MEMORANDUM

FROM: Sid Hemsley, Senior Law Consultant

DATE: June 19, 2001

RE: Minority Set Asides and Set-Aside Goals

You have the following question: Are minority set-aside quotas or set-aside goals legal on the part of Tennessee Municipalities?

Minority set-aside *quotas* have been roughly handled by the U.S. Supreme Court. Such programs are presumptively unconstitutional, are subject to strict scrutiny by the courts, and are reviewed with reference to three general propositions (which also apply to *all* governmental racial classifications):

1. "Skepticism: Any preference based on racial or ethnic criteria must necessarily receive a most searching examination."

2. The standard of review does not depend upon the race of those burdened or benefitted; and

3. "Congruence"--that is, strict scrutiny applies whether the claim applies to a federal or state or local program. [Adarand Constructors, Inc. v. Pena, 115 S.Ct. 2097 (1995); at 2111; City of Richmond v. Croson Co., 488 U.S. 469, 102 L.Ed.2d 854, 109 S.Ct. 706 (1989).] (Possibly only intermediate scrutiny for programs that apply to women).

In addition, any such program must also be "narrowly tailored." [Adarand and Croson, above.]

Generally, the lower federal courts have found minority set-aside quotas unconstitutional, but have found some minority set-aside goals constitutional. In the recent case of Associated General Contractors of Ohio, Inc. v. Drabnik, 214 F.3d 730 (6th Cir. 2000), the U.S. Court of Appeals for the Sixth Circuit (which includes Tennessee) struck down Ohio's Minority Business
Enterprise Act, in language that suggests that any minority set-asides in Tennessee would have to meet tough constitutional standards announced in Croson and Adarand, above.

Minority set-aside programs adopted by governments at all levels rise or fall on one or both of two basic requirements:

1. The government must make legitimate and supportable legislative finding of fact that it is guilty of past racial discrimination in the awarding of contracts to minorities.

2. The minority set-aside program must be "narrowly tailored" to achieve a compelling government interest (the ending of past or present discrimination).

Legislative finding of facts

It is critical that the government *statistically* prove that it has a history of discrimination in awarding contracts to minorities.

Generalized conclusions that the government is guilty of such discrimination are inadequate, as is only anecdotal proof. The proof of discrimination must be statistical, although anecdotal proof may support the statistical proof. [Associated General Contractors of Ohio, Inc. v. Drabik, 214 F.3d 730 (6th Cir. 2000); Engineering Contractors Association v. Metro Dade County, 122 F.3d 895 (11th Cir. 1997); Contractors Association of East Pennsylvania v. Philadelphia, 91 F3d 586 (3rd Cir. 1996); F. Buddie Contracting Co. v. City of Elyria, Ohio, 775 F.Supp. 1018 (N.D. Ohio 1991).]

Apparently in at least the Sixth Circuit the statistical evidence must be relatively recent. [Associated General Contractors of Ohio, Inc. v. Drabik, 214 F.3d 730 (6th Cir. 2000)]

The statistical proof must be legitimate and defensible. Recent cases reflect courts that have achieved considerable levels of sophistication in the both statistical and anecdotal evidence methodology, and some of them have literally trashed the government's evidence. [Associated General Contractors of Ohio, Inc. v. Drabik, 214 F.3d 730 (6th Cir. 2000); Associated General Contractors of America v. City of Columbus, 936 F.Supp. 1563 (S.D. Ohio 1996). Also see Engineering Contractors Association v. Metro Dade County, 122 F.3d 895 (11th Cir. 1997).]

The majority of courts have held that while there must be some evidence to support a finding of discrimination before adopting a minority set-aside program, the evidence of such discrimination can be developed after the program is adopted. [Coral Construction Company v. King County, 941 F.2d 910 (9th Cir. 1991); Harrison & Barrows Bridge Contractors, Inc. v. Cuomo, 981 F.2d 50 (2nd Cir. 1992); Contractors Association of Eastern Pennsylvania v. Philadelphia, 6 F.2d 990 (3rd Cir. 1993); Concrete Works of Colorado, Inv. v. City of Denver, 36 F.3d 1513 (10th Cir. 1994); Engineering Contractors Association of South Florida, Inc. v. Metropolitan Dade County, 122 F.3d 895 (11th Cir. 1997).

However, the U.S. District Court for the Western District of Tennessee strenuously disagrees with the majority. In West Tennessee Chapter of Associated Builders and Contractors, Inc. v. Board of Education of the Memphis City Schools, 64 F.Supp.2d 714 (W.D. Tenn. 1996), that Court expressly held that post-enactment evidence *cannot* be used to support its minority set-aside programs. The U.S. Sixth Circuit Court of Appeals also appears to have rejected the proposition that post-enactment evidence is legal. [Associated General Contractors of Ohio, Inc. v. Drabik, 214 F.3d 730 (6th Cir. 2000)].

Narrow Tailoring

The courts have pointed to a number of reasons that a particular minority set-aside program was not narrowly tailored:

1. The program reflects a quota rather than a goal.

2. Lack of proof that the set-aside was necessary to remedy the discrimination.

3. Race-neutral programs have not been tried by the government to remedy the discrimination.

4. The program contains no objective criteria by which to certify a particular business as a "minority business enterprise" (MBE).

5. The program contains no deadline.

6. The program injures "innocent third parties" (whites seeking to bid on contracts).

7. The program is under-inclusive or over-inclusive.

Programs not Narrowly Tailored

Associated General Contractors of Ohio, Inc. v. Drabik, 214 F.3d 730 (6th Cir. 2000): The State of Ohio enacted the Minority Business Enterprise Act in 1980. It set-aside 5%, by value, of all state construction projects for bidding exclusively by MBEs. An MBE was defined as a venture owned and controlled, to the extent of 51%, for at least one year previously, by members of one of the following economically disadvantaged groups: Blacks, American Indians, Hispanics, and Orientals.

The program was both under-inclusive and over-inclusive. By "lumping" Blacks, Native Americans, Hispanics and Orientals together (and by not clarify the extent of the last two groups), the program might have provided racial preferences where there had been no discrimination. For example, "the MBE is satisfied if all contractors of Thai origin, who might never have been seen in Ohio until recently, receive 10% of the state contracts, while African-Americans receive none." In addition, the state's records do not report the total use of minority firms, only those minority firms certified by the state.

There was no record that any consideration had been given by the Ohio General Assembly to race-neutral alternatives to the program.

The program contained no deadline.

F. Buddie Construction Co. v. City of Elyria, Ohio, 773 F.Supp. 1018 (N.D. Ohio 1991): The program was a *quota system* under which the following percentages of the total value of contracts for over $20,000 were awarded to minority business enterprises: 14% for construction, repair or maintenance contracts; 5% for supplies, services, or professional contracts. For contracts over $30,000, the following total percentages of the total dollar value of contracts were awarded to women's business enterprises: 3% for construction, repair or maintenance contracts; 3% for supplies, services or professional contracts. No race-neutral program had been tried by the city. The city declared that it had only a "goal" of meeting minority contract participation, but it applied the percentage to the MBEs and the WBEs, "without a finding of past discrimination by the city or by contractors or subcontractors in regard to city contracts. Calling a quota a goal will not convert a quota into a goal. A quota is a quota no matter what it is called." [At 1032]

The city failed to objectively provide for qualified minority business enterprises and women business enterprises. MBEs and WBEs were simply defined as a business at least 51% owned by one or more minorities who share in the capital invested to establish and maintain the business entity as well as in the profits and/or losses of the business. A WBE was defined as a

business at least 51% owned by one or more women who share in the capital invested as well as the profits or losses of the business. Nothing in those definitions objectively provided for the trade qualifications of particular MBEs or WBEs; they qualified merely by their race or gender.

There was no time limitation on the program. The limitation could be expressed in a chronological date or in term of when the program had achieved success, but a time line was necessary to the legality of the program.

Contractor's Association of Eastern Pennsylvania v. Philadelphia, 91 3d 586 (3rd Cir. 1996): Philadelphia's minority set-aside "goals" were adopted in 1982, and were based on Chapter 17-500 of the Philadelphia Code. The programs were extended for a number of years in 1987. Chapter 17-500 provided for increased participation in city contracting of "disadvantaged business enterprises," (DBEs), which were defined as those "at least owned by 'socially and economically disadvantaged' persons." It also contained participation "goals" for different categories of DBEs: racial minorities (15%), women (10%), and handicapped (2%). These percentage goals were based on the total dollar volume of certain categories of city contracts. In the construction area an elaborate set of presumptions and rules created a protected segment of city construction work in which non-DBE contractors could not compete.

The city was unable to provide evidence to prove that its 15% set-aside for minorities was necessary to remedy discrimination against black contractors in the market for prime contracts. Other race-neutral remedies were also available to ease the burden of minority contractors attempting to compete for city contracts, including simplification and relaxation of its procurement processes, training and financial assistance for disadvantaged contractors of all races, and the advanced review and certification of minority contractors.

Engineering Contractors Association v. Metro Dade County, 122 F3d. 895 (11th Cir. 1997), Cert denied by U.S. Supreme Court: the county had a black business enterprise program (BBE), a Hispanic Business Enterprise program (HBE), and a Minority & Women Business Enterprise program (MWBE). Participation goals were established for each of these programs with respect to construction contracts: 15% for BBEs, 19% for BHEs and 11% for MWBEs. The county could use any one of five "contract measures" to meet the goals:

1. Set-asides solely for MWBEs.

2. Subcontractor goals. Prime contractor required to subcontract certain percentage of work to MWBEs, on a case-by-case basis.

3. Project goals. County created a pool of MWBE subcontractors from which it selects firms for specified projects under county contracts.

4. Bid preferences. Artificially reduces an MWBE's bid price by as much as 10% for the purposes of determining the lowest bid.

5. Other selection factors. Similar to the bid preference, but operates on weights assigned to factors other than price.

Court declared that certain race-based remedies should be used only as a "last resort." Here no consideration had been given to race-neutral remedies. Many of the problems to which the county attributed to discrimination were actually institutional problems that could have been resolved by changing the county's contracts processes and procedures.

[Also see Associated General Contractors of America v. Columbus, 936 F.Supp. 1863 (S.D Ohio 1996.]

Programs Narrowly-Tailored

Adarand Constructors, Inc. v. Slater, 228 F.3d 1147 (10th Cir. 2000): The U.S. Department of Transportation let a prime contract to Mountain Gravel & Construction Company (MGCC) MGCC then solicited bids from subcontractors for guardrails. Adarand, a Colorado company specializing in guardrail work submitted the low bid. However, a clause in the U.S. DOT prime contract with MGCC provided that "Mountain Gravel would receive additional compensation if it hired subcontractors certified as small businesses controlled by 'socially and economically disadvantaged individuals.'" MGCC awarded the contract to Gonzolez Construction Company, which was so certified. The federal program was subsequently modified.

Under old federal regulations the program was not narrowly tailored with respect to race-neutral alternatives. However, new federal regulations require the use by highway funds recipients of race-neutral means to reach minority contract participation goals, and outline several race-neutral means to achieve those goals.

Under the new regulations, generally a disadvantaged business enterprise is limited to certification for approximately 10-1/2 years, and is subject to "graduation" from the program when it achieves a certain level of economic progress.

Under both the old regulations the program did not, and under the new regulations the program does not, compel the prime contractor to select a DBE subcontractor.

The new regulations also do a better job of requiring a nexus between the numerical goals and the amelioration of discrimination in the construction contracts field. Now the "overall goal must be based on demonstrable evidence of the availability of ready, willing and able DBEs relative to all businesses ready, willing and able to participate in [the recipient's] DOT assisted contracts. Only good faith efforts to meet the goal is required."

Coral Construction Co. v. King County, 941 F.2d 910 (9th Cir.1991): Court declared that the substantive provisions of the minority set-aside program itself met the narrow-tailoring test. That program provided two methods by which minority and women's business enterprises (MWBE's) could receive preferences on county contracts:

- On contracts of $10,000 or less, the "percentage preference methods" gives an MWBE or a bidder who will use MWBEs on a project preference when its bid is within 5% of the lowest bid.

- On contracts of more than $10,000 the "subcontractor set-aside method" applies, under which the successful contractor must use MWBEs for a prescribed percentage of the work performed on the contract. Those percentages are determined on an ad hoc basis according to the availability of MWBEs.

Several variations on those two methods could be used.

The Court had these observations about those two methods with respect to minority

business enterprises (MBEs):

The government is required to exhaust race-neutral remedies that it is authorized to enact, (In this case King County considered, but under Washington Law, could not avoid, bonding requirements, or extend credit to businesses), and can mix race-neutral and MBE programs to insure that its MBE program is narrowly tailored. (County annually hosted one or two training sessions for small businesses, and provides information on accessing small business assistance programs). King County had carried its burden in this area.

An indication of a narrowly tailored program is the use of minority utilization goals on a case-by-case basis rather than upon a system of rigid numerical goals--in short, "flexibility." The King County program was flexible. Under the "percentage preference method," there were no quotas because no MBE would receive a contract preference if its bid was not within the specified 5%. Under the "subcontractor set aside method" the prescribed percentage of MBE subcontractor participation was determined individually on each contract according to the availability of qualified MBEs.

However, the Court also found that the program failed the third prong of the narrow tailoring test: an MBE program must be limited in effective scope to the boundaries of the enacting jurisdiction. The King County program provided that a minority-owned business was entitled to preferential treatment if it had been discriminated against "in the particular geographical area in which [it] operates." The only question that King County could ask, declared the Court, was whether a business had been discriminated against in King County.

O'Donnell Construction Company v. District of Columbia, 762 F.Supp. 354 (D.D.C. 1991): Two minority set-aside goal programs withstood initial review. Plaintiff sought an injunction against two District of Columbia set-aside programs. The Minority Contracting Act passed in 1977, provided that the District of Columbia would "allocate its construction contracts in order to reach the goal of 35 percent...of the dollar volume of all construction contracts to be let to local [MBEs]..." [At 357] An MBE was defined as a business enterprise of which more than 50% of the ownership and control is held by individuals who are members of a minority, and of which more than 50% of the net profit or loss accrues to members of a minority. A "local" MBE was defined as an MBE with its principal office physically located in the District of Columbia. All firms participating in the program had to be issued a certificate of registration. A Minority Business Opportunity Commission was responsible for certification and enforcement. It was also responsible for designing programs to help minority contractors. One of the programs it designed was a "sheltered market." Under the sheltered market program certain contracts were designated for competition only among MBEs.

The Disadvantaged Business Enterprise Program was in the form of the Surface Transportation and Uniform Relocation Assistance Act of 1987. It provided that recipients of federal aid make reasonable efforts to award at least 10% of the funds to disadvantaged funds, generally with respect to state highway construction projects. One way that a state could achieve the overall goal was to set individual goals for disadvantaged business subcontractor participation, based on the availability of BDEs in desired areas of expertise. The District of Columbia set an overall goal of awarding 37% of federally-funded contracts to DBEs, and a goal of 37% of the total dollar volume for DBEs where the prime contractor had subcontracting possibilities.

The District satisfied the requirement that the program be narrowly tailored. The program included many of the race-neutral measures suggested in Croson, and the Committee

considered whether those remedies might by themselves be adequate to serve the purposes of the Act, and concluded that they would not. Furthermore, reasoned the Court, the Committee had established a nexus between its goal of 35% and the scope of the injurious discrimination. It had first considered a goal of 50%, but had decided that minority contractors could not operate at that level, and ultimately adjusted that figure to 35%.

The Court did have trouble with the plaintiff's argument that in reality not 35%, but over 90%, of all locally funded road construction contracts had been placed in the sheltered. While the Court reasoned that it was not necessary that each category of contracts reflect the 35% goal, it did conclude that "more submissions" were necessary to resolve that question.

With respect to the Disadvantaged Business Enterprise Program, the same statistical evidence that supported the 37% set-aside in the District of Columbia Minority Contracting Act supported this program. But the court did determine that the plaintiff's argument that in reality 49% of all federally-funded road construction projects raised a significant question as to whether the program had been narrowly tailored.

Another Potential Problems With Set-Asides: Lack of Legislative Authority

The courts have ignored a problem with local government minority set-asides briefly, but inconclusively, addressed in Croson: limitations on their legislative authority. [At 102 L.Ed. 879-881, particularly last paragraph on 880]. There is no general state statute supporting either set-asides or goals. While the Small Business and Minority-Owned Business Purchasing and Contracting Act found at Tennessee Code Annotated, ' 12-3-801, provides for the Commissioner of General Services to develop race-conscious procurement regulations (to be approved by the Board of Standards), there is no similar legislation with respect to local governments. While that Act contains no numerical goals, Tennessee Attorney General's Opinion 91-01, opines that Tennessee Code Annotated, ' 12-3-801, is not even supported by the appropriate finding of legislative facts required by City of Richmond v. Croson, above. Associated General Contractors of Ohio, Inc. v. Drabik, 214 F.3d 730 (6th Cir. 2000), supports that opinion.

Tennessee Attorney General's Opinion 87-83, also opines that the Memphis Board of Education cannot establish "policy preferences" with respect to purchases from minority businesses without legislative authority because such preferences would conflict with competitive purchasing laws. The Municipal Purchasing Law, found at Tennessee Code Annotated, ' 6-56-301 et seq. contains no authority for municipalities to take race into consideration in the awarding of municipal purchasing contracts. There may be some municipal charters in Tennessee that contain such authority; that would have to be determined on a city-by-city basis. The term "competitive bidding" is defined in State ex rel. Wright v. Leech, 622 S.W.2d 807 (Tenn. 1981). The Court reaches to similar definitions by other courts, all of which make much of bidders being placed on "the same plane of equality...", or "on terms of perfect quality...." It is difficult to envision the Court contemplated set-asides in those concepts.

In addition, the U.S. Sixth Circuit Court of Appeals in Owen of Georgia, Inc. v. Shelby County, 648 F.2d 1084 (1981), held that Shelby County could not award a county purchasing contract to the second lowest bidder on the grounds that he employed more minority employees than the lowest bidder, and was a local firm. The Court rejected Shelby County's argument that under the Shelby County Restructure Act, the county could reject any and all bids for "good cause," and that "good cause" included the consideration of the number of employees a bidder employed, and whether the bidder was a local firm.