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Legal Analysis of the 10% Disadvantaged Small Business Set-Aside Provisions of H.R. 2400, the "Building Efficient Surface Transportation and Equity Act of 1997"

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Summary

Surface transportation authorization bills before the 105th Congress continue a 10 % allocation of authorized funds for "socially and economically disadvantaged" small business concerns as defined by the Small Business Act (SBA). The racial presumption included in that SBA definition has figured in recent court cases challenging the constitutionality of minority group preferences in federal transportation funding programs.

The House will soon vote on H.R. 2400, the "Building Efficient Surface Transportation and Equity Act of 1997"(BESTEA), an omnibus bill to fund surface transportation into the next century. Like the version of the legislation which passed the Senate in early March (S. 1173), BESTEA continues a provision from the current transportation authorization law providing for a percentage allocation of appropriated funds for "disadvantaged business enterprises" as follows: "Except to the extent that the Secretary determines otherwise, not less than 10% of the amounts authorized to be appropriated under titles I, II, III, IV, and VI of this Act shall be expended with small business concerns owned and controlled by *socially and economically disadvantaged individuals*."¹ The italicized reference specifically incorporates the definition of the same term as used in §8(d) of the Small Business Act² and "relevant subcontracting regulations promulgated pursuant thereto."

Section 8(d) in effect codified regulations of the Small Business Administration (SBA) and established a "presumption" of social and economic disadvantage based on

¹ § 102(b)(1) of H.R. 2400.

² 15 U.S.C. §637(d).

minority group identification. Under the Act and SBA rules, small businesses owned and operated by members of certain groups--including Blacks, Hispanics, Native Americans, and Asian Pacific Americans--are "presumed" to be socially disadvantaged by the SBA.³ By contrast, nonminority applicants have the burden of proving "by clear and convincing evidence" that they have been victims of "racial or ethnic prejudice or cultural bias" in order to qualify as a disadvantaged business.⁴ In addition, the applicant must show that "economic disadvantage" has diminished its capital and credit opportunities, thereby limiting its ability to compete with other firms in the open market.⁵ Accordingly, nonminority applicants seeking to establish social and economic disadvantage must satisfy specified regulatory criteria.⁶

The ISTEA disadvantaged business "goal" provision was one leg of the statutory "stool" supporting a U.S. Department of Transportation (DOT) affirmative action program presently being challenged in the federal courts. 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 disadvantaged business enterprises (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 a white-owned construction firm whose low bid on a subcontract for highway guard rails was rejected in favor of a higher bidding DBE.

³ 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)..." *Id.*

⁴ 15 U.S.C. §637(a)(5).

⁵ 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.

⁶ 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).

In a 1995 decision, *Adarand Constructors v. Pena*,⁷ the U.S. Supreme Court 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, DOT had to show that its 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.

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 the DOT program in question.⁸ Judge Kane readily conceded as a threshold matter that the government had a "compelling" interest in "reducing discriminatory barriers in federal contracting." Nearly two decades of congressional hearings into the social and economic obstacles facing minority entrepreneurs, and "disparity studies" illustrating exclusion of minority contractors at the state and local level, provided Congress with a "strong basis in evidence" for concluding that a nationwide remedy was warranted. But the program as administered failed the constitutional requirement of "narrow tailoring" because of its "almost exclusive" emphasis on race and ethnicity.

The narrow tailoring aspect of strict scrutiny analysis generally entails consideration of a host of factors--limitations on program scope and duration, waiver authority, nonracial alternatives, and impact on nonminorities--relevant to the administration of governmental affirmative action.⁹ Periodic congressional oversight and approval of federal affirmative action remedies often appeared to be of pivotal constitutional significance in the pre-*Adarand* era. The Court in *Fullilove v. Klutznick*¹⁰ pointed to the congressional reauthorization process as an inherent limitation on the duration of a 10% set-aside of federal public work funding for minority contractors, thereby insuring that it "is not a permanent part of federal contracting requirements." *Metro Broadcasting Inc. v. FCC*¹¹ reviewed two FCC programs affording minority preferences in "distress sales" of existing broadcast facilities and in comparative proceedings for new licenses as a means of promoting "viewpoint diversity." In applying a standard of "intermediate scrutiny," Justice Brennan wrote for the Court that it was "of overriding significance in these cases that the FCC's minority ownership programs have been specifically approved--indeed, mandated--

⁷ 115 S. Ct. 2097 (1995).

⁸ *Adarand Constructors Inc. v. Pena*, 966 F.Supp. 1556 (D. Colo. 1997).

⁹ In *United States v. Paradise*, 480 U.S. 149, 187 (1986), the U.S. Supreme Court identified five factors which may be relevant to the determination of whether an affirmative action remedy is narrowly drawn to achieve its goal: "(i) the efficacy of alternative remedies; (ii) the planned duration of the remedy; (iii) the relationship between the percentage of minority group members in the relevant population or workforce, (iv) the availability of waiver provisions if the hiring plan could not be met; and (v) the effect of the remedy upon innocent third parties."

¹⁰ 448 U.S. 448, 513 (Powell, J. concurring).

¹¹ 497 U.S. 547, 563 (1990).

by Congress."¹² Thus, the Court distinguished earlier rulings which had applied strict scrutiny state and local affirmative action programs on the grounds that the FCC program was supported by Congress' institutional competence and commerce powers.

Just what weight the courts would accord the fact of congressional authorization or reauthorization when determining whether a racial classification is narrowly tailored after *Adarand* can only be speculated. The Supreme Court in *Adarand* "altered the playing field" of prior federal affirmative action law by expressly overruling *Metro's* intermediate review standard in favor of strict judicial scrutiny and left other aspects of the decision in considerable doubt. In addition, the federal district court on remand from *Adarand* found that the DOT program as administered lacked narrow tailoring for reasons unrelated to the duration of the remedy. Consequently, it refused to address the government's argument that regular congressional review of DOT's disadvantaged small business program since 1982 reinforced the current ISTEA program by assuring that it "will not last longer than the discriminatory effect it is designed to eliminate."

Judge Kane's opinion does emulate *Fullilove* and *Metro Broadcasting* in its deferential approach to the congressional determination of a compelling governmental interest. But after conceding to Congress the power to determine and legislate the national elimination of discriminatory barriers in federal contracting, the district court largely forecloses the exercise of that legislative authority by race-conscious means. Any constitutional fortification provided by congressional reenactment of the ISTEA disadvantage business goal may prove marginal when measured against *dicta* from Judge Kane's opinion that "it [is] difficult to envisage a race-based classification that is narrowly tailored." Thus, while the absence of active legislative oversight could be a factor further undermining the constitutional validity of congressional affirmative action measures, it is questionable whether the mere reauthorization of existing authority would materially strengthen race-conscious legislation against strict judicial scrutiny.

Two aspects of the district court's analysis of the "narrow tailoring" requirement could prove most unsettling for federal small disadvantaged business programs if they become the prevailing judicial view. 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 disadvantaged small business provision in ISTEA or BESTEA -- 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

¹² Justice Brennan's reference was to Congress' enactment of FCC appropriations legislation that prohibited the FCC from re-examining the two minority ownership policies at issue in *Metro*.

question much of the federal government's current effort to advance minority small business participation in the procurement process by race-conscious means.