department of Transportation.

18 15 U.S.C. § 637(a)(5).

19 *See* 49 C.F.R. Pt. 23, Subpt. D, App. C.

20 P.L. 103-355, 108 Stat. 3243, 3374, § 7106 (1994).

21 *See generally "Compilation and Overview of Federal Laws and Regulations Establishing Affirmative Action Goals or Other Preference Based on Race, Gender, or Ethnicity,"* CRS Memorandum, February 17, 1995 (Dale), *reprinted at* 141 *Cong. Rec.* S 3929 (daily ed. 3-15-95).

22 Pub. L. 103-355, 108 Stat. 3242, § 7104 (1994).

Business Act requires prime contractors to maximize opportunities for participation in the performance of federal contracts by "small business concerns owned and controlled by socially and economically disadvantaged persons [DBEs]." In addition, § 502 of the Act establishes an annual 5% government-wide participation goal for DBEs in federal contracting activities and requires specific goals for businesses owned by minorities and other disadvantaged businesses.[23] To implement this policy, a subcontracting clause must be included in all covered prime contracts stating that "[t]he contractors shall presume that socially and economically disadvantaged individuals include Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and other minorities, or any other individual found to be disadvantaged by the Administration pursuant to § 8(a). . ."

Firms applying for § 8(a) certification must show "socially disadvantaged" status or that they "have been subjected to racial or ethnic prejudice or cultural bias because of their identities as members of groups without regard to individual qualities."[24] SBA's § 8(a) regulations track the minority subcontracting clause by "presuming," absent contrary evidence, that Black, Hispanic, Asian Pacific, Subcontinent Asian, and Native Americans, as well as "members of other groups designated from time to time by SBA," are "socially disadvantaged."[25] Any individual not a member of one of these groups must "establish his/her individual social disadvantage on the basis of clear and convincing evidence." In addition, any § 8(a) applicant, minority or nonminority, must show that "economic disadvantage" has diminished its credit and capital opportunities in the competitive market. Accordingly, while disadvantaged status under the SBA includes a racial component, in terms of presumptive eligibility, it is not restricted to racial minorities, but also includes persons subjected to "ethnic prejudice or cultural bias."[26] It also excludes businesses owned or controlled by persons who, regardless of race, are "not truly socially and/or economically disadvantaged."[27] The Small Business Act definition of DBE also applies to contracts, like that in the *Adarand* case, financed by

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[23] 15 U.S.C. § 644(g)(1). That law establishes a government-wide goal of at least five percent participation by "socially and economically disadvantaged individuals" in all federal procurements as measured by the total value of all prime contract and subcontract awards. The overall annual goal for the government is set by the President with individual goals determined jointly by the head of each federal agency and the Office of Federal Procurement Policy so as to provide the "maximum practicable opportunity" for DBEs "to participate in the performance of contracts let by such agency."

[24] 15 U.S.C. § 637(a)(5).

[25] 13 C.F.R. § 124.105(c).

[26] 15 U.S.C. § 637(a)(5).

[27] *See* 49 C.F.R. Pt. 23, Subpt. D, App. C.

STURRA--a 1987 DOT appropriations measure which included a 10% disadvantaged business set-aside.[28]

In *Adarand*, the Federal Highway Lands Program, a component of the Federal Highway Administration within DOT, had developed a "race-conscious subcontracting compensation clause (SCC)" program. The SCC did not allocate or set-aside a specific percentage of subcontract awards for DBEs or require a commitment on the part of prime contractors to subcontract with minority firms. Rather, "incentive payments" varying from 1.5% to 2% of the contract amount were paid to prime contractors whose subcontracts with one or more qualified DBEs exceeded 10% of total contract value. The SCC program was challenged by *Adarand*, a white-owned construction firm whose low bid on a subcontract for highway guard rails was rejected in favor of a higher bidding DBE. Both the federal trial court and the Tenth Circuit upheld the program by applying "lenient" judicial review--"resembling intermediate scrutiny"--rather than strict scrutiny under *Croson*, and required no detailed showing of past discrimination as remedial justification for congressionally-mandated affirmative action. Because the program was not limited to racial minorities, and nondisadvantaged minority group members were ineligible to participate, the appeals court concluded, the program was "narrowly tailored." The 10% threshold was deemed "an optional goal, not a set-aside" since it was "entirely at the discretion of the prime contractor" whether to accept or forego the monetary DBE subcontracting incentives.

THE U.S. SUPREME COURT DECISION IN *ADARAND*

Justice O'Connor, author of the majority opinion, was joined by the Chief Justice and Justices Scalia, Thomas and Kennedy in reversing the appeals court decision. The majority rejected the equal protection approach that applied "intermediate scrutiny" or some other relaxed standard of review to racial line-drawing by the Congress for remedial or other "benign" legislative purpose. "Strict scrutiny" of all racial classifications by the government, at whatever level, was required to determine whether benign or invidious motives inspired the legislative action and because the guarantee of equal protection secured by the 5th and 14th Amendments is a "personal" right extending to the "individual" and "not groups." Strict scrutiny of federal race conscious affirmative action was dictated by "three general propositions" that the majority deduced from the constitutional precedents culminating in *Croson*: judicial "skepticism" regarding all disparate governmental treatment based on race or ethnicity; "consistency," without regard to the race of those "burdened or benefitted" by the classification; and "congruence" between equal protection and due process analysis. Consequently, because the "race-based rebuttable presumption" in the DOT program was an "explicit" racial classification, Justice O'Connor determined, "it must be analyzed by a reviewing court under strict scrutiny," and to survive, must be "narrowly tailored" to serve a "compelling governmental interest."

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[28] P.L. 100-17 § 106(c).

Adarand directly negated prior judicial holdings that Congress has substantially greater latitude than the states or localities in crafting affirmative action measures for racial or ethnic minorities. *Metro Broadcasting* was expressly overruled, and *Fullilove* adjudged "no longer controlling," insofar as those decisions exhibited greater tolerance for race-conscious lawmaking by Congress. The Court refrained, however, from invalidating or deciding the ultimate constitutional fate of the minority subcontracting incentive program in *Adarand*. Rather, "because our decision today alters the playing field in some important respects," Justice O'Connor remanded the case to the lower courts for application of the principles announced by the majority. In a caveat to her opinion, Justice O'Connor made an important observation in which she sought to "dispel the notion," advanced by Justice Marshall's concurrence in *Fullilove*, that "strict scrutiny is 'strict in theory, but fatal in fact.'"[29] The role of Congress as architect of remedies for past societal discrimination is also obliquely acknowledged. "The unhappy persistence of both the practice and the lingering effects of racial discrimination against minorities in this country is an unfortunate reality, and the government is not disqualified from acting in response to it."[30] Thus, a majority of the Justices--all but Justices Scalia and Thomas--may accept some forms of racial preference in at least some circumstances. No further guidance was provided, however, as to the scope of remedial authority remaining in congressional hands, or the conditions for its exercise.

Two members of the majority, Justices Scalia and Thomas, wrote separately to espouse a far more restrictive view that would foreclose all governmental classifications by race or ethnicity. Justice Scalia declared that "government can never have a 'compelling interest' in discriminating on the basis of race in order to 'make up' for past racial discrimination in the opposite direction." Justice Thomas was of the view that the "racial paternalism" of affirmative action was more injurious than beneficial to minorities. "In my mind, government-sponsored racial discrimination based on benign prejudice is just as noxious as discrimination inspired by malicious prejudice. In each instance, it is racial discrimination, plain and simple."

Justices Stevens, Souter, Ginsburg, and Breyer dissented. Justice Stevens, a member of the majority striking down the minority set-aside in *Croson*, chided the majority for ignoring distinctions between invidious discrimination and governmental efforts to "foster equality in society" through racial preferences. "There is no moral or constitutional equivalence between a policy that is designed to perpetuate a caste system and one that seeks to eradicate racial subordination," he declared. Justices Souter and Ginsburg, in separate dissents, shared a belief that federal affirmative action programs remain viable under the majority's analysis. Justice Souter anticipated "some interpretive forks in the road before the significance of strict scrutiny for congressional remedial statutes becomes entirely clear." Despite this, Justices Ginsburg and Breyer felt "[t]he

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[29] 115 S. Ct. at 2117.

[30] *Id.*

divisions in this difficult case should not obscure the Court's recognition of the persistence of racial inequality and a majority's acknowledgement of Congress' authority to act affirmatively, not only to end discrimination, but also to counteract discrimination's lingering effects."

In *Adarand*, therefore, the Supreme Court did not condemn all federal affirmative action efforts, and even the task of assaying the constitutionality of the specific program before it was remanded to the courts below. Justice O'Connor's order generally echoed *Croson* by asking the lower courts to determine whether the governmental interest served by the federal program is "compelling," whether the program is "narrowly tailored," limited in duration, and whether "any consideration of race-neutral means to increase minority business participation" had preceded adoption of race-conscious remedies. By requiring "strict scrutiny" of racial or ethnic preferences imposed by Act of Congress, however, the ruling implies that both the legislative justification for such programs and the means chosen for their execution will henceforth be subject to closer judicial examination. In its remand order, Justice O'Connor stressed the need to clarify the precise operation of the complex federal statutes and regulations relating to social and economic disadvantage and the race-based presumption under the Small Business Act. The majority sought technical clarification of the regulatory scheme in relation to operation of the presumption and, in particular, whether "individualized showings" of economic disadvantage were required by various SBA and DOT regulations. The answer to questions such as these may reveal whether the "rebuttable" presumptions are irrebuttable in fact, or may be a subterfuge for rigid racial "quotas." By way of parallel, one flaw in the Richmond program voided by *Croson* was the absence of a "waiver" for situations where "the particular MBE seeking a racial preference has [not] suffered from the effects of past discrimination by the city or prime contractors."[31]

THE U.S. DISTRICT COURT INVALIDATES THE DOT PROGRAM

On June 2, 1997, the Colorado federal district court issued its memorandum decision and order on remand in the *Adarand* case.[32] As a threshold matter, the District Judge Kane considered whether the concept of congruence enunciated by Justice O'Connor for the *Adarand* majority required the federal government to make the same particularized showing of past discrimination as demanded of states and localities to support adoption of minority contracting programs or whether Congress, as national legislature, had broader authority to enact remedies for nationwide discrimination. Opting for the latter position, Judge Kane determined that "Congress' constitutionally imposed role as... guardian against racial discrimination" under § 5 of the Fourteenth Amendment distinguished federal authority from that of the states and localities. Consequently, findings of nationwide discrimination derived from congressional

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[31] 488 U.S. at 508.

[32] *Supra* n. 2.

hearings and statements of individual federal lawmakers were entitled to greater weight than the "conclusory statements" of state or local legislators rejected by *Croson*. "Congress," in other words, "may recognize a nationwide evil, and act accordingly, provided the chosen remedy is narrowly tailored so as to preclude the application of a race-conscious measure where it is not warranted."

The government's brief catalogued congressional hearings over a nearly two decade period depicting the social and economic obstacles faced by small and disadvantaged entrepreneurs, mainly minorities, in business formation and competition for government contracts. In addition, "disparity studies" conducted after *Croson* in most of the nation's major cities comparing minority-owned business utilization with availability had disclosed "a serious pattern of discrimination across all regions. . .and across a wide range of industries." This record satisfied Judge Kane that Congress had a "strong basis in evidence" for concluding that official complicity with private discrimination in the construction industry contributed to discriminatory barriers in federal contracting, a situation the government had a "compelling" interest in remedying.

The "narrow tailoring" aspect of the Judge Kane's decision entailed a fairly technical analysis of the SCC program in actual operation. The rejected white contractor in *Adarand* contended that by linking the race-based presumptions mandated by the SBA programs statutes and regulations with financial "bonus" incentives of the SCC, the program caused prime contractors to discriminate against lower-bidding non-DBE subcontractors. The government countered that the SCC payment was "compensation" designed only to reimburse prime contractors for additional sums they may have to expend as a result of hiring DBE's, an objective directly relevant to the program's remedial purpose. Judge Kane ruled in favor of the nonminority contractor. The record revealed no increased costs to this prime contractor associated with this particular DBE subcontract. The payment thus appeared to the court a "gratuity" for a prime contractor whose choice of a subcontractor was based "only on race" and could not "be said to be narrowly tailored to the government's interest of eliminating discriminatory barriers."

Second, although revised since, the application forms used by the state to grant DBE certification in 1985 when the case arose required minimal information from the applicant as to financial condition and property ownership, centering instead "almost exclusively" on minority status. "Indeed," observed the district judge, "under these standards, the Sultan of Brunei would qualify." For this reason, the racial presumption governing the SCC program was found to be both "overinclusive"--in that its benefits were available to all named minority group members--and "underinclusive"--because it excluded members of other minority groups or caucasians who may share similar disadvantages. "This supports the conclusion that the presumptions of disadvantage set out in federal statutes and regulations are not narrowly tailored to those who have suffered the effects of prior discrimination in that they allow implementation in such a way as to permit an absolute preference to certain business entities based solely on their race."

Also indicative of governmental failure to narrowly tailor the program were inconsistencies between the statutes and regulations, noted in Justice O'Connor's opinion, as to the definition of disadvantaged individual and, in particular, the scope of presumption in relation to economic disadvantage and racial minorities. Whereas the SBA's § 8(a) regulations, for example, presumed social disadvantage only and required individualized inquiry into each participant's economic disadvantage, DOT regulations under related transportation funding measures presumed racial minorities were both socially and economically disadvantaged.[33] While conceding that the SCC program was "more flexible" than the "rigid racial quota" in *Croson*, or the 10% set-aside approved by *Fullilove*, Judge Kane in effect found it tainted by the government-wide 5% goals and transportation set-asides which it implemented.

> Thus, although the SCC's contain no quotas, they are used as one of the methods to attain the percentage goals in the SBA, STURAA and ISTEA, and are thus inextricably linked with these goals. Insofar as the percentage goals are a foundation for the use of the SCCs, rooted in the same race-based presumptions contained in the SCCs, I find the statutory sections containing those goals insufficiently narrowly tailored for the same reasons as I stated in making that determination regarding the SCCs themselves.[34]

For these reasons, the SCC program did not survive strict scrutiny; summary judgment was granted for Adarand Constructors, Inc. and against the federal government. The SBA's 5% government-wide goal, the transportation set-aides of STURAA and ISTEA, and SCC program "as applied to highway construction in the State of Colorado" was declared unconstitutional and enjoined.

Although limited in scope to operation of the SCC program and underlying federal statutes "as applied" to the specific circumstances before the court, Judge Kane's decision may have broader legal ramifications. Both the supporting rational for the order, and sweeping *dicta* from his opinion, suggest that federal

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[33] According to Judge Kane:

> The inconsistencies between these statutes and regulation and the resultant uncertainty as to who may or may not participate in the race-based SCC program preclude a finding of narrow tailoring. As discussed in relation to the different forms which have been used in the certifying process, without a well-defined set of consistent definitions, the SCC program cannot provide the 'reasonable assurance that the application of racial or ethnic criteria will be limited to accomplishing the remedial objectives of Congress and that misapplications of the program will be promptly and adequately remedied administratively." slip op at p. 64 (citing *Fullilove*).

[34] Slip opinion at p. 68.

agency consideration of race in the distribution of contracts or other federal benefits--by way of a racial presumption of "social and economic disadvantage" or other explicit preference--may be in substantial constitutional jeopardy. After conceding, on one hand, that Congress is empowered to determine and legislate the national elimination of discriminatory barriers to specific groups, the opinion appears to largely foreclose the exercise of that legislative authority by race-conscious means. In this regard, Judge Kane's stated view that "it [is] difficult to envisage a race-based classification that is narrowly tailored" stands in contrast to Justice O'Connor observation in *Adarand* that strict scrutiny is not "fatal in fact."

Two aspects of the district court's analysis of the "narrow tailoring" requirement could prove most unsettling for federal small disadvantaged business programs in their present form. First, the "optional" or voluntary nature of the SCC program was not enough to save it, notwithstanding the fact that prime contractors were free to accept bid proposals from any subcontractor, regardless of race or ethnicity. The government's failure to prevail on this issue may cast a shadow over other federal minority contracting efforts--e.g. the § 8(a) set-aside, bid or evaluation preferences, and the like--which, under Judge Kane's reasoning, may be viewed as imposing a "choice based only on race" at least as "mandatory" and "absolute" as the incentive payment to prime contractors in *Adarand*, if not more so. Similarly, the fact that the SCC program did not expressly incorporate any "goals, quotas, or set-asides" was not sufficient to divorce it, in the district court's view, from the percentage goal requirements imposed by statutes the program was designed to implement. Those statutory provisions--the 5% minimum disadvantaged small business goal in § 8(d) of the SBA and the parallel 10% requirement in STURAA and ISTEA--were deemed invalid for lack of narrow tailoring. The district court ruling could place in question much of the federal government's current effort to advance minority small business participation in the procurement process by race-conscious means.

RECENT EXECUTIVE AND LEGISLATIVE ACTIONS ON MINORITY PROCUREMENT

Regulatory revisions put forward by the Clinton Administration seek to achieve "narrow tailoring" required of federal minority contracting programs by *Adarand*. An initial focus of the Administration's post-*Adarand* review was a DOD program, known as the "rule of two," developed as a means to attain the 5% goal for DBEs in 10 U.S.C. § 2323. Section 2323 authority--permitting "less than full and open competit[ion]" in DOD procurements provided that the cost of using set-asides or affirmative action measures is not more than 10% above fair market price--was extended to all agencies of the federal government by the Federal Acquisition Streamlining Act in 1994 (FASA).[35] Under the rule of two,

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[35] Pub. L. 103-355, § 7102, 108 Stat. 3243 (1994). FASA states that in order to achieve goals for DBE participation in procurement negotiated with the SBA, an "agency may enter into contracts using--(A) less than full and open competition by restricting the

whenever a DOD contract officer could identify two or more qualified SDBs to bid on a project within that cost range, the officer was required to set the contract aside for bidding exclusively by SDBs. Due to *Adarand*, use of the rule of two was suspended and FASA rulemaking delayed.

On May 23, 1996, the Justice Department proposed a structure for reform of affirmative action in federal procurement which would set stricter certification and eligibility requirements for minority contractors claiming "socially and economically disadvantaged" status under the § 8(a) and other federal affirmative action programs.[36] The plan would suspend for two years set-aside programs in which only minority firms may bid on contracts. Statistical "benchmarks" developed by the Commerce Department, and adjusted every five years, would provide the basis for estimating expected DBE participation as federal contractors, in the absence of discrimination, for nearly 80 different industries. Where minority participation in an industry falls below the benchmark, bid and evaluation credits or incentives would be authorized for economically disadvantaged firms and prime contractors who commit to subcontract with such firms. Conversely, when DBE participation exceeds an industry benchmark, the credit would be lowered or suspended in that industry for the following year. The new system would be monitored by the Commerce Department, using data already collected to evaluate the percentage of federal contracting dollars awarded to minority-owned businesses, and would rely more heavily on "outreach and technical assistance" to avoid potential constitutional pitfalls.

The Justice Department's response to comments on its proposal, together with proposed amendments to the Federal Acquisition Regulation (FAR) to implement it, were published on May 8, 1997. Three procurement mechanisms would interact with benchmark limits pursuant to the FAR regulation proposed jointly by the Departments of Defense, General Services Administration, and National Aeronautics and Space Administration. A "price evaluation adjustment" not to exceed fair market value by more than 10 %, as authorized by current law, would be available to DBEs bidding on competitive procurements. Second, an "evaluation" credit would apply to bids by nonminority prime contractors participating in joint ventures, teaming arrangements, or subcontracts, with DBE firms. Finally, contracting officers may employ "monetary incentives" to increase subcontracting opportunities for DBEs in negotiated procurements. The comment period for the FAR amendment is 60 days, with a final regulation to follow.

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competition for such awards to small business concerns owned and controlled by socially and economically disadvantaged individuals described in subsection (d)(3)(c) of section 8 of the Small Business Act (15 U.S.C. 637); and (B) a price evaluation preference not in excess of 10 percent when evaluating an offer received from such a small business concern as the result of an unrestricted solicitation."

[36] 61 *Fed Reg.* 26042, Notices, Department of Justice, Proposed Reforms to Affirmative Action in Federal Procurement, Part IV (May 23, 1996).

The SBA definition of social and economic disadvantage would remain largely intact under the Administration proposal. Members of designated minority groups seeking to participate in DBE and § 8(d) programs would continue to fall within the statutorily mandated presumption of social and economic disadvantage. Such applicants, however, would be required to state their group identification and meet certification criteria for economic disadvantage, according to SBA standards, subject to third party challenge under existing administrative mechanisms. Individuals who do not fall within the statutory presumption may qualify for DBE status by proving that the individuals who own and control the firm are socially and economically disadvantaged. Under current SBA § 8(a) certification policies, persons who are not members of presumed groups must prove social and economic disadvantage by "clear and convincing evidence". The latest DOJ proposal would ease the burden on nonminority applicants by adopting a "preponderance of evidence" rule.

On January 17, 1997, Representative Canady introduced the "Civil Rights Act of 1997," a proposal to abolish most racial, ethnic, and gender preferences in federal law. Senators McConnell and Hatch are lead sponsors of a companion measure in the Senate. H.R. 1909 proposes a broad-based prohibition against discrimination and preferential treatment in the administration of federal contracting, employment, and "any other federally conducted program or activity." Although primarily concerned with "numerical" preferences for "any person or group" predicated on considerations of "race, color, national origin, or sex"--including "a quota, set-aside, numerical goal, timetable, or other numerical objective"--the bill is not limited to such measures. Rather, "an advantage of any kind" in the administration of any program or activity carried out by a federal department or agency, or any officer or employee thereof, would be forbidden by the bill. There are certain exceptions, however. First, there is a basic exemption for federal efforts to expand the "applicant pool" of women and minorities in employment or to "encourage" their participation as federal contractors or subcontractors. Such affirmative recruitment efforts are permitted so long as no preference in selection is involved. In addition, there are specific exemptions for federal actions to aid educational institutions recognized by law as "historically black colleges and universities;" for federal actions authorized by law or treaty in relation to Indian Tribes; or for sex-based classifications where "sex is a bona fide occupational qualification;" or in matters respecting the Armed Forces or the immigration and nationality laws.