Narrow Tailoring the Federal Transportation DBE Program

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Introduction

Under the Supreme Court's strict scrutiny test, governments must have both a compelling interest to employ a racial classification in a program and that use of race must be narrowly tailored. After *Adarand Constructors, Inc. v. Pena*,[1] the Clinton Administration took steps to buttress the Disadvantaged Business Enterprise (DBE) components in the massive federal transportation subsidy programs. The DBE classification which makes firms eligible for preferences in meeting contracting goals relies on racial, ethnic and gender presumptions about which firm owners are economically and socially disadvantaged.[2] Under its "mend, don't end" philosophy toward affirmative action, new studies and reports were created to provide the compelling interest prong for the DBE program, while some administrative revisions were made to meet the narrow tailoring test.

These program patches have survived several plaintiff challenges, but in May 2005 the 9th Circuit in *Western States Paving Co. Inc. v. Washington State Department of Transportation* (WSDOT) found WSDOT's administration of the DBE program failed the narrow tailoring test and was unconstitutional.[3] The U.S. Department of Justice (USDOJ) decided not to appeal the decision and, six months later, the US Department of Transportation (USDOT) issued new narrow tailoring requirements that it insisted applied only to federal aid recipients in the 9th Circuit states. The USDOJ and USDOT responses to the case, however, will inevitably influence the administration of DBE programs across the country.

Federal transportation subsidies to highways, rapid transit districts, ports, and airports are longstanding, huge expenditures.[4] Beginning in 1982, there has been a requirement that DBEs receive a portion of those funds. For years, the standard DBE allotment required of every recipient, unless waivers were given, was a minimum quota of 10% of all federal transportation dollars. After the Clinton Administration post-*Adarand* adjustments, the DBE program was made more flexible and each recipient was given the responsibility to determine its overall annual goal, as well as goals on particular contracts. The annual goals were to be based on measures of the availability of DBEs and non-DBEs in local markets and could be upwardly adjusted for the effects of local discrimination, if any. Some goals, therefore, were much higher than 10% and some much lower.

The availability measure is absolutely critical in the operation of a DBE program, since it determines the share of contract dollars DBEs are expected to get. If the availability percent is set too high, a large annual goal will result. Very substantial individual contract goals, then, will have to be established to meet the inflated annual goal. The impact on non-DBEs can be severe.

Concerned that the hundreds of its recipients would be over burdened by the new requirement to determine local availability and, perhaps, wishing to allow recipients to respond to local political pressures, USDOT decided to permit a wide variety of data sources and methodologies to be used for that task. These data sources create very different estimates of DBE availability[5] and USDOT has conducted no research comparing the outcomes or validity of various availability sources. As far as adjusting the goals to account for the effects of discrimination, few recipients even attempted any statistical measures. To make a goal submission proposal to USDOT, about 30% of recipients hired consultants to conduct disparity studies, but most used in-house staff to make rudimentary calculations.

This process was vigorously criticized by the General Accountability Office (GAO) in a 2001 report to Congress.[6] GAO concluded that here were flaws in the way census data and directories were used to set DBE availability because those sources "cannot adequately indicate whether a firm is truly available, that is, whether it has the qualifications, willingness, or ability to complete contracts."[7] These sources could result in an overstatement of available firms for transportation contracting and may not contain current information. Finally, GAO believed that prequalification and bidders lists "may be better sources of availability," but that recipients had misused them.[8]

GAO also reviewed 14 transportation-specific disparity studies completed between 1996 and 2000 and found that:

> the limited data used to calculate disparities, compounded by the methodological weaknesses, create uncertainties about the studies findings. . . . While not all studies suffered from every problem, each suffered enough problems to make its findings questionable. We recognize there are difficulties inherent in conducting disparity studies and that such limitations are common to social science research; however, the studies we reviewed did not sufficiently address such problems or disclose their limitations.[9]

Western States

Despite these criticisms, USDOT did not tighten its requirements for DBE goal setting and the system survived several attempts to attack it. Plaintiffs were unsuccessful in getting courts to engage in any serious analysis of whether Congress had made findings of discrimination anything like those required of state and local governments. Further, the data by which state recipients set goals were not rigorously scrutinized.[10]

Then, in *Western States*, the focus changed. The plaintiff made the obligatory challenge to Congressional findings which were brushed aside by the 9th Circuit as other courts had done. But the plaintiff also argued that WSDOT had done no study about whether there was discrimination in the transportation contracting industry in that state. Therefore, Western States argued WSDOT's use of race conscious goals, instead of race neutral means, to fulfill its DBE goals violated the equal protection clause's narrow tailoring requirement. The USDOJ intervened and vigorously defended Congress's compelling interest finding to create a national program, but agreed that Washington state had to make its own finding of discrimination to set particular race conscious goals, much to the annoyance of WSDOT and USDOT.[11] The 9th Circuit stated, "As the United States correctly observed in its brief and in oral argument, it can not 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 present."[12] Otherwise, the Court noted:

> Whether Washington's DBE program is narrowly tailored to further Congress's remedial objective depends upon the presence or absence of discrimination in the State's transportation industry. If no such discrimination is present in Washington, then the State's DBE program does not serve a remedial purpose; it instead provides an unconstitutional windfall to minority contractors based solely on race.[13]

Now left holding the bag, WSDOT attempted to salvage its position by arguing that discrimination did exist in Washington because there was a fall off in DBE utilization when goals were not required; there was a slight disparity between DBE availability (11.17%) and utilization (9%) on race neutral contracts; and that it had certified DBE owners as socially and economically disadvantaged. The 9th Circuit disagreed with each argument and in its reply added burdens that states will face in justifying race conscious goals.

With regard to the fact that DBEs were less used on contracts without goals than with, the 9th Circuit very commonsensically replied, ". . .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."[14]

Regarding the disparity WSDOT had shown, the 9th Circuit replied that a small disparity standing alone has no probative value in proving discrimination and, then, dealt a knockout blow to many existing disparity studies by stating:

> This oversimplified statistical evidence is entitled to little weight, however, because it does not because it does not account for factors that may affect the relative capacity of DBEs to undertake contracting work. . . . 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 geographical areas of the State, rendering them unavailable for a disproportionate amount of work.[15]

Few existing disparity studies meet that evidentiary standard.

With regard to DBE certification as evidence of discrimination, the 9th Circuit noted that the affidavits DBEs signed do not require them to attest that they have suffered discrimination in the transportation industry, but merely that they have been subject to some kind of racial ethnic or cultural bias at some time.[16] Citing *Croson,* the 9th Circuit affirmed, "Such claims of societal discrimination—and even generalized assertions about discrimination in an entire industry—cannot be used to justify race conscious measures."[17]

Now USDOT had a significant problem on its hand. The 9th Circuit had found there were flaws in the way most recipients operated their DBE programs. That Department did not agree with the *Western States* ruling, but USDOJ "speaks for the United States" and Justice had declined to appeal *en banc* or petition for certiorari. Recipients, without evidence of local discrimination, wondering whether their race conscious programs were now indefensible, clamored for advice from USDOT. Though all judicial rulings on the matter have found that Congress had a compelling interest in establishing the regime of preferences in federal transportation contracting, USDOJ had "unambiguously conceded that T-21's race-conscious measures can be constitutionally applied only in those states where the effects of discrimination are present."[18] In this situation, the 9th Circuit's *Western States* decision adopted the standards of *City of Richmond v. Croson*[19] and its progeny in their requirements for finding local discrimination. Congressional findings, thus, became irrelevant in administering race conscious local DBE programs.

USDOT *Western States* Interpretations

USDOT has issued two documents: "What actions must State Transportation Agencies (STAs) and FHWA take in compliance with 48 CFR part 26 for FY 2006" (hereafter actions); and "Questions and Answers Concerning Response to *Western States Paving Co. v. Washington State Department of Transportation."* (hereafter Q&A) giving its interpretation of the new obligations of recipients under *Western States*.

Both documents concede that *Western States* requires fundamental changes in the operation of DBE programs for all recipients of federal transportation funds in the 9th Circuit jurisdictions (Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington). But they also try to confine these changes to recipients in the 9th Circuit. That is a technically correct interpretation, since 9th Circuit decisions are legally binding only in that Circuit. But given

statements USDOJ made in the case and its choice not to appeal the decision, it can be argued, as USDOT lawyers admit, that "the United States" has accepted at least some *Western States* rulings about narrow tailoring the DBE program. Further, the 9th Circuit decision is consistent with *Croson* and other circuit decisions about state and local preferential contracting programs. So the implications of *Western States* are national and, as one consulting company has stated, the decision provides "a blueprint for groups wishing to challenge DBE programs in other states."

While recipients can always use race neutral means to meet their goals, USDOT has changed the rules for employing race conscious goals and how availability is calculated for recipients in the 9th Circuit. The most important new rules are:

1. Recipients should ascertain the evidence of discrimination for each separate group presumed to be disadvantaged.[20]

In the past, USDOT has tried to insist that the DBE inclusive category precluded the necessity of race, ethnic and gender specific findings that *Croson* and it progeny required for state and local MWBE programs. Now in the 9th Circuit, at least, there will have to be findings about discrimination for each principal group. (Black Americans, Hispanic Americans, Native Americans, Asian-Pacific Americans, Subcontinent Asian Americans and women).[21] The result of this requirement is that such findings will be rarely made for smaller groups (Asian-Americans in Montana, for example) and even major groups, (particularly white women) are often times not underutilized. When some groups are excluded from the preferences and treated like non-DBEs, the politics for supporting the program inside and outside recipient agencies changes. So moving to group specific findings is very significant.

2. Disparity studies should be done with more rigor.

USDOT has said, "Recipients should exercise caution in drawing conclusions about the presence of discrimination and its effects based on small differences."[22] Further, ". . .the study should rigorously determine the effects of factors other than discrimination that may account for statistical disparities between DBE availability and participation. This is likely to require multivariate/regression analysis."[23] This guidance is enormously significant for several reasons. First, it appears to shift the burden of proof that a study must meet from the simple showing of disparities to showing the disparities were caused by discrimination after controlling for size, age, qualifications, etc. through multiple regression. Almost no existing disparity study meets that standard. Most disparity consultants do not have the necessary skills.

USDOT has also instructed recipients, "In calculating availability of DBEs, the study should not rely on numbers that may have been inflated by race-conscious programs that may not have been narrowly tailored."[24] This guidance is important because many recipients had determined DBE availability by past utilization without making any independent new assessment and thus continued to replicate preference inflated availability. Further, it undermines the logic of one of USDOT's principal defenses of DBE programs, *i.e* that when they are discontinued DBE utilization falls.

USDOT also instructed that, "The study should include an assessment of any anecdotal and complaint evidence of discrimination."[25] While most disparity studies include anecdotal data, they almost never include data about formal complaints of discrimination because such complaints are very few and after investigation only rarely found to be caused by discrimination. Both *Croson* and *Western State*s suggest that if there are few complaints of discrimination that may suggest that the "patterns of deliberate exclusion" that would constitute a compelling interest do not exist.

USDOT suggested that recipients should consider evidence such as bonding and financing, disparities in business and formation and earnings. It is not clear where this suggestion will lead. If societal discrimination and generalized assertions about discrimination in an entire industry are not a sufficient basis for a race conscious remedy as *Croson* and *Western States* affirm, then why would a DBE construction goal be a narrowly tailored remedy for finding of discrimination in the banking or surety industries?

Finally, USDOT, citing *Sherbrooke, Gross Seed,* and *Northern Contracting,* said that recipients should consider the "evidence gathering efforts that Federal courts have approved in the past."[26] But the studies in those cases did not meet the *Western States*' standards and their data were subject only to cursory judicial scrutiny.

Creating new studies according to USDOT guidance

It is clear that recipients will now have to invest in studies that will not only measure availability in a more sophisticated manner, but establish the existence of discrimination as well. This means:

1. Each state should create a disparity study that covers highways, airports, and transit recipients. If done properly, that would require separate availability measures, since different types of services are required in the different transit modes.

2. According to USDOT, "Larger transit and/or airport districts may want to conduct their own studies, since the demographics of large urban areas may differ from that of the state as a whole."[27] Perhaps USDOT has in mind that more DBE firms will be available in "large urban areas," but conversely fewer will be available in smaller areas. Thus a statewide study can not reveal what availability should be for airports in San Luis Obispo or Spokane. Further, each recipient will have its own utilization statistics.

3. The cost of these studies can be "defrayed" by federal funds. "FHWA, FTA, and FAA have all stated that the costs of conducting disparity studies are reimbursable from Federal program funds, subject to the availability of those funds."[28] It would not be unreasonable to predict that the initial round of compliance with the new *Western States* rules will be about $20 to $30 million dollars of disparity studies. The new studies will have to be done to higher standards than past studies and that will require more difficult-to-find data. Further, the life span of the study should only be about three years. Goals are set every year.

4. A new process for reviewing goals (and therefore the studies used to create the goals) has been established. According to the "action" document, all state goals will be reviewed by USDOT headquarters. "For those matters in litigation, or risk of litigation," the Office of General Counsel will review the goals.[29] Also in need of further review are situations where there is substantial change in the goal setting methodology or significant controversy about the evidence relied on. The Q&A document states that, in the 9th Circuit, recipient goals will require the concurrence of the Office of the Chief Counsel in D.C. and the FHWA and/or the FTA Offices for Civil Rights. For some reason, the FTA process has not changed. New rules probably will emerge from this new review process that will limit the discretion of recipients in establishing goals.

This new disparity study process will determine the expenditures of billions of dollars as well as shape constitutional rights in the contracting field. This suggests several policy considerations. First, USDOT should provide clearer guidance about what methodologies will produce acceptable proofs of discrimination. Fortunately, in March 2006, the U.S. Commission on Civil Rights will release its report on disparity studies which will provide some guidelines about their conduct.[30] Second, the disparity study process needs to be much more transparent. Currently, USDOT requires public comment on recipient DBE goals, but not on the studies that underlie the goals. There should be a requirement for public hearings on studies and the underlying study data should be publicly accessible. That would serve the purpose of making sure the agency has the data and that it is complete and accurate when checked by independent researchers. Few agencies ever examine the underlying data on which their preferential programs are based. Several jurisdictions have been embarrassed to find that their consultants had destroyed or lost the underlying data, leaving the jurisdiction unable to defend its DBE or MWBE program in litigation.

There may be as many as 200 individual recipients of federal transportation funds in the 9th Circuit. Each of them will be interesting case studies in the application of *Western States*. Some recipients (Arizona and Hawaii, for example) have already converted to race neutral programs, but USDOT says that all state recipients need to complete disparity studies to determine if race conscious programs are warranted. Even assuming some studies will be statewide or regional consortiums, the disparity study industry (now down to about three major providers) does not appear to have the capacity to meet the new demand. Further race conscious programs must now be approved by several layers of bureaucracy, so there will be the development of a lot of applied law in this process. Monitoring these policies on what are valid disparity studies and, therefore, valid race conscious policies will be the focus of civil rights lawyers in the 9th Circuit and elsewhere for the next several years.

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Footnotes

[1] 515 U.S. 200, (1995) (hereafter *Adarand*).

[2] The preferred racial and ethnic groups are: Black (a person having origins in any of the original racial groups of Africa); Hispanic(a person of Mexican-American, Puerto Rican, Cuban, Central or South American, or other Spanish or Portuguese origin or culture, regardless of race); Native American(an American Indian, Eskimo, Aleut or Native Hawaiian); Asian- American (Burma, Thailand, Malaysia, Indonesia, Singapore, Brunei, Japan, China, Taiwan, Laos, Cambodia (Kampuchea), Vietnam, Korea, The Philippines, U.S. Trust Territory of the Pacific Islands (Republic of Palau), Republic of the Marshall Islands, Federated States of Micronesia, the Commonwealth of the Northern Mariana Islands, Guam, Samoa, Macao, Hong Kong, Fiji, Tonga, Kiribati, Tuvalu, Nauru, India, Pakistan, Bangladesh, Sri Lanka, Bhutan, the Maldives Islands and Nepal.

[3] 407 F.3d 983 (9th Cir. 2005). Western States Paving was the low bidder by $100,000 on a subcontract for a project substantially financed by T-21 funds. The prime contractor acknowledged that he selected a DBE to meet the project's 14% goals. At 983.

[4] The most recent extension of the federal transportation programs called SAFETEA-LU authorizes $244 billion to be spent between FY 2005 and FY 2010.

[5] Occasionally a recipient will report the results of measuring availability with different data sources. For New Jersey Transit, consultants reported that when census data were considered, DBE availability was 22.20%, Dun & Bradstreet data 11.82% and measuring the actual numbers of certified DBEs 8.64%. The NJT consultants solved the problem of the wide variation in availability by averaging the three sources to create an annual DBE goal of 14.22%. Final Report to Establish New Jersey Transit's FY 2006 DBE Goals, December 2005, p.12.

[6] GAO, GAO Report GAO-01-586, Disadvantaged Business Enterprises: Critical Information is needed to Understand Program Impact (June 8, 2001).

[7] *Id*. at 50.

[8] *Id*. at 31.

[9] *Id*. at 29.

[10] Gross Seed Company v. Nebraska Department of Roads and Sherbrooke Turf, Inc. v. Minnesota Department of Transportation, 345 F.3rd 964 (8th Cir. 2003) and Northern Contracting, Inc. v. Illinois Department of Transportation, 2005 U.S. District Lexis 1986 8 (N.D. Ill. 2004).

[11] *Western States* at 996.

[12] *Id*. at 998.

[13] *Id*. at pp. 997-998.

[14] *Id*. at 1001.

[15] *Id*. at pp.1000-1001.

[16] *Id*. at 1002. Even this process is entirely *pro forma*. No one asks for any details or checks the accuracy of any statement made in these affidavits used by every state DOT.

[17] *Id*. *Croson*, 488 U.S. at 488.

[18] *Id*. at 996.

[19] 488 U.S. 469 (1989).

[20] Q&A, p.4.

[21] *Western States* at 998-999.

[22] Q&A, p.4.

[23] *Id*.

[24] *Id*.

[25] *Id*.

[26] *Id*., pp. 4-5.

[27] *Id.* at 5.

[28] *Id*.

[29] Action, p.2.

[30] Disparity Studies as Evidence of Discrimination in Federal Contracting. March 2006.