No. 00-730

In the Supreme Court of the United States

ADARAND CONSTRUCTORS, INC., PETITIONER

v.

NORMAN Y. MINETA, SECRETARY OF TRANSPORTATION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

APPENDIX TO THE BRIEF FOR THE RESPONDENTS

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APPENDIX A

CONSTITUTIONAL PROVISIONS

1. The Spending Clause of the United States Constitution, U.S. Const. Art. 1, § 8, Cl. 1, provides:

The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defense and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

2. The Fifth Amendment to the United States Constitution, U.S. Const. Amend. V, provides:

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

3. The Fourteenth Amendment to the United States Constitution, U.S. Const. Amend. XIV, provides in pertinent part:

SECTION 1. * * * No state shall * * * deny to any person within its jurisdiction the equal protection of the laws.

* * * * *

SECTION 5. The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

APPENDIX B

THE TRANSPORTATION EQUITY ACT FOR THE 21ST CENTURY

The Transportation Equity Act for the 21st Century, Pub. L. No. 105-178, Tit. I, § 1101, 112 Stat. 111, provides in pertinent part:

An Act

To authorize funds for Federal-aid highways, highway safety programs, and transit programs, and for other purposes.

June 9, 1998
[H.R. 2400]

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * *

TITLE I—FEDERAL AID HIGHWAYS

Subtitle A—Authorizations and Programs

SEC. 1101. AUTHORIZATION OF APPROPRIATIONS.

(a) IN GENERAL.—The following sums are authorized to be appropriated out of the Highway Trust Fund (other than the Mass Transit Account):

* * * * *

(b) DISADVANTAGED BUSINESS ENTERPRISES.—

(1) GENERAL RULE.—Except to the extent that the Secretary determines otherwise, not less than 10 percent of the amounts made available for any program under titles I, III, and V of this Act shall be expended with small business

concerns owned and controlled by socially and economically disadvantaged individuals.

(2) DEFINITIONS.—In this subsection, the following definitions apply:

(A) SMALL BUSINESS CONCERN.—The term "small business concern" has the meaning such term has under section 3 of the Small Business Act (15 U.S.C. 632); except that such term shall not include any concern or group of concerns controlled by the same socially and economically disadvantaged individual or individuals which has average annual gross receipts over the preceding 3 fiscal years in excess of $16,600,000, as adjusted by the Secretary for inflation.

(B) SOCIALLY AND ECONOMICALLY DISADVANTAGED INDIVIDUALS.—The term "socially and economically disadvantaged individuals" has the meaning such term has under section 8(d) of the Small Business Act (15 U.S.C. 637(d)) and relevant subcontracting regulations promulgated pursuant thereto; except that women shall be presumed to be socially and economically disadvantaged individuals for purposes of this subsection.

(3) ANNUAL LISTING OF DISADVANTAGED BUSINESS ENTERPRISES.—Each State shall annually survey and compile a list of the small business concerns referred to in paragraph (1) and the location of such concerns in the State and notify the Secretary, in writing, of the percentage of such concerns which are controlled by women, by socially and economically disadvantaged individuals (other than women), and by individuals who are women and are otherwise socially and economically disadvantaged individuals.

(4) UNIFORM CERTIFICATION.—The Secretary shall establish minimum uniform criteria for State governments to

use in certifying whether a concern qualifies for purposes of this subsection. Such minimum uniform criteria shall include, but not be limited to on-site visits, personal interviews, licenses, analysis of stock ownership, listing of equipment, analysis of bonding capacity, listing of work completed, résumé of principal owners, financial capacity, and type of work preferred.

(5) COMPLIANCE WITH COURT ORDERS.—Nothing in this subsection limits the eligibility of an entity or person to receive funds made available under titles I, III, and V of this Act, if the entity or person is prevented, in whole or in part, from complying with paragraph (1) because a Federal court issues a final order in which the court finds that the requirement of paragraph (1), or the program established under paragraph (1), is unconstitutional.

(6) REVIEW BY COMPTROLLER GENERAL.—Not later than 3 years after the date of enactment of this Act, the Comptroller General of the United States shall conduct a review of, and publish and report to Congress findings and conclusions on, the impact throughout the United States of administering the requirement of paragraph (1), including an analysis of—

(A) in the case of small business concerns certified in each State under paragraph (4) as owned and controlled by socially and economically disadvantaged individuals—

(i) the number of the small business concerns; and

(ii) the participation rates of the small business concerns in prime contracts and subcontracts funded under titles I, III, and V of this Act;

(B) in the case of small business concerns described in subparagraph (A) that receive prime contracts and subcontracts funded under titles I, III, and V of this Act—

(i) the number of the small business concerns;

(ii) the annual gross receipts of the small business concerns; and

(iii) the net worth of socially and economically disadvantaged individuals that own and control the small business concerns;

(C) in the case of small business concerns described in subparagraph (A) that do not receive prime contracts and subcontracts funded under titles I, III, and V of this Act—

(i) the annual gross receipts of the small business concerns; and

(ii) the net worth of socially and economically disadvantaged individuals that own and control the small business concerns;

(D) in the case of business concerns that receive prime contracts and subcontracts funded under titles I, III, and V of this Act, other than small business concerns described in subparagraph (B)—

(i) the annual gross receipts of the business concerns; and

(ii) the net worth of individuals that own and control the business concerns;

(E) the rate of graduation from any programs carried out to comply with the requirement of paragraph (1) for small business concerns owned and controlled by socially and economically disadvantaged individuals;

(F) the overall cost of administering the requirement of paragraph (1), including administrative costs, certification costs, additional construction costs, and litigation costs;

(G) any discrimination on the basis of race, color, national origin, or sex against small business concerns owned and controlled by socially and economically disadvantaged individuals;

(H) (i) any other factors limiting the ability of small business concerns owned and controlled by socially and economically disadvantaged individuals to compete for prime contracts and subcontracts funded under titles I, III, and V of this Act; and

(ii) the extent to which any of those factors are caused, in whole or in part, by discrimination based on race, color, national origin, or sex;

(I) any discrimination, on the basis of race, color, national origin, or sex, against construction companies owned and controlled by socially and economically disadvantaged individuals in public and private transportation contracting and the financial, credit, insurance, and bond markets;

(J) the impact on small business concerns owned and controlled by socially and economically disadvantaged individuals of—

(i) the issuance of a final order described in paragraph (5) by a Federal court that suspends a program established under paragraph (1); or

(ii) the repeal or suspension of State or local disadvantaged business enterprise programs; and

(K) the impact of the requirement of paragraph (1), and any program carried out to comply with paragraph (1), on competition and the creation of jobs, including the creation of jobs for socially and economically disadvantaged individuals.

APPENDIX C

SECTION 8(D) OF THE SMALL BUSINESS ACT

Section 8(d) of the Small Business Act, 15 U.S.C. 637(d) (1994 & Supp. V 1999), as amended Pub. L. No. 106-554, § 1(a)(9) [Tit. VI, § 615(b), Tit. VIII, § 803], 114 Stat. 2763, 2763A-667, 2763A-701 to 2763A-703, provides in pertinent part:

(d) **Performance of contracts by small business concerns; inclusion of required contract clause; subcontracting plans; contract eligibility; incentives; breach of contract; review; report to Congress**

(1) It is the policy of the United States that small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women, shall have the maximum practicable opportunity to participate in the performance of contracts let by any Federal agency, including contracts and subcontracts for subsystems, assemblies, components, and related services for major systems. It is further the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women.

(2) The clause stated in paragraph (3) shall be included in all contracts let by any Federal agency except any contract which—

(A) does not exceed the simplified acquisition threshold;

(B) including all subcontracts under such contracts will be performed entirely outside of any State, territory, or possession of the United States, the District of Columbia, or the Commonwealth of Puerto Rico; or

(C) is for services which are personal in nature.

(3) The clause required by paragraph (2) shall be as follows:

"(A) It is the policy of the United States that small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women shall have the maximum practicable opportunity to participate in the performance of contracts let by any Federal agency, including contracts and subcontracts for subsystems, assemblies, components, and related services for major systems. It is further the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women.

"(B) The contractor hereby agrees to carry out this policy in the awarding of subcontracts to the fullest extent consistent with the efficient performance of this contract. The contractor further agrees to cooperate in any studies or surveys as may be conducted by the United States Small Business Administration or the awarding agency of the United States as may be necessary to determine the extent of the contractor's compliance with this clause.

"(C) As used in this contract, the term 'small business concern' shall mean a small business as defined pursuant to section 3 of the Small Business Act [15 U.S.C. 632] and relevant regulations promulgated pursuant thereto. The term 'small business concern owned and controlled by socially and economically disadvantaged individuals' shall mean a small business concern—

> "(i) which is at least 51 per centum owned by one or more socially and economically disadvantaged individuals; or, in the case of any publicly owned business, at least 51 per centum of the stock of which is owned by one or more socially and economically disadvantaged individuals; and
>
> "(ii) whose management and daily business operations are controlled by one or more of such individuals.
>
> "The contractor 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 section 8(a) of the Small Business Act [15 U.S.C. 637(a)].

"(D) The term 'small business concern owned and controlled by women' shall mean a small business concern—

> "(i) which is at least 51 per centum owned by one or more women; or, in the case of any publicly owned busi-

ness, at least 51 per centum of the stock of which is owned by one or more women; and

"(ii) whose management and daily business operations are controlled by one or more women.

"(E) The term 'small business concern owned and controlled by veterans' shall mean a small business concern—

"(i) which is at least 51 per centum owned by one or more eligible veterans; or, in the case of any publicly owned business, at least 51 per centum of the stock of which is owned by one or more veterans; and

"(ii) whose management and daily business operations are controlled by such veterans. The contractor shall treat as veterans all individuals who are veterans within the meaning of the term under section 632(q) of this title.

"(F) Contractors acting in good faith may rely on written representations by their subcontractors regarding their status as either a small business concern, small business concern owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, a small business concern owned and controlled by socially and economically disadvantaged individuals, or a small business concern owned and controlled by women.

"(G) In this contract, the term 'qualified HUBZone small business concern' has the meaning given that term in section 632(p) of this Title."

(4)(A) Each solicitation of an offer for a contract to be let by a Federal agency which is to be awarded pursuant to the negotiated method of procurement and which may exceed $1,000,000, in the case of a contract for the construction of any public facility, or $500,000, in the case of all other contracts, shall contain a clause notifying potential offering companies of the provisions of this subsection relating to con-

tracts awarded pursuant to the negotiated method of procurement.

(B) Before the award of any contract to be let, or any amendment or modification to any contract let, by any Federal agency which—

(i) is to be awarded, or was let, pursuant to the negotiated method of procurement,

(ii) is required to include the clause stated in paragraph (3),

(iii) may exceed $1,000,000 in the case of a contract for the construction of any public facility, or $500,000 in the case of all other contracts, and

(iv) which offers subcontracting possibilities,

the apparent successful offeror shall negotiate with the procurement authority a subcontracting plan which incorporates the information prescribed in paragraph (6). The subcontracting plan shall be included in and made a material part of the contract.

(C) If, within the time limit prescribed in regulations of the Federal agency concerned, the apparent successful offeror fails to negotiate the subcontracting plan required by this paragraph, such offeror shall become ineligible to be awarded the contract. Prior compliance of the offeror with other such subcontracting plans shall be considered by the Federal agency in determining the responsibility of that offeror for the award of the contract.

(D) No contract shall be awarded to any offeror unless the procurement authority determines that the plan to be negotiated by the offeror pursuant to this paragraph provides the maximum practicable opportunity for small business concerns, qualified HUBZone small business concerns, small business concerns owned and controlled by veterans,

small business concerns owned and controlled by service-disabled veterans, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women to participate in the performance of the contract.

(E) Notwithstanding any other provision of law, every Federal agency, in order to encourage subcontracting opportunities for small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, and small business concerns owned and controlled by the socially and economically disadvantaged individuals as defined in paragraph (3) of this subsection and for small business concerns owned and controlled by women, is hereby authorized to provide such incentives as such Federal agency may deem appropriate in order to encourage such subcontracting opportunities as may be commensurate with the efficient and economical performance of the contract: *Provided*, That, this subparagraph shall apply only to contracts let pursuant to the negotiated method of procurement.

(F)(i) Each contract subject to the requirements of this paragraph or paragraph (5) shall contain a clause for the payment of liquidated damages upon a finding that a prime contractor has failed to make a good faith effort to comply with the requirements imposed on such contractor by this subsection.

(ii) The contractor shall be afforded an opportunity to demonstrate a good faith effort regarding compliance prior to the contracting officer's final decision regarding the imposition of damages and the amount thereof. The final decision of a contracting officer regarding the contractor's obligation to pay such damages, or the amounts thereof, shall be

subject to the Contract Disputes Act of 1978 (41 U.S.C. 601-613).

(iii) Each agency shall ensure that the goals offered by the apparent successful bidder or offeror are attainable in relation to—

(I) the subcontracting opportunities available to the contractor, commensurate with the efficient and economical performance of the contract;

(II) the pool of eligible subcontractors available to fulfill the subcontracting opportunities; and

(III) the actual performance of such contractor in fulfilling the subcontracting goals specified in prior plans.

(G) The following factors shall be designated by the Federal agency as significant factors for purposes of evaluating offers for a bundled contract where the head of the agency determines that the contract offers a significant opportunity for subcontracting:

(i) A factor that is based on the rate provided under the subcontracting plan for small business participation in the performance of the contract.

(ii) For the evaluation of past performance of an offeror, a factor that is based on the extent to which the offeror attained applicable goals for small business participation in the performance of contracts.

(5)(A) Each solicitation of a bid for any contract to be let, or any amendment or modification to any contract let, by any Federal agency which—

(i) is to be awarded pursuant to the formal advertising method of procurement,

(ii) is required to contain the clause stated in paragraph (3) of this subsection,

(iii) may exceed $1,000,000 in the case of a contract for the construction of any public facility, or $500,000, in the case of all other contracts, and

(iv) offers subcontracting possibilities,

shall contain a clause requiring any bidder who is selected to be awarded a contract to submit to the Federal agency concerned a subcontracting plan which incorporates the information prescribed in paragraph (6).

(B) If, within the time limit prescribed in regulations of the Federal agency concerned, the bidder selected to be awarded the contract fails to submit the subcontracting plan required by this paragraph, such bidder shall become ineligible to be awarded the contract. Prior compliance of the bidder with other such subcontracting plans shall be considered by the Federal agency in determining the responsibility of such bidder for the award of the contract. The subcontracting plan of the bidder awarded the contract shall be included in and made a material part of the contract.

(6) Each subcontracting plan required under paragraph (4) or (5) shall include—

(A) percentage goals for the utilization as subcontractors of small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women;

(B) the name of an individual within the employ of the offeror or bidder who will administer the subcontracting program of the offeror or bidder and a description of the duties of such individual;

(C) a description of the efforts the offeror or bidder will take to assure that small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women will have an equitable opportunity to compete for subcontracts;

(D) assurances that the offeror or bidder will include the clause required by paragraph (2) of this subsection in all subcontracts which offer further subcontracting opportunities, and that the offeror or bidder will require all subcontractors (except small business concerns) who receive subcontracts in excess of $1,000,000 in the case of a contract for the construction of any public facility, or in excess of $500,000 in the case of all other contracts, to adopt a plan similar to the plan required under paragraph (4) or (5);

(E) assurances that the offeror or bidder will submit such periodic reports and cooperate in any studies or surveys as may be required by the Federal agency or the Administration in order to determine the extent of compliance by the offeror or bidder with the subcontracting plan; and

(F) a recitation of the types of records the successful offeror or bidder will maintain to demonstrate procedures which have been adopted to comply with the requirements and goals set forth in this plan, including the establishment of source lists of small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small

business concerns, small business concerns owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women; and efforts to identify and award subcontracts to such small business concerns.

(7) The provisions of paragraphs (4), (5), and (6) shall not apply to offerors or bidders who are small business concerns.

(8) The failure of any contractor or subcontractor to comply in good faith with—

(A) the clause contained in paragraph (3) of this subsection, or

(B) any plan required of such contractor pursuant to the authority of this subsection to be included in its contract or subcontract,

shall be a material breach of such contract or subcontract.

APPENDIX D

DEPARTMENT OF TRANSPORTATION DISADVANTAGED BUSINESS ENTERPRISE REGULATIONS

The Department of Transportations Disadvantaged Business Enterprise Regulations, 64 Fed. Reg. 5127-5148 (1999), to be codified at 49 C.F.R. Pt. 26, provide in pertinent part:

§ 26.1 What are the objectives of this part?

This part seeks to achieve several objectives:

(a) To ensure nondiscrimination in the award and administration of DOT-assisted contracts in the Department's highway, transit, and airport financial assistance programs;

(b) To create a level playing field on which DBEs can compete fairly for DOT-assisted contracts;

(c) To ensure that the Department's DBE program is narrowly tailored in accordance with applicable law;

(d) To ensure that only firms that fully meet this part's eligibility standards are permitted to participate as DBEs;

(e) To help remove barriers to the participation of DBEs in DOT-assisted contracts;

(f) To assist the development of firms that can compete successfully in the marketplace outside the DBE program; and

(g) To provide appropriate flexibility to recipients of Federal financial assistance in establishing and providing opportunities for DBEs.

§ 26.3 To whom does this part apply?

(a) If you are a recipient of any of the following types of funds, this part applies to you:

(1) Federal-aid highway funds authorized under Titles I (other than Part B) and V of the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA), Pub. L. 102-240, 105 Stat. 1914, or Titles I, III, and V of the Transportation Equity Act for the 21st Century (TEA-21), Pub. L. 105-178, 112 Stat. 107.

(2) Federal transit funds authorized by Titles I, III, V and VI of ISTEA, Pub. L. 102-240 or by Federal transit laws in Title 49, U.S. Code, or Titles I, III, and V of the TEA-21, Pub. L. 105-178.

(3) Airport funds authorized by 49 U.S.C. 47101, *et seq*.

(b) [Reserved]

(c) If you are letting a contract, and that contract is to be performed entirely outside the United States, its territories and possessions, Puerto Rico, Guam, or the Northern Marianas Islands, this part does not apply to the contract.

(d) If you are letting a contract in which DOT financial assistance does not participate, this part does not apply to the contract.

§ 26.5 What do the terms used in this part mean?

* * * * *

Contractor means one who participates, through a contract or subcontract (at any tier), in a DOT-assisted highway, transit, or airport program.

Department or DOT means the U.S. Department of Transportation, including the Office of the Secretary, the Federal Highway Administration (FHWA), the Federal Transit Administration (FTA), and the Federal Aviation Administration (FAA).

Disadvantaged business enterprise or DBE means a for-profit small business concern—

(1) That is at least 51 percent owned by one or more individuals who are both socially and economically disadvantaged or, in the case of a corporation, in which 51 percent of the stock is owned by one or more such individuals; and

(2) Whose management and daily business operations are controlled by one or more of the socially and economically disadvantaged individuals who own it.

DOT-assisted contract means any contract between a recipient and a contractor (at any tier) funded in whole or in part with DOT financial assistance, including letters of credit or loan guarantees, except a contract solely for the purchase of land.

Good faith efforts means efforts to achieve a DBE goal or other requirement of this part which, by their scope, intensity, and appropriateness to the objective, can reasonably be expected to fulfill the program requirement.

* * * * *

Personal net worth means the net value of the assets of an individual remaining after total liabilities are deducted. An individual's personal net worth does not include: The individual's ownership interest in an applicant or participating DBE firm; or the individual's equity in his or her primary place of residence. An individual's personal net worth includes only his or her own share of assets held jointly or as community property with the individual's spouse.

Primary industry classification means the four digit Standard Industrial Classification (SIC) code designation which best describes the primary business of a firm. The SIC code designations are described in the Standard Industry Classification Manual. As the North American Industrial Classification System (NAICS) replaces the SIC system, references to SIC codes and the SIC Manual are deemed to refer to the NAICS manual and applicable codes. The SIC Manual and the NAICS Manual are available through the National Technical Information Service (NTIS) of the U.S. Department of Commerce (Springfield, VA, 22261). NTIS also makes materials available through its web site (www.ntis.gov/naics).

Race-conscious measure or program is one that is focused specifically on assisting only DBEs, including women-owned DBEs.

Race-neutral measure or program is one that is, or can be, used to assist all small businesses. For the purposes of this part, *race-neutral* includes gender-neutrality.

Recipient is any entity, public or private, to which DOT financial assistance is extended, whether directly or through another recipient, through the programs of the FAA, FHWA, or FTA, or who has applied for such assistance.

Secretary means the Secretary of Transportation or his/her designee.

Set-aside means a contracting practice restricting eligibility for the competitive award of a contract solely to DBE firms.

Small Business Administration or SBA means the United States Small Business Administration.

Small business concern means, with respect to firms seeking to participate as DBEs in DOT-assisted contracts, a small business concern as defined pursuant to section 3 of the Small Business Act and Small Business Administration regulations implementing it (13 CFR part 121) that also does not exceed the cap on average annual gross receipts specified in § 26.65(b).

Socially and economically disadvantaged individual means any individual who is a citizen (or lawfully admitted permanent resident) of the United States and who is—

(1) Any individual who a recipient finds to be a socially and economically disadvantaged individual on a case-by-case basis.

(2) Any individual in the following groups, members of which are rebuttably presumed to be socially and economically disadvantaged:

(i) "Black Americans," which includes persons having origins in any of the Black racial groups of Africa;

(ii) "Hispanic Americans," which includes persons of Mexican, Puerto Rican, Cuban, Dominican, Central or South American, or other Spanish or Portuguese culture or origin, regardless of race;

(iii) "Native Americans," which includes persons who are American Indians, Eskimos, Aleuts, or Native Hawaiians;

(iv) "Asian-Pacific Americans," which includes persons whose origins are from Japan, China, Taiwan, Korea, Burma (Myanmar), Vietnam, Laos, Cambodia (Kampuchea), Thailand, Malaysia, Indonesia, the Philippines, Brunei, Samoa, Guam, the U.S. Trust Territories of the Pacific Islands (Republic of Palau), the Commonwealth of the Northern Marianas Islands, Macao, Fiji, Tonga, Kirbati, Juvalu, Nauru, Federated States of Micronesia, or Hong Kong;

(v) "Subcontinent Asian Americans," which includes persons whose origins are from India, Pakistan, Bangladesh, Bhutan, the Maldives Islands, Nepal or Sri Lanka;

(vi) Women;

(vii) Any additional groups whose members are designated as socially and economically disadvantaged by the SBA, at such time as the SBA designation becomes effective.

Tribally-owned concern means any concern at least 51 percent owned by an Indian tribe as defined in this section.

You refers to a recipient, unless a statement in the text of this part or the context requires otherwise (i.e., 'You must do XYZ' means that recipients must do XYZ).

§ 26.7 What discriminatory actions are forbidden?

(a) You must never exclude any person from participation in, deny any person the benefits of, or otherwise discriminate against anyone in connection with the award

and performance of any contract covered by this part on the basis of race, color, sex, or national origin.

(b) In administering your DBE program, you must not, directly or through contractual or other arrangements, use criteria or methods of administration that have the effect of defeating or substantially impairing accomplishment of the objectives of the program with respect to individuals of a particular race, color, sex, or national origin.

* * * * *

§ 26.13 What assurances must recipients and contractors make?

(a) Each financial assistance agreement you sign with a DOT operating administration (or a primary recipient) must include the following assurance:

The recipient shall not discriminate on the basis of race, color, national origin, or sex in the award and performance of any DOT-assisted contract or in the administration of its DBE program or the requirements of 49 CFR part 26. The recipient shall take all necessary and reasonable steps under 49 CFR part 26 to ensure nondiscrimination in the award and administration of DOT-assisted contracts. The recipient's DBE program, as required by 49 CFR part 26 and as approved by DOT, is incorporated by reference in this agreement. Implementation of this program is a legal obligation and failure to carry out its terms shall be treated as a violation of this agreement. Upon notification to the recipient of its failure to carry out its approved program, the Department may impose sanctions as provided for under part 26 and may, in appropriate cases, refer the matter for enforcement under 18 U.S.C. 1001 and/or the Program Fraud Civil Remedies Act of 1986 (31 U.S.C. 3801 *et seq.*).

(b) Each contract you sign with a contractor (and each subcontract the prime contractor signs with a subcontractor) must include the following assurance:

The contractor, sub recipient or subcontractor shall not discriminate on the basis of race, color, national origin, or sex in the performance of this contract. The contractor shall carry out applicable requirements of 49 CFR part 26 in the award and administration of DOT-assisted contracts. Failure by the contractor to carry out these requirements is a material breach of this contract, which may result in the termination of this contract or such other remedy as the recipient deems appropriate.

§ 26.15 How can recipients apply for exemptions or waivers?

(a) You can apply for an exemption from any provision of this part. To apply, you must request the exemption in writing from the Office of the Secretary of Transportation, FHWA, FTA, or FAA. The Secretary will grant the request only if it documents special or exceptional circumstances, not likely to be generally applicable, and not contemplated in connection with the rulemaking that established this part, that make your compliance with a specific provision of this part impractical. You must agree to take any steps that the Department specifies to comply with the intent of the provision from which an exemption is granted. The Secretary will issue a written response to all exemption requests.

(b) You can apply for a waiver of any provision of Subpart B or C of this part including, but not limited to, any provisions regarding administrative requirements, overall goals, contract goals or good faith efforts. Program waivers are for the purpose of authorizing you to operate a DBE program that achieves the objectives of this part by means that may

differ from one or more of the requirements of Subpart B or C of this part. To receive a program waiver, you must follow these procedures:

(1) You must apply through the concerned operating administration. The application must include a specific program proposal and address how you will meet the criteria of paragraph (b)(2) of this section. Before submitting your application, you must have had public participation in developing your proposal, including consultation with the DBE community and at least one public hearing. Your application must include a summary of the public participation process and the information gathered through it.

(2) Your application must show that—

(i) There is a reasonable basis to conclude that you could achieve a level of DBE participation consistent with the objectives of this part using different or innovative means other than those that are provided in subpart B or C of this part;

(ii) Conditions in your jurisdiction are appropriate for implementing the proposal;

(iii) Your proposal would prevent discrimination against any individual or group in access to contracting opportunities or other benefits of the program; and

(iv) Your proposal is consistent with applicable law and program requirements of the concerned operating administration's financial assistance program.

(3) The Secretary has the authority to approve your application. If the Secretary grants your application, you may administer your DBE program as provided in your proposal, subject to the following conditions:

(i) DBE eligibility is determined as provided in subparts D and E of this part, and DBE participation is counted as provided in § 26.49;

(ii) Your level of DBE participation continues to be consistent with the objectives of this part;

(iii) There is a reasonable limitation on the duration of your modified program; and

(iv) Any other conditions the Secretary makes on the grant of the waiver.

(4) The Secretary may end a program waiver at any time and require you to comply with this part's provisions. The Secretary may also extend the waiver, if he or she determines that all requirements of paragraphs (b)(2) and (3) of this section continue to be met. Any such extension shall be for no longer than period originally set for the duration of the program.

Subpart B—Administrative Requirements for DBE Programs for Federally-Assisted Contracting

§ 26.21 Who must have a DBE program?

(a) If you are in one of these categories and let DOT-assisted contracts, you must have a DBE program meeting the requirements of this part:

(1) All FHWA recipients receiving funds authorized by a statute to which this part applies;

(2) FTA recipients that receive $250,000 or more in FTA planning, capital, and/or operating assistance in a Federal fiscal year;

(3) FAA recipients that receive a grant of $250,000 or more for airport planning or development.

(b)(1) You must submit a DBE program conforming to this part by August 31, 1999 to the concerned operating administration (OA). Once the OA has approved your program, the approval counts for all of your DOT-assisted programs (except that goals are reviewed and approved by the particular operating administration that provides funding for your DOT-assisted contracts).

(2) You do not have to submit regular updates of your DBE programs, as long as you remain in compliance. However, you must submit significant changes in the program for approval.

(c) You are not eligible to receive DOT financial assistance unless DOT has approved your DBE program and you are in compliance with it and this part. You must continue to carry out your program until all funds from DOT financial assistance have been expended.

* * * * *

§ 26.29 What prompt payment mechanisms must recipients have?

(a) You must establish, as part of your DBE program, a contract clause to require prime contractors to pay subcontractors for satisfactory performance of their contracts no later than a specific number of days from receipt of each payment you make to the prime contractor. This clause must also require the prompt return of retainage payments from the prime contractor to the subcontractor within a specific number of days after the subcontractor's work is satisfactorily completed.

(1) This clause may provide for appropriate penal ties for failure to comply, the terms and conditions of which you set.

(2) This clause may also provide that any delay or postponement of payment among the parties may take place only for good cause, with your prior written approval.

(b) You may also establish, as part of your DBE program, any of the following additional mechanisms to ensure prompt payment:

(1) A contract clause that requires prime contractors to include in their subcontracts language providing that prime contractors and subcontractors will use appropriate alternative dispute resolution mechanisms to resolve payment disputes. You may specify the nature of such mechanisms.

(2) A contract clause providing that the prime contractor will not be reimbursed for work performed by subcontractors unless and until the prime contractor ensures that the subcontractors are promptly paid for the work they have performed.

(3) Other mechanisms, consistent with this part and applicable state and local law, to ensure that DBEs and other contractors are fully and promptly paid.

§ 26.31 What requirements pertain to the DBE directory?

You must maintain and make available to interested persons a directory identifying all firms eligible to participate as DBEs in your program. In the listing for each firm, you must include its address, phone number, and the types of work the firm has been certified to perform as a DBE. You must revise your directory at least annually and make updated information available to contractors and the public on request.

§ 26.33 What steps must a recipient take to address overconcentration of DBEs in certain types of work?

(a) If you determine that DBE firms are so overconcentrated in a certain type of work as to unduly burden the opportunity of non-DBE firms to participate in this type of work, you must devise appropriate measures to address this overconcentration.

(b) These measures may include the use of incentives, technical assistance, business development programs, mentor-protégé programs, and other appropriate measures designed to assist DBEs in performing work outside of the specific field in which you have determined that non-DBEs are unduly burdened. You may also consider varying your use of contract goals, to the extent consistent with § 26.51, to ensure that non-DBEs are not unfairly prevented from competing for subcontracts.

(c) You must obtain the approval of the concerned DOT operating administration for your determination of overconcentration and the measures you devise to address it. Once approved, the measures become part of your DBE program.

* * * * *

Subpart C—Goals, Good Faith Efforts, and Counting

§ 26.41 What is the role of the statutory 10 percent goal in this program?

(a) The statutes authorizing this program provide that, except to the extent the Secretary determines otherwise, not less than 10 percent of the authorized funds are to be expended with DBEs.

(b) This 10 percent goal is an aspirational goal at the national level, which the Department uses as a tool in evaluating and monitoring DBEs' opportunities to participate in DOT-assisted contracts.

(c) The national 10 percent goal does not authorize or require recipients to set overall or contract goals at the 10 percent level, or any other particular level, or to take any special administrative steps if their goals are above or below 10 percent.

§ 26.43 Can recipients use set-asides or quotas as part of this program?

(a) You are not permitted to use quotas for DBEs on DOT-assisted contracts subject to this part.

(b) You may not set-aside contracts for DBEs on DOT-assisted contracts subject to this part, except that, in limited and extreme circumstances, you may use set-asides when no other method could be reasonably expected to redress egregious instances of discrimination.

§ 26.45 How do recipients set overall goals?

(a) You must set an overall goal for DBE participation in your DOT-assisted contracts.

(b) Your 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 on your DOT-assisted contracts (hereafter, the "relative availability of DBEs"). The goal must reflect your determination of the level of DBE participation you would expect absent the effects of discrimination. You cannot simply rely on either the 10 percent national goal, your previous overall goal or past DBE participation rates in your

program without reference to the relative availability of DBEs in your market.

(c) *Step 1.* You must begin your goal setting process by determining a base figure for the relative availability of DBEs. The following are examples of approaches that you may take toward determining a base figure. These examples are provided as a starting point for your goal setting process. Any percentage figure derived from one of these examples should be considered a basis from which you begin when examining all evidence available in your jurisdiction. These examples are not intended as an exhaustive list. Other methods or combinations of methods to determine a base figure may be used, subject to approval by the concerned operating administration.

(1) *Use DBE Directories and Census Bureau Data.* Determine the number of ready, willing and able DBEs in your market from your DBE directory. Using the Census Bureau's County Business Pattern (CBP) data base, determine the number of all ready, willing and able businesses available in your market that perform work in the same SIC codes. (Information about the CBP data base may be obtained from the Census Bureau at their web site, www.census.gov/epcd/cbp/view/cbpview.html.) Divide the number of DBEs by the number of all businesses to derive a base figure for the relative availability of DBEs in your market.

(2) *Use a bidders list.* Determine the number of DBEs that have bid or quoted on your DOT-assisted prime contracts or subcontracts in the previous year. Determine the number of all businesses that have bid or quoted on prime or subcontracts in the same time period. Divide the number of DBE bidders and quoters by the number for all businesses

to derive a base figure for the relative availability of DBEs in your market.

(3) *Use data from a disparity study.* Use a percentage figure derived from data in a valid, applicable disparity study.

(4) *Use the goal of another DOT recipient.* If another DOT recipient in the same, or substantially similar, market has set an overall goal in compliance with this rule, you may use that goal as a base figure for your goal.

(5) *Alternative methods*. Subject to the approval of the DOT operating administration, you may use other methods to determine a base figure for your overall goal. Any methodology you choose must be based on demonstrable evidence of local market conditions and be designed to ultimately attain a goal that is rationally related to the relative availability of DBEs in your market.

(d) *Step 2.* Once you have calculated a base figure, you must examine all of the evidence available in your jurisdiction to determine what adjustment, if any, is needed to the base figure in order to arrive at your overall goal.

(1) There are many types of evidence that must be considered when adjusting the base figure. These include:

(i) The current capacity of DBEs to perform work in your DOT-assisted contracting program, as measured by the volume of work DBEs have performed in recent years;

(ii) Evidence from disparity studies conducted anywhere within your jurisdiction, to the extent it is not already accounted for in your base figure; and

(iii) If your base figure is the goal of another recipient, you must adjust it for differences in your local market and your contracting program.

(2) You may also consider available evidence from related fields that affect the opportunities for DBEs to form, grow and compete. These include, but are not limited to:

(i) Statistical disparities in the ability of DBEs to get the financing, bonding and insurance required to participate in your program;

(ii) Data on employment, self-employment, education, training and union apprenticeship programs, to the extent you can relate it to the opportunities for DBEs to perform in your program.

(3) If you attempt to make an adjustment to your base figure to account for the continuing effects of past discrimination (often called the "but for" factor) or the effects of an ongoing DBE program, the adjustment must be based on demonstrable evidence that is logically and directly related to the effect for which the adjustment is sought.

(e) Once you have determined a percentage figure in accordance with paragraphs (c) and (d) of this section, you should express your overall goal as follows:

(1) If you are an FHWA recipient, as a percentage of all Federal-aid highway funds you will expend in FHWA-assisted contracts in the forthcoming fiscal year;

(2) If you are an FTA or FAA recipient, as a percentage of all FTA or FAA funds (exclusive of FTA funds to be used for the purchase of transit vehicles) that you will expend in FTA or FAA-assisted contracts in the forthcoming fiscal year. In appropriate cases, the FTA or FAA Administrator may permit you to express your overall goal as a percentage

of funds for a particular grant or project or group of grants and/or projects.

(f)(1) If you set overall goals on a fiscal year basis, you must submit them to the applicable DOT operating administration for review on August 1 of each year, unless the Administrator of the concerned operating administration establishes a different submission date.

(2) If you are an FTA or FAA recipient and set your overall goal on a project or grant basis, you must submit the goal for review at a time determined by the FTA or FAA Administrator.

(3) You must include with your overall goal submission a description of the methodology you used to establish the goal, including your base figure and the evidence with which it was calculated, and the adjustments you made to the base figure and the evidence relied on for the adjustments. You should also include a summary listing of the relevant available evidence in your jurisdiction and, where applicable, an explanation of why you did not use that evidence to adjust your base figure. You must also include your projection of the portions of the overall goal you expect to meet through race-neutral and race-conscious measures, respectively (see § 26.51(c)).

(4) You are not required to obtain prior operating administration concurrence with the your overall goal. However, if the operating administration's review suggests that your overall goal has not been correctly calculated, or that your method for calculating goals is inadequate, the operating administration may, after consulting with you, adjust your overall goal or require that you do so. The adjusted overall goal is binding on you.

(5) If you need additional time to collect data or take other steps to develop an approach to setting overall goals, you may request the approval of the concerned operating administration for an interim goal and/or goal-setting mechanism. Such a mechanism must:

(i) Reflect the relative availability of DBEs in your local market to the maximum extent feasible given the data available to you; and

(ii) Avoid imposing undue burdens on non-DBEs.

(g) In establishing an overall goal, you must provide for public participation. This public participation must include:

(1) Consultation with minority, women's and general contractor groups, community organizations, and other officials or organizations which could be expected to have information concerning the availability of disadvantaged and non-disadvantaged businesses, the effects of discrimination on opportunities for DBEs, and your efforts to establish a level playing field for the participation of DBEs.

(2) A published notice announcing your proposed overall goal, informing the public that the proposed goal and its rationale are available for inspection during normal business hours at your principal office for 30 days following the date of the notice, and informing the public that you and the Department will accept comments on the goals for 45 days from the date of the notice. The notice must include addresses to which comments may be sent, and you must publish it in general circulation media and available minority-focused media and trade association publications.

(h) Your overall goals must provide for participation by all certified DBEs and must not be subdivided into group-specific goals.

§ 26.47 Can recipients be penalized for failing to meet overall goals?

(a) You cannot be penalized, or treated by the Department as being in noncompliance with this rule, because your DBE participation falls short of your overall goal, unless you have failed to administer your program in good faith.

(b) If you do not have an approved DBE program or overall goal, or if you fail to implement your program in good faith, you are in noncompliance with this part.

* * * * *

§ 26.51 What means do recipients use to meet overall goals?

(a) You must meet the maximum feasible portion of your overall goal by using race-neutral means of facilitating DBE participation. Race-neutral DBE participation includes any time a DBE wins a prime contract through customary competitive procurement procedures, is awarded a subcontract on a prime contract that does not carry a DBE goal, or even if there is a DBE goal, wins a subcontract from a prime contractor that did not consider its DBE status in making the award (e.g., a prime contractor that uses a strict low bid system to award subcontracts).

(b) Race-neutral means include, but are not limited to, the following:

(1) Arranging solicitations, times for the presentation of bids, quantities, specifications, and delivery schedules in ways that facilitate DBE, and other small businesses, participation (e.g., unbundling large contracts to make them more accessible to small businesses, requiring or encouraging prime contractors to subcontract portions of work that they might otherwise perform with their own forces);

(2) Providing assistance in overcoming limitations such as inability to obtain bonding or financing (e.g., by such means as simplifying the bonding process, reducing bonding requirements, eliminating the impact of surety costs from bids, and providing services to help DBEs, and other small businesses, obtain bonding and financing);

(3) Providing technical assistance and other services;

(4) Carrying out information and communications programs on contracting procedures and specific contract opportunities (e.g., ensuring the inclusion of DBEs, and other small businesses, on recipient mailing lists for bidders; ensuring the dissemination to bidders on prime contracts of lists of potential subcontractors; provision of information in languages other than English, where appropriate);

(5) Implementing a supportive services program to develop and improve immediate and long-term business management, record keeping, and financial and accounting capability for DBEs and other small businesses;

(6) Providing services to help DBEs, and other small businesses, improve long-term development, increase opportunities to participate in a variety of kinds of work, handle increasingly significant projects, and achieve eventual self-sufficiency;

(7) Establishing a program to assist new, start-up firms, particularly in fields in which DBE participation has historically been low;

(8) Ensuring distribution of your DBE directory, through print and electronic means, to the widest feasible universe of potential prime contractors; and

(9) Assisting DBEs, and other small businesses, to develop their capability to utilize emerging technology and conduct business through electronic media.

(c) Each time you submit your overall goal for review by the concerned operating administration, you must also submit your projection of the portion of the goal that you expect to meet through race-neutral means and your basis for that projection. This projection is subject to approval by the concerned operating administration, in conjunction with its review of your overall goal.

(d) You must establish contract goals to meet any portion of your overall goal you do not project being able to meet using race-neutral means.

(e) The following provisions apply to the use of contract goals:

(1) You may use contract goals only on those DOT-assisted contracts that have subcontracting possibilities.

(2) You are not required to set a contract goal on every DOT-assisted contract. You are not required to set each contract goal at the same percentage level as the overall goal. The goal for a specific contract may be higher or lower than that percentage level of the overall goal, depending on such factors as the type of work involved, the location of the work, and the availability of DBEs for the work of the particular contract. However, over the period covered by your overall goal, you must set contract goals so that they will cumulatively result in meeting any portion of your overall goal you do not project being able to meet through the use of race-neutral means.

(3) Operating administration approval of each contract goal is not necessarily required. However, operating admini-

strations may review and approve or disapprove any contract goal you establish.

(4) Your contract goals must provide for participation by all certified DBEs and must not be subdivided into group-specific goals.

(f) To ensure that your DBE program continues to be narrowly tailored to overcome the effects of discrimination, you must adjust your use of contract goals as follows:

(1) If your approved projection under paragraph (c) of this section estimates that you can meet your entire overall goal for a given year through race-neutral means, you must implement your program without setting contract goals during that year.

Example to Paragraph (f)(1): Your overall goal for Year I is 12 percent. You estimate that you can obtain 12 percent or more DBE participation through the use of race-neutral measures, without any use of contract goals. In this case, you do not set any contract goals for the contracts that will be performed in Year I.

(2) If, during the course of any year in which you are using contract goals, you determine that you will exceed your overall goal, you must reduce or eliminate the use of contract goals to the extent necessary to ensure that the use of contract goals does not result in exceeding the overall goal. If you determine that you will fall short of your overall goal, then you must make appropriate modifications in your use of race-neutral and/or race-conscious measures to allow you to meet the overall goal.

Example to Paragraph (f)(2): In Year II, your overall goal is 12 percent. You have estimated that you can obtain 5 percent DBE participation through use of race-neutral

measures. You therefore plan to obtain the remaining 7 percent participation through use of DBE goals. By September, you have already obtained 11 percent DBE participation for the year. For contracts let during the remainder of the year, you use contract goals only to the extent necessary to obtain an additional one percent DBE participation. However, if you determine in September that your participation for the year is likely to be only 8 percent total, then you would increase your use of race-neutral and/or race-conscious means during the remainder of the year in order to achieve your overall goal.

(3) If the DBE participation you have obtained by race-neutral means alone meets or exceeds your overall goals for two consecutive years, you are not required to make a projection of the amount of your goal you can meet using such means in the next year. You do not set contract goals on any contracts in the next year. You continue using only race-neutral means to meet your overall goals unless and until you do not meet your overall goal for a year.

Example to Paragraph (f)(3): Your overall goal for Year I and Year II is 10 percent. The DBE participation you obtain through race-neutral measures alone is 10 percent or more in each year. (For this purpose, it does not matter whether you obtained additional DBE participation through using contract goals in these years.) In Year III and following years, you do not need to make a projection under paragraph (c) of this section of the portion of your overall goal you expect to meet using race-neutral means. You simply use race-neutral means to achieve your overall goals. However, if in Year VI your DBE participation falls short of your overall goal, then you must make a paragraph (c) projection for Year VII and, if necessary, resume use of contract goals in that year.

(4) If you obtain DBE participation that exceeds your overall goal in two consecutive years through the use of contract goals (i.e., not through the use of race-neutral means alone), you must reduce your use of contract goals proportionately in the following year.

Example to Paragraph (f)(4): In Years I and II, your overall goal is 12 percent, and you obtain 14 and 16 percent DBE participation, respectively. You have exceeded your goals over the two-year period by an average of 25 percent. In Year III, your overall goal is again 12 percent, and your paragraph (c) projection estimates that you will obtain 4 percent DBE participation through race-neutral means and 8 percent through contract goals. You then reduce the contract goal projection by 25 percent (i.e., from 8 to 6 percent) and set contract goals accordingly during the year. If in Year III you obtain 11 percent participation, you do not use this contract goal adjustment mechanism for Year IV, because there have not been two *consecutive* years of exceeding overall goals.

(g) In any year in which you project meeting part of your goal through race-neutral means and the remainder through contract goals, you must maintain data separately on DBE achievements in those contracts with and without contract goals, respectively. You must report this data to the concerned operating administration as provided in § 26.11.

§ 26.53 What are the good faith efforts procedures recipients follow in situations where there are contract goals?

(a) When you have established a DBE contract goal, you must award the contract only to a bidder/offeror who makes good faith efforts to meet it. You must determine

that a bidder/offeror has made good faith efforts if the bidder/offeror does either of the following things:

(1) Documents that it has obtained enough DBE participation to meet the goal; or

(2) Documents that it made adequate good faith efforts to meet the goal, even though it did not succeed in obtaining enough DBE participation to do so. If the bidder/offeror does document adequate good faith efforts, you must not deny award of the contract on the basis that the bidder/offeror failed to meet the goal. See Appendix A of this part for guidance in determining the adequacy of a bidder/offeror's good faith efforts.

(b) In your solicitations for DOT-assisted contracts for which a contract goal has been established, you must require the following:

(1) Award of the contract will be conditioned on meeting the requirements of this section;

(2) All bidders/offerors will be required to submit the following information to the recipient, at the time provided in paragraph (b)(3) of this section:

(i) The names and addresses of DBE firms that will participate in the contract;

(ii) A description of the work that each DBE will perform;

(iii) The dollar amount of the participation of each DBE firm participating;

(iv) Written documentation of the bidder/offeror's commitment to use a DBE subcontractor whose participation it submits to meet a contract goal;

(v) Written confirmation from the DBE that it is participating in the contract as provided in the prime contractor's commitment; and

(vi) If the contract goal is not met, evidence of good faith efforts (see Appendix A of this part); and

(3) At your discretion, the bidder/offeror must present the information required by paragraph (b)(2) of this section—

(i) Under sealed bid procedures, as a matter of responsiveness, or with initial proposals, under contract negotiation procedures; or

(ii) At any time before you commit yourself to the performance of the contract by the bidder/offeror, as a matter of responsibility.

(c) You must make sure all information is complete and accurate and adequately documents the bidder/offeror's good faith efforts before committing yourself to the performance of the contract by the bidder /offeror.

(d) If you determine that the apparent successful bidder/offeror has failed to meet the requirements of paragraph (a) of this section, you must, before awarding the contract, provide the bidder/offeror an opportunity for administrative reconsideration.

(1) As part of this reconsideration, the bidder/offeror must have the opportunity to provide written documentation or argument concerning the issue of whether it met the goal or made adequate good faith efforts to do so.

(2) Your decision on reconsideration must be made by an official who did not take part in the original determination

that the bidder/offeror failed to meet the goal or make adequate good faith efforts to do so.

(3) The bidder/offeror must have the opportunity to meet in person with your reconsideration official to discuss the issue of whether it met the goal or made adequate good faith efforts to do so.

(4) You must send the bidder/offeror a written decision on reconsideration, explaining the basis for finding that the bidder did or did not meet the goal or make adequate good faith efforts to do so.

(5) The result of the reconsideration process is not administratively appealable to the Department of Transportation.

(e) In a "design-build" or "turnkey" contracting situation, in which the recipient lets a master contract to a contractor, who in turn lets subsequent subcontracts for the work of the project, a recipient may establish a goal for the project. The master contractor then establishes contract goals, as appropriate, for the subcontracts it lets. Recipients must maintain oversight of the master contractor's activities to ensure that they are conducted consistent with the requirements of this part.

(f)(1) You must require that a prime contractor not terminate for convenience a DBE subcontractor listed in response to paragraph (b)(2) of this section (or an approved substitute DBE firm) and then perform the work of the terminated subcontract with its own forces or those of an affiliate, without your prior written consent.

(2) When a DBE subcontractor is terminated, or fails to complete its work on the contract for any reason, you must require the prime contractor to make good faith efforts to

find another DBE subcontractor to substitute for the original DBE. These good faith efforts shall be directed at finding another DBE to perform at least the same amount of work under the contract as the DBE that was terminated, to the extent needed to meet the contract goal you established for the procurement.

(3) You must include in each prime contract a provision for appropriate administrative remedies that you will invoke if the prime contractor fails to comply with the requirements of this section.

(g) You must apply the requirements of this section to DBE bidders/offerors for prime contracts. In determining whether a DBE bidder/offeror for a prime contract has met a contract goal, you count the work the DBE has committed to performing with its own forces as well as the work that it has committed to be performed by DBE subcontractors and DBE suppliers.

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Subpart D—Certification Standards

§ 26.61 How are burdens of proof allocated in the certification process?

(a) In determining whether to certify a firm as eligible to participate as a DBE, you must apply the standards of this subpart.

(b) The firm seeking certification has the burden of demonstrating to you, by a preponderance of the evidence, that it meets the requirements of this subpart concerning group membership or individual disadvantage, business size, ownership, and control.

(c) You must rebuttably presume that members of the designated groups identified in § 26.67(a) are socially and economically disadvantaged. This means that they do not have the burden of proving to you that they are socially and economically disadvantaged. However, applicants have the obligation to provide you information concerning their economic disadvantage (see § 26.67).

(d) Individuals who are not presumed to be socially and economically disadvantaged, and individuals concerning whom the presumption of disadvantage has been rebutted, have the burden of proving to you, by a preponderance of the evidence, that they are socially and economically disadvantaged. (See Appendix E of this part.)

(e) You must make determinations concerning whether individuals and firms have met their burden of demonstrating group membership, ownership, control, and social and economic disadvantage (where disadvantage must be demonstrated on an individual basis) by considering all the facts in the record, viewed as a whole.

§ 26.63 What rules govern group membership determinations?

(a) If you have reason to question whether an individual is a member of a group that is presumed to be socially and economically disadvantaged, you must require the individual to demonstrate, by a preponderance of the evidence, that he or she is a member of the group.

(b) In making such a determination, you must consider whether the person has held himself out to be a member of the group over a long period of time prior to application for certification and whether the person is regarded as a member of the group by the relevant community. You may re-

quire the applicant to produce appropriate documentation of group membership.

(1) If you determine that an individual claiming to be a member of a group presumed to be disadvantaged is not a member of a designated disadvantaged group, the individual must demonstrate social and economic disadvantage on an individual basis.

(2) Your decisions concerning membership in a designated group are subject to the certification appeals procedure of § 26.89.

§ 26.65 What rules govern business size determinations?

(a) To be an eligible DBE, a firm (including its affiliates) must be an existing small business, as defined by Small Business Administration (SBA) standards. You must apply current SBA business size standard(s) found in 13 CFR part 121 appropriate to the type(s) of work the firm seeks to perform in DOT-assisted contracts.

(b) Even if it meets the requirements of paragraph (a) of this section, a firm is not an eligible DBE in any Federal fiscal year if the firm (including its affiliates) has had average annual gross receipts, as defined by SBA regulations (see 13 CFR 121.402), over the firm's previous three fiscal years, in excess of $16.6 million. The Secretary adjusts this amount for inflation from time to time.

§ 26.67 What rules determine social and economic disadvantage?

(a) *Presumption of disadvantage.* (1) You must rebuttably presume that citizens of the United States (or lawfully admitted permanent residents) who are women, Black Americans, Hispanic Americans, Native Americans, Asian-

Pacific Americans, Subcontinent Asian Americans, or other minorities found to be disadvantaged by the SBA, are socially and economically disadvantaged individuals. You must require applicants to submit a signed, notarized certification that each presumptively disadvantaged owner is, in fact, socially and economically disadvantaged.

(2)(i) You must require each individual owner of a firm applying to participate as a DBE whose ownership and control are relied upon for DBE certification to submit a signed, notarized statement of personal net worth, with appropriate supporting documentation.

(ii) In determining net worth, you must exclude an individual's ownership interest in the applicant firm and the individual's equity in his or her primary residence (except any portion of such equity that is attributable to excessive withdrawals from the applicant firm). A contingent liability does not reduce an individual's net worth. The personal net worth of an individual claiming to be an Alaska Native will include assets and income from sources other than an Alaska Native Corporation and exclude any of the following which the individual receives from any Alaska Native Corporation: cash (including cash dividends on stock received from an ANC) to the extent that it does not, in the aggregate, exceed $2,000 per individual per annum; stock (including stock issued or distributed by an ANC as a dividend or distribution on stock); a partnership interest; land or an interest in land (including land or an interest in land received from an ANC as a dividend or distribution on stock); and an interest in a settlement trust.

(b) *Rebuttal of presumption of disadvantage.* (1) If the statement of personal net worth that an individual submits under paragraph (a)(2) of this section shows that the individual's personal net worth exceeds $750,000, the indi-

vidual's presumption of economic disadvantage is rebutted. You are not required to have a proceeding under paragraph (b)(2) of this section in order to rebut the presumption of economic disadvantage in this case.

(2) If you have a reasonable basis to believe that an individual who is a member of one of the designated groups is not, in fact, socially and/or economically disadvantaged you may, at any time, start a proceeding to determine whether the presumption should be regarded as rebutted with respect to that individual. Your proceeding must follow the procedures of § 26.87.

(3) In such a proceeding, you have the burden of demonstrating, by a preponderance of the evidence, that the individual is not socially and economically disadvantaged. You may require the individual to produce information relevant to the determination of his or her disadvantage.

(4) When an individual's presumption of social and/or economic disadvantage has been rebutted, his or her ownership and control of the firm in question cannot be used for purposes of DBE eligibility under this subpart unless and until he or she makes an individual showing of social and/or economic disadvantage. If the basis for rebutting the presumption is a determination that the individual's personal net worth exceeds $750,000, the individual is no longer eligible for participation in the program and cannot regain eligibility by making an individual showing of disadvantage.

(c) *8(a) and SDB Firms.* If a firm applying for certification has a current, valid certification from or recognized by the SBA under the 8(a) or small and disadvantaged business (SDB) program (except an SDB certification based on the firm's self-certification as an SDB), you may accept the firm's 8(a) or SDB certification in lieu of conducting your

own certification proceeding, just as you may accept the certification of another DOT recipient for this purpose. You are not required to do so, however.

(d) *Individual determinations of social and economic disadvantage.* Firms owned and controlled by individuals who are not presumed to be socially and economically disadvantaged (including individuals whose presumed disadvantage has been rebutted) may apply for DBE certification. You must make a case-by-case determination of whether each individual whose ownership and control are relied upon for DBE certification is socially and economically disadvantaged. In such a proceeding, the applicant firm has the burden of demonstrating to you, by a preponderance of the evidence, that the individuals who own and control it are socially and economically disadvantaged. An individual whose personal net worth exceeds $750,000 shall not be deemed to be economically disadvantaged. In making these determinations, use the guidance found in Appendix E of this part. You must require that applicants provide sufficient information to permit determinations under the guidance of Appendix E of this part.

* * * * *

Subpart E—Certification Procedures

§ 26.81 What are the requirements for Unified Certification Programs?

(a) You and all other DOT recipients in your state must participate in a Unified Certification Program (UCP).

* * * * *

(b) The UCP shall make all certification decisions on behalf of all DOT recipients in the state with respect to participation in the DOT DBE Program.

* * * * *

§ 26.83 What procedures do recipients follow in making certification decisions?

(a) You must ensure that only firms certified as eligible DBEs under this section participate as DBEs in your program.

(b) You must determine the eligibility of firms as DBEs consistent with the standards of subpart D of this part. When a UCP is formed, the UCP must meet all the requirements of subpart D of this part and this subpart that recipients are required to meet.

(c) You must take all the following steps in determining whether a DBE firm meets the standards of subpart D of this part:

(1) Perform an on-site visit to the offices of the firm. You must interview the principal officers of the firm and review their résumés and/or work histories. You must also perform an on-site visit to job sites if there are such sites on which the firm is working at the time of the eligibility investigation in your jurisdiction or local area. You may rely upon the site visit report of any other recipient with respect to a firm applying for certification;

(2) If the firm is a corporation, analyze the ownership of stock in the firm;

(3) Analyze the bonding and financial capacity of the firm;

(4) Determine the work history of the firm, including contracts it has received and work it has completed;

(5) Obtain a statement from the firm of the type of work it prefers to perform as part of the DBE program and its preferred locations for performing the work, if any;

(6) Obtain or compile a list of the equipment owned by or available to the firm and the licenses the firm and its key personnel possess to perform the work it seeks to do as part of the DBE program;

(7) Require potential DBEs to complete and submit an appropriate application form.

(i) *Uniform form.* [Reserved]

(ii) You must make sure that the applicant attests to the accuracy and truthfulness of the information on the application form. This shall be done either in the form of an affidavit sworn to by the applicant before a person who is authorized by state law to administer oaths or in the form of an unsworn declaration executed under penalty of perjury of the laws of the United States.

(iii) You must review all information on the form prior to making a decision about the eligibility of the firm.

* * * * *

(h) Once you have certified a DBE, it shall remain certified for a period of at least three years unless and until its certification has been removed through the procedures of § 26.87. You may not require DBEs to reapply for certification as a condition of continuing to participate in the program during this three-year period, unless the factual basis on which the certification was made changes.

(i) If you are a DBE, you must inform the recipient or UCP in writing of any change in circumstances affecting your ability to meet size, disadvantaged status, ownership,

or control requirements of this part or any material change in the information provided in your application form.

(1) Changes in management responsibility among members of a limited liability company are covered by this requirement.

(2) You must attach supporting documentation describing in detail the nature of such changes.

(3) The notice must take the form of an affidavit sworn to by the applicant before a person who is authorized by state law to administer oaths or of an unsworn declaration executed under penalty of perjury of the laws of the United States. You must provide the written notification within 30 days of the occurrence of the change. If you fail to make timely notification of such a change, you will be deemed to have failed to cooperate under § 26.109(c).

(j) If you are a DBE, you must provide to the recipient, every year on the anniversary of the date of your certification, an affidavit sworn to by the firm's owners before a person who is authorized by state law to administer oaths or an unsworn declaration executed under penalty of perjury of the laws of the United States. This affidavit must affirm that there have been no changes in the firm's circumstances affecting its ability to meet size, disadvantaged status, ownership, or control requirements of this part or any material changes in the information provided in its application form, except for changes about which you have notified the recipient under paragraph (i) of this section. The affidavit shall specifically affirm that your firm continues to meet SBA business size criteria and the overall gross receipts cap of this part, documenting this affirmation with supporting documentation of your firm's size and gross receipts. If you

fail to provide this affidavit in a timely manner, you will be deemed to have failed to cooperate under § 26.109(c).

(k) If you are a recipient, you must make decisions on applications for certification within 90 days of receiving from the applicant firm all information required under this part. You may extend this time period once, for no more than an additional 60 days, upon written notice to the firm, explaining fully and specifically the reasons for the extension. You may establish a different time frame in your DBE program, upon a showing that this time frame is not feasible, and subject to the approval of the concerned operating administration. Your failure to make a decision by the applicable deadline under this paragraph is deemed a constructive denial of the application, on the basis of which the firm may appeal to DOT under § 26.89.

§ 26.85 What rules govern recipients' denials of initial requests for certification?

(a) When you deny a request by a firm, which is not currently certified with you, to be certified as a DBE, you must provide the firm a written explanation of the reasons for the denial, specifically referencing the evidence in the record that supports each reason for the denial. All documents and other information on which the denial is based must be made available to the applicant, on request.

(b) When a firm is denied certification, you must establish a time period of no more than twelve months that must elapse before the firm may reapply to the recipient for certification. You may provide, in your DBE program, subject to approval by the concerned operating administration, a shorter waiting period for reapplication. The time period for reapplication begins to run on the date the explanation

required by paragraph (a) of this section is received by the firm.

(c) When you make an administratively final denial of certification concerning a firm, the firm may appeal the denial to the Department under § 26.89.

§ 26.87 What procedures does a recipient use to remove a DBE's eligibility?

(a) *Ineligibility complaints.* (1) Any person may file with you a written complaint alleging that a currently-certified firm is ineligible and specifying the alleged reasons why the firm is ineligible. You are not required to accept a general allegation that a firm is ineligible or an anonymous complaint. The complaint may include any information or arguments supporting the complainant's assertion that the firm is ineligible and should not continue to be certified. Confidentiality of complainants' identities must be protected as provided in § 26.109(b).

(2) You must review your records concerning the firm, any material provided by the firm and the complainant, and other available information. You may request additional information from the firm or conduct any other investigation that you deem necessary.

(3) If you determine, based on this review, that there is reasonable cause to believe that the firm is ineligible, you must provide written notice to the firm that you propose to find the firm ineligible, setting forth the reasons for the proposed determination. If you determine that such reasonable cause does not exist, you must notify the complainant and the firm in writing of this determination and the reasons for it. All statements of reasons for findings on the issue of reasonable cause must specifically reference the evidence in the record on which each reason is based.

(b) *Recipient-initiated proceedings.* If, based on notification by the firm of a change in its circumstances or other information that comes to your attention, you determine that there is reasonable cause to believe that a currently certified firm is ineligible, you must provide written notice to the firm that you propose to find the firm ineligible, setting forth the reasons for the proposed determination. The statement of reasons for the finding of reasonable cause must specifically reference the evidence in the record on which each reason is based.

(c) *DOT directive to initiate proceeding.* (1) If the concerned operating administration determines that information in your certification records, or other information available to the concerned operating administration, provides reasonable cause to believe that a firm you certified does not meet the eligibility criteria of this part, the concerned operating administration may direct you to initiate a proceeding to remove the firm's certification.

(2) The concerned operating administration must provide you and the firm a notice setting forth the reasons for the directive, including any relevant documentation or other information.

(3) You must immediately commence and prosecute a proceeding to remove eligibility as provided by paragraph (b) of this section.

(d) *Hearing.* When you notify a firm that there is reasonable cause to remove its eligibility, as provided in paragraph (a), (b), or (c) of this section, you must give the firm an opportunity for an informal hearing, at which the firm may respond to the reasons for the proposal to remove its eligibility in person and provide information and arguments concerning why it should remain certified.

(1) In such a proceeding, you bear the burden of proving, by a preponderance of the evidence, that the firm does not meet the certification standards of this part.

(2) You must maintain a complete record of the hearing, by any means acceptable under state law for the retention of a verbatim record of an administrative hearing. If there is an appeal to DOT under § 26.89, you must provide a transcript of the hearing to DOT and, on request, to the firm. You must retain the original record of the hearing. You may charge the firm only for the cost of copying the record.

(3) The firm may elect to present information and arguments in writing, without going to a hearing. In such a situation, you bear the same burden of proving, by a preponderance of the evidence, that the firm does not meet the certification standards, as you would during a hearing.

(e) *Separation of functions.* You must ensure that the decision in a proceeding to remove a firm's eligibility is made by an office and personnel that did not take part in actions leading to or seeking to implement the proposal to remove the firm's eligibility and are not subject, with respect to the matter, to direction from the office or personnel who did take part in these actions.

(1) Your method of implementing this requirement must be made part of your DBE program.

(2) The decisionmaker must be an individual who is knowledgeable about the certification requirements of your DBE program and this part.

(3) Before a UCP is operational in its state, a small airport or small transit authority (i.e., an airport or transit authority serving an area with less than 250,000 population)

is required to meet this requirement only to the extent feasible.

(f) *Grounds for decision.* You must not base a decision to remove eligibility on a reinterpretation or changed opinion of information available to the recipient at the time of its certification of the firm. You may base such a decision only on one or more of the following:

(1) Changes in the firm's circumstances since the certification of the firm by the recipient that render the firm unable to meet the eligibility standards of this part;

(2) Information or evidence not available to you at the time the firm was certified;

(3) Information that was concealed or misrepresented by the firm in previous certification actions by a recipient;

(4) A change in the certification standards or requirements of the Department since you certified the firm; or

(5) A documented finding that your determination to certify the firm was factually erroneous.

(g) *Notice of decision.* Following your decision, you must provide the firm written notice of the decision and the reasons for it, including specific references to the evidence in the record that supports each reason for the decision. The notice must inform the firm of the consequences of your decision and of the availability of an appeal to the Department of Transportation under § 26.89. You must send copies of the notice to the complainant in an ineligibility complaint or the concerned operating administration that had directed you to initiate the proceeding.

(h) *Status of firm during proceeding.* (1) A firm remains an eligible DBE during the pendancy of your proceeding to remove its eligibility.

(2) The firm does not become ineligible until the issuance of the notice provided for in paragraph (g) of this section.

(i) *Effects of removal of eligibility.* When you remove a firm's eligibility, you must take the following action:

(1) When a prime contractor has made a commitment to using the ineligible firm, or you have made a commitment to using a DBE prime contractor, but a subcontract or contract has not been executed before you issue the decertification notice provided for in paragraph (g) of this section, the ineligible firm does not count toward the contract goal or overall goal. You must direct the prime contractor to meet the contract goal with an eligible DBE firm or demonstrate to you that it has made a good faith effort to do so.

(2) If a prime contractor has executed a subcontract with the firm before you have notified the firm of its ineligibility, the prime contractor may continue to use the firm on the contract and may continue to receive credit toward its DBE goal for the firm's work. In this case, or in a case where you have let a prime contract to the DBE that was later ruled ineligible, the portion of the ineligible firm's performance of the contract remaining after you issued the notice of its ineligibility shall not count toward your overall goal, but may count toward the contract goal.

(3) *Exception*: If the DBE's ineligibility is caused solely by its having exceeded the size standard during the performance of the contract, you may continue to count its participation on that contract toward overall and contract goals.

(j) *Availability of appeal.* When you make an administratively final removal of a firm's eligibility under this section, the firm may appeal the removal to the Department under § 26.89.

§ 26.89 What is the process for certification appeals to the Department of Transportation?

(a)(1) If you are a firm which is denied certification or whose eligibility is removed by a recipient, you may make an administrative appeal to the Department.

(2) If you are a complainant in an ineligibility complaint to a recipient (including the concerned operating administration in the circumstances provided in § 26.87(c)), you may appeal to the Department if the recipient does not find reasonable cause to propose removing the firm's eligibility or, following a removal of eligibility proceeding, determines that the firm is eligible.

(3) Send appeals to the following address: Department of Transportation, Office of Civil Rights, 400 7th Street, SW, Room 2401, Washington, DC 20590.

(b) Pending the Department's decision in the matter, the recipient's decision remains in effect. The Department does not stay the effect of the recipient's decision while it is considering an appeal.

(c) If you want to file an appeal, you must send a letter to the Department within 90 days of the date of the recipient's final decision, including information and arguments concerning why the recipient's decision should be reversed. The Department may accept an appeal filed later than 90 days after the date of the decision if the Department determines that there was good cause for the late filing of the appeal.

(1) If you are an appellant who is a firm which has been denied certification, whose certification has been removed, whose owner is determined not to be a member of a designated disadvantaged group, or concerning whose owner the presumption of disadvantage has been rebutted, your letter must state the name and address of any other recipient which currently certifies the firm, which has rejected an application for certification from the firm or removed the firm's eligibility within one year prior to the date of the appeal, or before which an application for certification or a removal of eligibility is pending. Failure to provide this information may be deemed a failure to cooperate under § 26.109(c).

(2) If you are an appellant other than one described in paragraph (c)(1) of this section, the Department will request, and the firm whose certification has been questioned shall promptly provide, the information called for in paragraph (c)(1) of this section. Failure to provide this information may be deemed a failure to cooperate under § 26.109(c).

(d) When it receives an appeal, the Department requests a copy of the recipient's complete administrative record in the matter. If you are the recipient, you must provide the administrative record, including a hearing transcript, within 20 days of the Department's request. The Department may extend this time period on the basis of a recipient's showing of good cause. To facilitate the Department's review of a recipient's decision, you must ensure that such administrative records are well organized, indexed, and paginated. Records that do not comport with these requirements are not acceptable and will be returned to you to be corrected immediately. If an appeal is brought concerning one recipient's certification decision concerning a firm, and that recipient relied on the decision and/or administrative record of another recipient, this requirement applies to both recipients involved.

(e) The Department makes its decision based solely on the entire administrative record. The Department does not make a de novo review of the matter and does not conduct a hearing. The Department may supplement the administrative record by adding relevant information made available by the DOT Office of Inspector General; Federal, state, or local law enforcement authorities; officials of a DOT operating administration or other appropriate DOT office; a recipient; or a firm or other private party.

(f) As a recipient, when you provide supplementary information to the Department, you shall also make this information available to the firm and any third-party complainant involved, consistent with Federal or applicable state laws concerning freedom of information and privacy. The Department makes available, on request by the firm and any third-party complainant involved, any supplementary information it receives from any source.

(1) The Department affirms your decision unless it determines, based on the entire administrative record, that your decision is unsupported by substantial evidence or inconsistent with the substantive or procedural provisions of this part concerning certification.

(2) If the Department determines, after reviewing the entire administrative record, that your decision was unsupported by substantial evidence or inconsistent with the substantive or procedural provisions of this part concerning certification, the Department reverses your decision and directs you to certify the firm or remove its eligibility, as appropriate. You must take the action directed by the Department's decision immediately upon receiving written notice of it.

(3) The Department is not required to reverse your decision if the Department determines that a procedural error did not result in fundamental unfairness to the appellant or substantially prejudice the opportunity of the appellant to present its case.

(4) If it appears that the record is incomplete or unclear with respect to matters likely to have a significant impact on the outcome of the case, the Department may remand the record to you with instructions seeking clarification or augmentation of the record before making a finding. The Department may also remand a case to you for further proceedings consistent with Department instructions concerning the proper application of the provisions of this part.

(5) The Department does not uphold your decision based on grounds not specified in your decision.

(6) The Department's decision is based on the status and circumstances of the firm as of the date of the decision being appealed.

(7) The Department provides written notice of its decision to you, the firm, and the complainant in an ineligibility complaint. A copy of the notice is also sent to any other recipient whose administrative record or decision has been involved in the proceeding (see paragraph (d) of this section). The notice includes the reasons for the Department's decision, including specific references to the evidence in the record that supports each reason for the decision.

(8) The Department's policy is to make its decision within 180 days of receiving the complete administrative record. If the Department does not make its decision within this period, the Department provides written notice to concerned parties, including a statement of the reason for the delay and a date by which the appeal decision will be made.

(g) All decisions under this section are administratively final, and are not subject to petitions for reconsideration.

§ 26.91 What actions do recipients take following DOT certification appeal decisions?

(a) If you are the recipient from whose action an appeal under § 26.89 is taken, the decision is binding. It is not binding on other recipients.

(b) If you are a recipient to which a DOT determination under § 26.89 is applicable, you must take the following action:

(1) If the Department determines that you erroneously certified a firm, you must remove the firm's eligibility on receipt of the determination, without further proceedings on your part. Effective on the date of your receipt of the Department's determination, the consequences of a removal of eligibility set forth in § 26.87(i) take effect.

(2) If the Department determines that you erroneously failed to find reasonable cause to remove the firm's eligibility, you must expeditiously commence a proceeding to determine whether the firm's eligibility should be removed, as provided in § 26.87.

(3) If the Department determines that you erroneously declined to certify or removed the eligibility of the firm, you must certify the firm, effective on the date of your receipt of the written notice of Department's determination.

(4) If the Department determines that you erroneously determined that the presumption of social and economic disadvantage either should or should not be deemed rebutted, you must take appropriate corrective action as determined by the Department.

(5) If the Department affirms your determination, no further action is necessary.

(c) Where DOT has upheld your denial of certification to or removal of eligibility from a firm, or directed the removal of a firm's eligibility, other recipients with whom the firm is certified may commence a proceeding to remove the firm's eligibility under § 26.87. Such recipients must not remove the firm's eligibility absent such a proceeding. Where DOT has reversed your denial of certification to or removal of eligibility from a firm, other recipients must take the DOT action into account in any certification action involving the firm. However, other recipients are not required to certify the firm based on the DOT decision.

* * * * *

§ 26.107 What enforcement actions apply to firms participating in the DBE program?

(a) If you are a firm that does not meet the eligibility criteria of subpart D of this part and that attempts to participate in a DOT-assisted program as a DBE on the basis of false, fraudulent, or deceitful statements or representations or under circumstances indicating a serious lack of business integrity or honesty, the Department may initiate suspension or debarment proceedings against you under 49 CFR part 29.

(b) If you are a firm that, in order to meet DBE contract goals or other DBE program requirements, uses or attempts to use, on the basis of false, fraudulent or deceitful statements or representations or under circumstances indicating a serious lack of business integrity or honesty, another firm that does not meet the eligibility criteria of subpart D of this part, the Department may initiate suspension or debarment proceedings against you under 49 CFR part 29.

(c) In a suspension or debarment proceeding brought under paragraph (a) or (b) of this section, the concerned operating administration may consider the fact that a purported DBE has been certified by a recipient. Such certification does not preclude the Department from determining that the purported DBE, or another firm that has used or attempted to use it to meet DBE goals, should be suspended or debarred.

(d) The Department may take enforcement action under 49 CFR Part 31, Program Fraud and Civil Remedies, against any participant in the DBE program whose conduct is subject to such action under 49 CFR part 31.

(e) The Department may refer to the Department of Justice, for prosecution under 18 U.S.C. 1001 or other applicable provisions of law, any person who makes a false or fraudulent statement in connection with participation of a DBE in any DOT-assisted program or otherwise violates applicable Federal statutes.

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Appendix E to Part 26—Individual Determinations of Social and Economic Disadvantage

The following guidance is adapted, with minor modifications, from SBA regulations concerning social and economic disadvantage determinations (see 13 CFR 124.103(c) and 124.104).

Social Disadvantage

I. Socially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities. Social disadvantage must stem from circumstances beyond their control. Evidence of individual social disadvantage must include the following elements:

(A) At least one objective distinguishing feature that has contributed to social disadvantage, such as race, ethnic origin, gender, disability, long-term residence in an environment isolated from the mainstream of American society, or other similar causes not common to individuals who are not socially disadvantaged;

(B) Personal experiences of substantial and chronic social disadvantage in American society, not in other countries; and

(C) Negative impact on entry into or advancement in the business world because of the disadvantage. Recipients will consider any relevant evidence in assessing this element. In every case, however, recipients will consider education, employment and business history, where applicable, to see if the totality of circumstances shows disadvantage in entering into or advancing in the business world.

(1) *Education.* Recipients will consider such factors as denial of equal access to institutions of higher education and vocational training, exclusion from social and professional association with students or teachers, denial of educational honors rightfully earned, and social patterns or pressures which discouraged the individual from pursuing a professional or business education.

(2) *Employment.* Recipients will consider such factors as unequal treatment in hiring, promotions and other aspects of professional advancement, pay and fringe benefits, and other terms and conditions of employment; retaliatory or discriminatory behavior by an employer or labor union; and social patterns or pressures which have channeled the individual into non-professional or non-business fields.

(3) *Business history.* The recipient will consider such factors as unequal access to credit or capital, acquisition of credit or capital under commercially unfavorable circumstances, unequal treatment in opportunities for government contracts or other work, unequal treatment by potential customers and business associates, and exclusion from business or professional organizations.

II. With respect to paragraph I.(A) of this appendix, the Department notes that people with disabilities have disproportionately low incomes and high rates of unemployment. Many physical and attitudinal barriers remain to their full participation in education, employment, and business opportunities available to the general public. The Americans with Disabilities Act (ADA) was passed in recognition of the discrimination faced by people with disabilities. It is plausible that many individuals with disabilities—especially persons with severe disabilities (e.g., significant mobility, vision, or hearing impairments)—may be socially and economically disadvantaged.

III. Under the laws concerning social and economic disadvantage, people with disabilities are not a group presumed to be disadvantaged. Nevertheless, recipients should look carefully at individual showings of disadvantage by individuals with disabilities, making a case-by-case judgment about whether such an individual meets the criteria of this appendix. As public entities subject to Title II of the ADA,

recipients must also ensure their DBE programs are accessible to individuals with disabilities. For example, physical barriers or the lack of application and information materials in accessible formats cannot be permitted to thwart the access of potential applicants to the certification process or other services made available to DBEs and applicants.

Economic Disadvantage

(A) *General.* Economically disadvantaged individuals are 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 in the same or similar line of business who are not socially disadvantaged.

(B) *Submission of narrative and financial information.*

(1) Each individual claiming economic disadvantage must describe the conditions which are the basis for the claim in a narrative statement, and must submit personal financial information.

(2) When married, an individual claiming economic disadvantage also must submit separate financial information for his or her spouse, unless the individual and the spouse are legally separated.

(C) *Factors to be considered.* In considering diminished capital and credit opportunities, recipients will examine factors relating to the personal financial condition of any individual claiming disadvantaged status, including personal income for the past two years (including bonuses and the value of company stock given in lieu of cash), personal net worth, and the fair market value of all assets, whether encumbered or not. Recipients will also consider the financial condition of the applicant compared to the financial profiles

of small businesses in the same primary industry classification, or, if not available, in similar lines of business, which are not owned and controlled by socially and economically disadvantaged individuals in evaluating the individual's access to credit and capital. The financial profiles that recipients will compare include total assets, net sales, pre-tax profit, sales/working capital ratio, and net worth.

(D) *Transfers within two years.*

(1) Except as set forth in paragraph (D)(2) of this appendix, recipients will attribute to an individual claiming disadvantaged status any assets which that individual has transferred to an immediate family member, or to a trust, a beneficiary of which is an immediate family member, for less than fair market value, within two years prior to a concern's application for participation in the DBE program, unless the individual claiming disadvantaged status can demonstrate that the transfer is to or on behalf of an immediate family member for that individual's education, medical expenses, or some other form of essential support.

(2) Recipients will not attribute to an individual claiming disadvantaged status any assets transferred by that individual to an immediate family member that are consistent with the customary recognition of special occasions, such as birthdays, graduations, anniversaries, and retirements.

(3) In determining an individual's access to capital and credit, recipients may consider any assets that the individual transferred within such two-year period described by paragraph (D)(1) of this appendix that are not considered in evaluating the individual's assets and net worth (e.g., transfers to charities).

APPENDIX E

FEDERAL ACQUISITION REGULATIONS, 48 C.F.R. Pt. 19

1. Section 19.201 of Volume 48 of the Code of Federal Regulations, as amended 65 Fed. Reg. 60,542, 60,544 (2000), provides:

§ 19.201 General policy.

(a) It is the policy of the Government to provide maximum practicable opportunities in its acquisitions to small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns. Such concerns must also have the maximum practicable opportunity to participate as subcontractors in the contracts awarded by any executive agency, consistent with efficient contract performance. The Small Business Administration (SBA) counsels and assists small business concerns and assists contracting personnel to ensure that a fair proportion of contracts for supplies and services is placed with small business.

(b) The Department of Commerce will determine on an annual basis, by North American Industry Classification System (NAICS) Industry Subsector, and region, if any, the authorized small disadvantaged business (SDB) procurement mechanisms and applicable factors (percentages). The Department of Commerce determination shall only affect solicitations that are issued on or after the effective date of the determination. The effective date of the Department of Commerce determination shall be no less than 60 days after its publication date. The Department of Commerce determination shall not affect ongoing acquisitions. The SDB procurement mechanisms are a price evaluation adjustment for SDB concerns (see Subpart 19.11), an evaluation factor or

subfactor for participation of SDB concerns (see 19.1202), and monetary subcontracting incentive clauses for SDB concerns (see 19.1203). The Department of Commerce determination shall also include the applicable factors, by NAICS Industry Subsector, to be used in the price evaluation adjustment for SDB concerns (see 19.1104). The General Services Administration shall post the Department of Commerce determination at http://www.arnet.gov/References/sdbadjustments.htm. The authorized procurement mechanisms shall be applied consistently with the policies and procedures in this subpart. The agencies shall apply the procurement mechanisms determined by the Department of Commerce. The Department of Commerce, in making its determination, is not limited to the SDB procurement mechanisms identified in this section where the Department of Commerce has found substantial and persuasive evidence of—

(1) A persistent and significant underutilization of minority firms in a particular industry, attributable to past or present discrimination; and

(2) A demonstrated incapacity to alleviate the problem by using those mechanisms.

(c) Heads of contracting activities are responsible for effectively implementing the small business programs within their activities, including achieving program goals. They are to ensure that contracting and technical personnel maintain knowledge of small business program requirements and take all reasonable action to increase participation in their activities' contracting processes by these businesses.

(d) The Small Business Act requires each agency with contracting authority to establish an Office of Small and Disadvantaged Business Utilization (see section (k) of the Small Business Act). Management of the office shall be the respon-

sibility of an officer or employee of the agency who shall, in carrying out the purposes of the Act—

(1) Be known as the Director of Small and Disadvantaged Business Utilization;

(2) Be appointed by the agency head;

(3) Be responsible to and report directly to the agency head or the deputy to the agency head;

(4) Be responsible for the agency carrying out the functions and duties in sections 8, 15, and 31 of the Small Business Act.

(5) Work with the SBA procurement center representative to—

(i) Identify proposed solicitations that involve bundling;

(ii) Facilitate small business participation as contractors including small business contract teams, where appropriate; and

(iii) Facilitate small business participation as subcontractors and suppliers where participation by small business concerns as contractors is unlikely;

(6) Assist small business concerns in obtaining payments under their contracts, late payment, interest penalties, or information on contractual payment provisions;

(7) Have supervisory authority over agency personnel to the extent that their functions and duties relate to sections 8, 15, and 31 of the Small Business Act.

(8) Assign a small business technical advisor to each contracting activity within the agency to which the SBA has assigned a representative (see 19.402)—

(i) Who shall be a full-time employee of the contracting activity, well qualified, technically trained, and familiar with the supplies or services contracted for by the activity; and

(ii) Whose principal duty is to assist the SBA's assigned representative in performing functions and duties relating to sections 8, 15, and 31 of the Small Business Act;

(9) Cooperate and consult on a regular basis with the SBA in carrying out the agency's functions and duties in sections 8, 15, and 31 of the Small Business Act;

(10) Make recommendations in accordance with agency procedures as to whether a particular acquisition should be awarded under subpart 19.5 as a small business set-aside, under subpart 19.8 as a Section 8(a) award, or under subpart 19.13 as a HUBZone set-aside.

(e) Small Business Specialists must be appointed and act in accordance with agency regulations.

(f)(1) Each agency shall designate, at levels it determines appropriate, personnel responsible for determining whether, in order to achieve the contracting agency's goal for SDB concerns, the use of the SDB mechanism in Subpart 19.11 has resulted in an undue burden on non-SDB firms in one of the Industry subsectors and regions identified by Department of Commerce following paragraph (b) of this section, or is otherwise inappropriate. Determinations under this subpart are for the purpose of determining future acquisitions and shall not affect ongoing acquisitions. Requests for a determination, including supporting rationale, may be submitted to the agency designee. If the agency designee makes an affirmative determination that the SDB mechanism has an undue burden or is otherwise inappropriate, the determination shall be forwarded through agency channels to the OFPP, which shall review the determination in con-

sultation with the Department of Commerce and the Small Business Administration. At a minimum, the following information should be included in any submittal:

(i) A determination of undue burden or other inappropriate effect, including proposed corrective action.

(ii) The Industry subsector affected.

(iii) Supporting information to justify the determination, including, but not limited to, dollars and percentages of contracts awarded by the contracting activity under the affected Industry subsector for the previous two fiscal years and current fiscal year to date for—

(A) Total awards;

(B) Total awards to SDB concerns;

(C) Awards to SDB concerns awarded contracts under the SDB price evaluation adjustment where the SDB concerns would not otherwise have been the successful offeror;

(D) Number of successful and unsuccessful SDB offerors; and

(E) Number of successful and unsuccessful non-SDB offerors.

(iv) A discussion of the pertinent findings, including any peculiarities related to the industry, regions or demographics.

(v) A discussion of other efforts the agency has undertaken to ensure equal opportunity for SDBs in contracting with the agency.

(2) After consultation with OFPP, or if the agency does not receive a response from OFPP within 90 days after notice is provided to OFPP, the contracting agency may limit the use of the SDB mechanism in Subpart 19.11 until

the Department of Commerce determines the updated price evaluation adjustment, as required by this section. This limitation shall not apply to solicitations that already have been synopsized.

2. Section 19.202-1 of Volume 48 of the Code of Federal Regulations provides:

§ 19.201-1 Encouraging small business participation in acquisitions.

Small business concerns shall be afforded an equitable opportunity to compete for all contracts that they can perform to the extent consistent with the Government's interest. When applicable, the contracting officer shall take the following actions:

(a) Divide proposed acquisitions of supplies and services (except construction) into reasonably small lots (not less than economic production runs) to permit offers on quantities less than the total requirement.

(b) Plan acquisitions such that, if practicable, more than one small business concern may perform the work, if the work exceeds the amount for which a surety may be guaranteed by SBA against loss under 15 U.S.C. 694b.

(c) Ensure that delivery schedules are established on a realistic basis that will encourage small business participation to the extent consistent with the actual requirements of the Government.

(d) Encourage prime contractors to subcontract with small business concerns (see subpart 19.7).

(e)(1) Provide a copy of the proposed acquisition package to the SBA procurement center representative at least 30 days prior to the issuance of the solicitation if—

(i) The proposed acquisition is for supplies or services currently being provided by a small business and the proposed acquisition is of a quantity or estimated dollar value, the magnitude of which makes it unlikely that small businesses can compete for the prime contract;

(ii) The proposed acquisition is for construction and seeks to package or consolidate discrete construction projects and the magnitude of this consolidation makes it unlikely that small businesses can compete for the prime contract; or

(iii) The proposed acquisition is for a bundled requirement. (See 10.001(c)(2)(i) for mandatory 30-day notice requirement to incumbent small business concerns.)

(2) The contracting officer also must provide a statement explaining why the—

(i) Proposed acquisition cannot be divided into reasonably small lots (not less than economic production runs) to permit offers on quantities less than the total requirement;

(ii) Delivery schedules cannot be established on a realistic basis that will encourage small business participation to the extent consistent with the actual requirements of the Government;

(iii) Proposed acquisition cannot be structured so as to make it likely that small businesses can compete for the prime contract;

(iv) Consolidated construction project cannot be acquired as separate discrete projects; or

(v) Bundling is necessary and justified.

(3) The 30-day notification process shall occur concurrently with other processing steps required prior to the issuance of the solicitation.

(4) If the contracting officer rejects the SBA procurement center representative's recommendation, made in accordance with 19.402(c)(2), the contracting officer shall document the basis for the rejection and notify the SBA procurement center representative in accordance with 19.505.

3. Section 19.202-2 of Volume 48 of the Code of Federal Regulations, as amended 65 Fed. Reg. 60,542, 60,544 (2000), provides:

§ 19.202-2 Locating small business sources.

The contracting officer must, to the extent practicable, encourage maximum participation by small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns in acquisitions by taking the following actions:

(a) Include on mailing lists all established and potential small business sources, including those located in labor surplus areas and HUBZones, if the concerns have submitted acceptable applications or appear from other representations to be qualified small business concerns.

(b) Before issuing solicitations, make every reasonable effort to find additional small business concerns, unless lists are already excessively long and only some of the concerns on the list will be solicited. This effort should include contacting the agency SBA procurement center representative, or if there is none, the SBA.

(c) Publicize solicitations and contract awards through the Governmentwide point of entry (see subparts 5.2 and 5.3).

4. Section 19.702 of Volume 48 of the Code of Federal Regulations, as amended 65 Fed. Reg. 60,542, 60,545 (2000), provides:

§ 19.702 Statutory requirements.

Any contractor receiving a contract for more than the simplified acquisition threshold must agree in the contract that small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns will have the maximum practicable opportunity to participate in contract performance consistent with its efficient performance. It is further the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns.

(a) Except as stated in paragraph (b) of this section, Section 8(d) of the Small Business Act (15 U.S.C. 637(d)) imposes the following requirements regarding subcontracting with small businesses and small business subcontracting plans:

(1) In negotiated acquisitions, each solicitation of offers to perform a contract or contract modification, that individually is expected to exceed $500,000 ($1,000,000 for construction) and that has subcontracting possibilities, shall require the apparently successful offeror to submit an acceptable subcontracting plan. If the apparently successful offeror fails to negotiate a subcontracting plan acceptable to the contracting officer within the time limit prescribed by the contracting officer, the offeror will be ineligible for award.

(2) In sealed bidding acquisitions, each invitation for bids to perform a contract or contract modification, that individually is expected to exceed $500,000 ($1,000,000 for construction) and that has subcontracting possibilities, shall require the bidder selected for award to submit a subcontracting plan. If the selected bidder fails to submit a plan within the time limit prescribed by the contracting officer, the bidder will be ineligible for award.

(b) Subcontracting plans (see subparagraphs (a)(1) and (2) above) are not required—

(1) From small business concerns;

(2) For personal services contracts;

(3) For contracts or contract modifications that will be performed entirely outside of any State, territory, or possession of the United States, the District of Columbia, and the Commonwealth of Puerto Rico; or

(4) For modifications to contracts within the general scope of the contract that do not contain the clause at 52.219-8, Utilization of Small Business Concerns (or equivalent prior clauses; e.g., contracts awarded before the enactment of Public Law 95-507).

(c) As stated in 15 U.S.C. 637(d)(8), any contractor or subcontractor failing to comply in good faith with the requirements of the subcontracting plan is in material breach of its contract. Further, 15 U.S.C. 637(d)(4)(F) directs that a contractor's failure to make a good faith effort to comply with the requirements of the subcontracting plan shall result in the imposition of liquidated damages.

(d) As authorized by 15 U.S.C. 637(d)(11), certain costs incurred by a mentor firm in providing developmental assistance to a Protege firm under the Department of Defense Pilot Mentor-Protege Program, may be credited as subcontract awards to a small disadvantaged business for the pur-

pose of determining whether the mentor firm attains a small disadvantaged business goal under any subcontracting plan entered into with any executive agency. However, the mentor-protege agreement must have been approved by the—

> Office of Small and Disadvantaged Business Utilization, Office of the Under Secretary of Defense (Acquisition, Technology and Logistics), 1777 N. Kent Street, Suite 9100, Arlington, VA 22209

before developmental assistance costs may be credited against subcontracting goals. A list of approved agreements may be obtained at http://www.acq.osd.mil/sadbu/mentor_protege/ or by calling 1-800-553-1858.

5. Section 19.704 of Volume 48 of the Code of Federal Regulations, as amended 65 Fed. Reg. 60,542, 60,545 (2000), provides:

§ 19.704 Subcontracting plan requirements.

(a) Each subcontracting plan required under 19.702(a)(1) and (2) must include—

(1) Separate percentage goals for using small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns as subcontractors. Service-disabled veteran-owned small business concerns meet the definition of veteran-owned small business concerns, and offerors may include them within the subcontracting plan goal for veteran-owned small business concerns. A separate goal for service-disabled veteran-owned small business concerns is not required;

(2) A statement of the total dollars planned to be subcontracted and a statement of the total dollars planned to be subcontracted to small business, veteran-owned small

business, HUBZone small business, small disadvantaged business, and women-owned small business concerns;

(3) A description of the principal types of supplies and services to be subcontracted and an identification of types planned for subcontracting to small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns;

(4) A description of the method used to develop the subcontracting goals;

(5) A description of the method used to identify potential sources for solicitation purposes;

(6) A statement as to whether or not the offeror included indirect costs in establishing subcontracting goals, and a description of the method used to determine the proportionate share of indirect costs to be incurred with small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns;

(7) The name of an individual employed by the offeror who will administer the offeror's subcontracting program, and a description of the duties of the individual;

(8) A description of the efforts the offeror will make to ensure that small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns have an equitable opportunity to compete for subcontracts;

(9) Assurances that the offeror will include the clause at 52.219-8, Utilization of Small Business Concerns (see 19.708(a)), in all subcontracts that offer further subcontracting opportunities, and that the offeror will require all subcontractors (except small business concerns) that receive subcontracts in excess of $500,000 ($1,000,000 for construction) to adopt a plan that complies with the requirements of

the clause at 52.219-9, Small Business Subcontracting Plan (see 19.708(b));

(10) Assurances that the offeror will—

(i) Cooperate in any studies or surveys as may be required;

(ii) Submit periodic reports so that the Government can determine the extent of compliance by the offeror with the subcontracting plan;

(iii) Submit Standard Form (SF) 294, Subcontracting Report for Individual Contracts, and SF 295, Summary Subcontract Report, following the instructions on the forms or as provided in agency regulations; and

(iv) Ensure that its subcontractors agree to submit SF 294 and SF 295; and

(11) A description of the types of records that will be maintained concerning procedures adopted to comply with the requirements and goals in the plan, including establishing source lists; and a description of the offeror's efforts to locate small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns and to award subcontracts to them.

(b) Contractors may establish, on a plant or division-wide basis, a master plan (see 19.701) that contains all the elements required by the clause at 52.219-9, Small Business Subcontracting Plan, except goals. Master plans shall be effective for a 3-year period after approval by the contracting officer; however, it is incumbent upon contractors to maintain and update master plans. Changes required to update master plans are not effective until approved by the contracting officer. A master plan, when incorporated in an individual plan, shall apply to that contract throughout the life of the contract.

(c) For multiyear contracts or contracts containing options, the cumulative value of the basic contract and all options is considered in determining whether a subcontracting plan is necessary (see 19.705-2(a)). If a plan is necessary and the offeror is submitting an individual contract plan, the plan shall contain all the elements required by paragraph (a) of this section and shall contain separate statements and goals for the basic contract and for each option.

(d) A commercial plan (as defined in 19.701) is the preferred type of subcontracting plan for contractors furnishing commercial items. The contractor shall—

(1) Submit the commercial plan to either the first contracting officer awarding a contract subject to the plan during the contractor's fiscal year, or, if the contractor has ongoing contracts with commercial plans, to the contracting officer responsible for the contract with the latest completion date. The contracting officer shall negotiate the commercial plan for the Government. The approved commercial plan shall remain in effect during the contractor's fiscal year for all Government contracts in effect during that period; and

(2) Submit a new commercial plan, 30 working days before the end of the fiscal year, to the contracting officer responsible for the uncompleted Government contract with the latest completion date. The contractor must provide to each contracting officer responsible for an ongoing contract subject to the plan, the identity of the contracting officer that will be negotiating the new plan. When the new commercial plan is approved, the contractor shall provide a copy of the approved plan to each contracting officer responsible for an ongoing contract that is subject to the plan.

6. Section 19.705-7 of Volume 48 of the Code of Federal Regulations, as amended 65 Fed. Reg. 60,542, 60,545 (2000), provides:

19.705-7 Liquidated damages.

(a) Maximum practicable utilization of small business, veteran-owned small business (including service-disabled veteran-owned small business), HUBZone small business, small disadvantaged business, and women-owned small business concerns as subcontractors in Government contracts is a matter of national interest with both social and economic benefits. When a contractor fails to make a good faith effort to comply with a subcontracting plan, these objectives are not achieved, and 15 U.S.C. 637(d)(4)(F) directs that liquidated damages shall be paid by the contractor.

(b) The amount of damages attributable to the contractor's failure to comply shall be an amount equal to the actual dollar amount by which the contractor failed to achieve each subcontracting goal.

(c) If, at completion of the basic contract or any option, or in the case of a commercial plan, at the close of the fiscal year for which the plan is applicable, a contractor has failed to meet its subcontracting goals, the contracting officer shall review all available information for an indication that the contractor has not made a good faith effort to comply with the plan. If no such indication is found, the contracting officer shall document the file accordingly. If the contracting officer decides in accordance with paragraph (d) of this subsection that the contractor failed to make a good faith effort to comply with its subcontracting plan, the contracting officer shall give the contractor written notice specifying the failure, advising the contractor of the possibility that the contractor may have to pay to the Government liquidated damages, and providing a period of 15 working days (or

longer period as necessary) within which to respond. The notice shall give the contractor an opportunity to demonstrate what good faith efforts have been made before the contracting officer issues the final decision, and shall further state that failure of the contractor to respond may be taken as an admission that no valid explanation exists.

(d) In determining whether a contractor failed to make a good faith effort to comply with its subcontracting plan, a contracting officer must look to the totality of the contractor's actions, consistent with the information and assurances provided in its plan. The fact that the contractor failed to meet its subcontracting goals does not, in and of itself, constitute a failure to make a good faith effort. For example, notwithstanding a contractor's diligent effort to identify and solicit offers from small business, veteran-owned small business (including service-disabled veteran-owned small business), HUBZone small business, small disadvantaged business, and women-owned small business concerns, factors such as unavailability of anticipated sources or unreasonable prices may frustrate achievement of the contractor's goals. However, when considered in the context of the contractor's total effort in accordance with its plan, the following, though not all inclusive, may be considered as indicators of a failure to make a good faith effort: a failure to attempt to identify, contact, solicit, or consider for contract award small business, veteran-owned small business (including service-disabled veteran-owned small business), HUBZone small business, small disadvantaged business, or women-owned small business concerns; a failure to designate and maintain a company official to administer the subcontracting program and monitor and enforce compliance with the plan; a failure to submit Standard Form (SF) 294, Subcontracting Report for Individual Contracts, or SF 295, Summary Subcontract Report, in accordance with the instructions on the forms or

as provided in agency regulations; a failure to maintain records or otherwise demonstrate procedures adopted to comply with the plan; or the adoption of company policies or procedures that have as their objectives the frustration of the objectives of the plan.

(e) If, after consideration of all the pertinent data, the contracting officer finds that the contractor failed to make a good faith effort to comply with its subcontracting plan, the contracting officer shall issue a final decision to the contractor to that effect and require the payment of liquidated damages in an amount stated. The contracting officer's final decision shall state that the contractor has the right to appeal under the clause in the contract entitled Disputes.

(f) With respect to commercial plans approved under the clause at 52.219-9, Small Business Subcontracting Plan, the contracting officer that approved the plan shall—

(1) Perform the functions of the contracting officer under this subsection on behalf of all agencies with contracts covered by the commercial plan;

(2) Determine whether or not the goals in the commercial plan were achieved and, if they were not achieved, review all available information for an indication that the contractor has not made a good faith effort to comply with the plan, and document the results of the review;

(3) If a determination is made to assess liquidated damages, in order to calculate and assess the amount of damages, the contracting officer shall ask the contractor to provide—

(i) Contract numbers for the Government contracts subject to the plan;

(ii) The total Government sales during the contractor's fiscal year; and

(iii) The amount of payments made under the Government contracts subject to that plan that contributed to the contractor's total sales during the contractor's fiscal year; and

(4) When appropriate, assess liquidated damages on the Government's behalf, based on the pro rata share of subcontracting attributable to the Government contracts. For example: The contractor's total actual sales were $50 million and its actual subcontracting was $20 million. The Government's total payments under contracts subject to the plan contributing to the contractor's total sales were $5 million, which accounted for 10 percent of the contractor's total sales. Therefore, the pro rata share of subcontracting attributable to the Government contracts would be 10 percent of $20 million, or $2 million. To continue the example, if the contractor failed to achieve its small business goal by 1 percent, the liquidated damages would be calculated as 1 percent of $2 million, or $20,000. The contracting officer shall make similar calculations for each category of small business where the contractor failed to achieve its goal and the sum of the dollars for all of the categories equals the amount of the liquidated damages to be assessed. A copy of the contracting officer's final decision assessing liquidated damages shall be provided to other contracting officers with contracts subject to the commercial plan.

(g) Liquidated damages shall be in addition to any other remedies that the Government may have.

(h) Every contracting officer with a contract that is subject to a commercial plan shall include in the contract file a copy of the approved plan and a copy of the final decision assessing liquidating damages, if applicable.

7. Section 52.219-9 of Volume 48 of the Code of Federal Regulations, as amended 65 Fed. Reg. 60,542, 60,547 (2000), provides:

§ 52.219-9 Small business subcontracting plan.

As prescribed in 19.708(b), insert the following clause:

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(a) This clause does not apply to small business concerns.

(b) Definitions. As used in this clause—

Commercial item means a product or service that satisfies the definition of commercial item in section 2.101 of the Federal Acquisition Regulation.

Commercial plan means a subcontracting plan (including goals) that covers the offeror's fiscal year and that applies to the entire production of commercial items sold by either the entire company or a portion thereof (e.g., division, plant, or product line).

Individual contract plan means a subcontracting plan that covers the entire contract period (including option periods), applies to a specific contract, and has goals that are based on the offeror's planned subcontracting in support of the specific contract, except that indirect costs incurred for common or joint purposes may be allocated on a prorated basis to the contract.

Master plan means a subcontracting plan that contains all the required elements of an individual contract plan, except goals, and may be incorporated into individual contract plans, provided the master plan has been approved.

Subcontract means any agreement (other than one involving an employer-employee relationship) entered into by a Federal Government prime [c]ontractor or subcontractor

calling for supplies or services required for performance of the contract or subcontract.

(c) The offeror, upon request by the Contracting Officer, shall submit and negotiate a subcontracting plan, where applicable, that separately addresses subcontracting with small business, veteran-owned small business, HUBZone small business concerns, small disadvantaged business, and women-owned small business concerns. If the offeror is submitting an individual contract plan, the plan must separately address subcontracting with small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns, with a separate part for the basic contract and separate parts for each option (if any). The plan shall be included in and made a part of the resultant contract. The subcontracting plan shall be negotiated within the time specified by the Contracting Officer. Failure to submit and negotiate the subcontracting plan shall make the offeror ineligible for award of a contract.

(d) The offeror's subcontracting plan shall include the following:

(1) Goals, expressed in terms of percentages of total planned subcontracting dollars, for the use of small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns as subcontractors. Service-disabled veteran-owned small business concerns meet the definition of veteran-owned small business concerns, and offerors may include them within the subcontracting plan goal for veteran-owned small business concerns. A separate goal for service-disabled veteran-owned small business concerns is not required. The offeror shall include all subcontracts that contribute to contract performance, and may include a pro-

portionate share of products and services that are normally allocated as indirect costs.

(2) A statement of—

(i) Total dollars planned to be subcontracted for an individual contract plan; or the offeror's total projected sales, expressed in dollars, and the total value of projected subcontracts to support the sales for a commercial plan;

(ii) Total dollars planned to be subcontracted to small business concerns;

(iii) Total dollars planned to be subcontracted to veteran-owned small business concerns;

(iv) Total dollars planned to be subcontracted to HUBZone small business concerns;

(v) Total dollars planned to be subcontracted to small disadvantaged business concerns; and

(vi) Total dollars planned to be subcontracted to women-owned small business concerns.

(3) A description of the principal types of supplies and services to be subcontracted, and an identification of the types planned for subcontracting to—

(i) Small business concerns;

(ii) Veteran-owned small business concerns;

(iii) HUBZone small business concerns;

(iv) Small disadvantaged business concerns; and

(v) Women-owned small business concerns.

(4) A description of the method used to develop the subcontracting goals in paragraph (d)(1) of this clause.

(5) A description of the method used to identify potential sources for solicitation purposes (e.g., existing company source lists, the Procurement Marketing and Access Network (PRO-Net) of the Small Business Administration

(SBA), veterans service organizations, the National Minority Purchasing Council Vendor Information Service, the Research and Information Division of the Minority Business Development Agency in the Department of Commerce, or small, HUBZone, small disadvantaged, and women-owned small business trade associations). A firm may rely on the information contained in PRO-Net as an accurate representation of a concern's size and ownership characteristics for the purposes of maintaining a small, veteran-owned small, HUBZone small, small disadvantaged, and women-owned small business source list. Use of PRO-Net as its source list does not relieve a firm of its responsibilities (e.g., outreach, assistance, counseling, or publicizing subcontracting opportunities) in this clause.

(6) A statement as to whether or not the offeror in [*sic*] included indirect costs in establishing subcontracting goals, and a description of the method used to determine the proportionate share of indirect costs to be incurred with—

(i) Small business concerns;

(ii) Veteran-owned small business concerns;

(iii) HUBZone small business concerns;

(iv) Small disadvantaged business concerns; and

(v) Women-owned small business concerns.

(7) The name of the individual employed by the offeror who will administer the offeror's subcontracting program, and a description of the duties of the individual.

(8) A description of the efforts the offeror will make to assure that small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns have an equitable opportunity to compete for subcontracts.

(9) Assurances that the offeror will include the clause of this contract entitled "Utilization of Small Business Concerns" in all subcontracts that offer further subcontracting opportunities, and that the offeror will require all subcontractors (except small business concerns) that receive subcontracts in excess of $500,000 ($1,000,000 for construction of any public facility) to adopt a subcontracting plan that complies with the requirements of this clause.

(10) Assurances that the offeror will—

(i) Cooperate in any studies or surveys as may be required;

(ii) Submit periodic reports so that the Government can determine the extent of compliance by the offeror with the subcontracting plan;

(iii) Submit Standard Form (SF) 294, Subcontracting Report for Individual Contracts, and/or SF 295, Summary Subcontract Report, in accordance with paragraph (j) of this clause. The reports shall provide information on subcontract awards to small business concerns, veteran-owned small business concerns, service-disabled veteran-owned small business concerns, small disadvantaged business concerns, women-owned small business concerns, and Historically Black Colleges and Universities and Minority Institutions. Reporting shall be in accordance with the instructions on the forms or as provided in agency regulations.

(iv) Ensure that its subcontractors agree to submit SF 294 and SF 295.

(11) A description of the types of records that will be maintained concerning procedures that have been adopted to comply with the requirements and goals in the plan, including establishing source lists; and a description of the offeror's efforts to locate small business, veteran-owned small business, HUBZone small business, small disadvan-

taged business, and women-owned small business concerns and award subcontracts to them. The records shall include at least the following (on a plant-wide or company-wide basis, unless otherwise indicated):

(i) Source lists (e.g., PRO-Net), guides, and other data that identify small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns.

(ii) Organizations contacted in an attempt to locate sources that are small business, veteran-owned small business, HUBZone small business, small disadvantaged business, or women-owned small business concerns.

(iii) Records on each subcontract solicitation resulting in an award of more than $100,000, indicating—

(A) Whether small business concerns were solicited and, if not, why not;

(B) Whether veteran-owned small business concerns were solicited and, if not, why not;

(C) Whether HUBZone small business concerns were solicited and, if not, why not;

(D) Whether small disadvantaged business concerns were solicited and, if not, why not;

(E) Whether women-owned small business concerns were solicited and, if not, why not; and

(F) If applicable, the reason award was not made to a small business concern.

(iv) Records of any outreach efforts to contact—

(A) Trade associations;

(B) Business development organizations;

(C) Conferences and trade fairs to locate small, HUBZone small, small disadvantaged, and women-owned small business sources; and

(D) Veterans service organizations.

(v) Records of internal guidance and encouragement provided to buyers through—

(A) Workshops, seminars, training, etc.; and

(B) Monitoring performance to evaluate compliance with the program's requirements.

(vi) On a contract-by-contract basis, records to support award data submitted by the offeror to the Government, including the name, address, and business size of each subcontractor. Contractors having commercial plans need not comply with this requirement.

(e) In order to effectively implement this plan to the extent consistent with efficient contract performance, the Contractor shall perform the following functions:

(1) Assist small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns by arranging solicitations, time for the preparation of bids, quantities, specifications, and delivery schedules so as to facilitate the participation by such concerns. Where the Contractor's lists of potential small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business subcontractors are excessively long, reasonable effort shall be made to give all such small business concerns an opportunity to compete over a period of time.

(2) Provide adequate and timely consideration of the potentialities of small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns in all "make-or-buy" decisions.

(3) Counsel and discuss subcontracting opportunities with representatives of small business, veteran-owned small

business, HUBZone small business, small disadvantaged business, and women-owned small business firms.

(4) Provide notice to subcontractors concerning penalties and remedies for misrepresentations of business status as small, veteran-owned small business, HUBZone small, small disadvantaged, or women-owned small business for the purpose of obtaining a subcontract that is to be included as part or all of a goal contained in the Contractor's subcontracting plan.

(f) A master plan on a plant or division-wide basis that contains all the elements required by paragraph (d) of this clause, except goals, may be incorporated by reference as a part of the subcontracting plan required of the offeror by this clause; provided—

(1) The master plan has been approved,

(2) The offeror ensures that the master plan is updated as necessary and provides copies of the approved master plan, including evidence of its approval, to the Contracting Officer, and

(3) Goals and any deviations from the master plan deemed necessary by the Contracting Officer to satisfy the requirements of this contract are set forth in the individual subcontracting plan.

(g) A commercial plan is the preferred type of subcontracting plan for contractors furnishing commercial items. The commercial plan shall relate to the offeror's planned subcontracting generally, for both commercial and Government business, rather than solely to the Government contract. Commercial plans are also preferred for subcontractors that provide commercial items under a prime contract, whether or not the prime contractor is supplying a commercial item.

(h) Prior compliance of the offeror with other such subcontracting plans under previous contracts will be considered by the Contracting Officer in determining the responsibility of the offeror for award of the contract.

(i) The failure of the Contractor or subcontractor to comply in good faith with (1) the clause of this contract entitled "Utilization Of Small Business Concerns," or (2) an approved plan required by this clause, shall be a material breach of the contract.

(j) The Contractor shall submit the following reports:

(1) Standard Form 294, Subcontracting Report for Individual Contracts. This report shall be submitted to the Contracting Officer semi-annually and at contract completion. The report covers subcontract award data related to this contract. This report is not required for commercial plans.

(2) Standard Form 295, Summary Subcontract Report. This report encompasses all of the contracts with the awarding agency. It must be submitted semi- annually for contracts with the Department of Defense and annually for contracts with civilian agencies. If the reporting activity is covered by a commercial plan, the reporting activity must report annually all subcontract awards under that plan. All reports submitted at the close of each fiscal year (both individual and commercial plans) shall include a breakout, in the Contractor's format, of subcontract awards, in whole dollars, to small disadvantaged business concerns by North American Industry Classification System (NAICS) Industry Subsector. For a commercial plan, the Contractor may obtain from each of its subcontractors a predominant NAICS Industry Subsector and report all awards to that subcontractor under its predominant NAICS Industry Subsector.

(End of clause)

Alternate I (Oct 2000). When contracting by sealed bidding rather than by negotiation, substitute the following paragraph (c) for paragraph (c) of the basic clause:

(c) The apparent low bidder, upon request by the Contracting Officer, shall submit a subcontracting plan, where applicable, that separately addresses subcontracting with small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns. If the bidder is submitting an individual contract plan, the plan must separately address subcontracting with small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns, with a separate part for the basic contract and separate parts for each option (if any). The plan shall be included in and made a part of the resultant contract. The subcontracting plan shall be submitted within the time specified by the Contracting Officer. Failure to submit the subcontracting plan shall make the bidder ineligible for the award of a contract.

Alternate II (Oct 2000). As prescribed in 19.708(b)(1), substitute the following paragraph (c) for paragraph (c) of the basic clause:

(c) Proposals submitted in response to this solicitation shall include a subcontracting plan that separately addresses subcontracting with small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns. If the offeror is submitting an individual contract plan, the plan must separately address subcontracting with small business, veteran-owned small business, HUBZone small business, small disadvantaged business, and women-owned small business concerns, with a separate part for the basic contract and separate parts for each option (if any). The plan shall be included in and made a part of the resultant contract. The

subcontracting plan shall be negotiated within the time specified by the Contracting Officer. Failure to submit and negotiate a subcontracting plan shall make the offeror ineligible for award of a contract.

APPENDIX F

DEPARTMENT OF JUSTICE GUIDELINES FOR AFFIRMATIVE ACTION

The Department of Justice Proposed Rules governing Affirmative Action in Federal Procurement, 61 Fed. Reg. 26,042-26,063 (1996), provide in pertinent part:

DEPARTMENT OF JUSTICE

Proposed Reforms to Affirmative Action in Federal Procurement

* * * * *

SUMMARY: The proposal set forth herein to reform affirmative action in federal procurement has been designed to ensure compliance with the constitutional standards established by the Supreme Court in *Adarand Constructors, Inc. v. Peña*, 115 S. Ct. 2097 (1995). The proposed structure, which has been developed by the Justice Department, will form a model for amending the affirmative action provisions of the Federal Acquisition Regulation and the Defense Federal Acquisition Regulation Supplement.

* * * * *

Introduction

In *Adarand*, the Supreme Court extended strict judicial scrutiny to federal affirmative action programs that use racial or ethnic criteria as a basis for decisionmaking. In procurement, this means that any use of race in the decision to award a contract is subject to strict scrutiny. Under strict scrutiny, any federal programs that make race a basis for contract decisionmaking must be narrowly tailored to serve a compelling government interest.

Through its initial authorization of the use of section 8(a) of the Small Business Act to expand opportunities for minority-owned firms and through reenactments of this and other programs designed to assist such businesses, Congress has repeatedly made the judgment that race-conscious federal procurement programs are needed to remedy the effects of discrimination that have raised artificial barriers to the formation, development and utilization of businesses owned by minorities and other socially disadvantaged individuals. In repeated legislative enactments, Congress has, among other measures, established goals and granted authority to promote the participation of Small Disadvantaged Businesses (SDBs) 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 successively authorized a goal for participation by Disadvantaged Business Enterprises. Congress also included similar provisions in the Airport and Airway Improvement Act of 1982 with respect to procurement regarding airport development and concessions. Under Section 15(g) of the Small Business Act, 15 U.S.C. 644(g), Congress has established goals for SDB participation in agency procurement. Finally, in 1994, Congress enacted the Federal Acquisition Streamlining Act (FASA), which extended generally to federal agencies authority to conduct various race-conscious procurement activities. The purpose of this measure was to facilitate the achievement of goals for SDB participation established for agencies pursuant to Section 15(g) of the Small Business Act.

Based upon these congressional actions, the legislative history supporting them, and the evidence available to Congress, this congressional judgment is credible and consti-

tutionally defensible. Indeed, the survey of currently available evidence conducted by the Justice Department since the *Adarand* decision, including the review of numerous specific studies of discrimination conducted by state and local governments throughout the nation, leads to the conclusion that, in the absence of affirmative remedial efforts, federal contracting would unquestionably reflect the continuing impact of discrimination that has persisted over an extended period. For purposes of these proposed reforms, therefore, the Justice Department takes as a constitutionally justified premise that affirmative action in federal procurement is necessary, and that the federal government has a compelling interest to act on that basis in the award of federal contracts.[1]

Subject to certain statutory limitations (that are discussed below), Congress has largely left to the executive agencies the determination of how to achieve the remedial goals that it has established. The Court in *Adarand* made clear that, even when there is a constitutionally sustainable compelling interest supporting the use of race in decisionmaking, any such programs must be narrowly tailored to meet that interest. We have focused, therefore, on ensuring that the means of serving the congressionally mandated interest in this area are narrowly tailored to meet that objective. This task must be taken very seriously. *Adarand* made clear that Congress has the authority to use race-conscious decisionmaking to remedy the effects of past and present discrimination but emphasized that such decisionmaking must be done carefully. This Administration is committed to ensuring that discriminatory barriers to the opportunity of minority-owned firms are eliminated and the maximum opportunities possible under the law are maintained. Our

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[1] Set forth as an appendix to this notice is a preliminary survey of evidence establishing the compelling interest for affirmative action in federal procurement.

focus, therefore, has been on creating a structure for race-conscious procurement that will meet the congressionally determined objective in a manner that will survive constitutional scrutiny.

In giving content to the narrow tailoring prong of strict scrutiny, courts have identified six principal factors: (1) Whether the government considered race neutral alternatives and determined that they would prove insufficient before resorting to race-conscious action; (2) the scope of the program and whether it is flexible; (3) whether race is relied upon as the sole factor in eligibility, or whether it is used as one factor in the eligibility determination; (4) whether any numerical target is reasonably related to the number of qualified minorities in the applicable pool; (5) whether the duration of the program is limited and whether it is subject to periodic review; and (6) the extent of the burden imposed on nonbeneficiaries of the program. Not all of these factors are relevant in every circumstance and courts generally consider a strong showing with respect to most of the factors to be sufficient. This proposal, however, responds to all six factors.

The Department of Defense (DoD), which conducts a substantial majority of the federal government's procurement, was the focus of initial post-*Adarand* compliance actions by the federal government. In particular, DoD, acting pursuant to authority granted by 10 U.S.C. § 2323,[2] had developed

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[2] Section 2323 establishes a five percent goal for DoD contracting with small disadvantaged businesses ("SDBs") and authorizes DoD to "enter into contracts using less than full and open competitive procedures * * * and partial set asides for [SDBs]." Section 2323 states that the cost of using such measures may not exceed fair market price by more than ten percent. It authorizes the Secretary of Defense to adjust the applicable percentage "for any industry category if available information clearly indicates that nondisadvantaged small business concerns in such industry

through regulation a practice known as the "rule of two." Pursuant to the rule of two, whenever a contract officer could identify two or more SDBs that were qualified to bid on a project at a price within 10% of fair market price, the officer was required to set the contract aside for bidding exclusively by SDBs. Under section 2323, firms owned by individuals from designated racial minority groups are presumed to be SDBs.[3] Others may enter the program by establishing that they are socially and economically disadvantaged. After consultation with the Department of Justice, DoD suspended use of the rule of two in October 1995.

Congress in 1994 extended the affirmative action authority granted DoD by section 2323 to all agencies of the federal government through enactment of the Federal Acquisition Streamlining Act (FASA), Public Law No. 103-355, sec. 7102, 108 Stat. 3243, 15 U.S.C. 644 note.[4] Because of *Adarand* and the effort to review federal affirmative action programs in light of that decision, regulations to implement the affirma-

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category are generally being denied a reasonable opportunity to compete for contracts because of the use of that percentage in the application of this paragraph."

[3] 10 U.S.C. 2323 incorporates by explicit reference the language of section 8(d) of the Small Business Act, which states that members of designated racial or ethnic groups are presumed to be socially and economically disadvantaged. Participants in the 8(a) program are also presumed to be SDBs.

[4] FASA states that in order to achieve goals for SDB participation in procurement negotiated with the Small Business Administration, an "agency may enter into contracts using—(A) less than full and open competition by restricting the 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."

tive action authority granted by FASA have been delayed. See 60 Fed. Reg. 448258, 48259 (Sept. 18, 1995). This proposal provides the basis for those regulations.

The proposed structure will necessarily affect a wide range of measures that promote minority participation in government contracting through race-conscious means. Taking DoD as an example, approximately one-sixth of contracting with minority-owned firms in 1994 resulted from use of the rule of two. The majority of dollars to minority firms was awarded by DoD through other means: direct competitive awards, the Small Business Administration's (SBA) section 8(a) program, subcontracting pursuant to section 8(d) of the Small Business Act, and a price credit applied pursuant to section 2323. With the exception of direct competitive awards (which do not take race into account), activities pursuant to all of these methods will be affected by the proposed reforms.[5]

The 8(a) program merits special mention at the outset. This program serves a purpose that is distinct from that served by general SDB programs. The 8(a) program is designed to assist the development of businesses owned by socially and economically disadvantaged individuals. To this end, the program is targeted toward concerns that are more disadvantaged economically than other SDBs (*e.g.*, the standard for economic disadvantage for entry into 8(a) is an

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[5] This proposal addresses only affirmative action in the federal government's own direct procurement. It does not address affirmative action in procurement and contracting that is undertaken by states and localities pursuant to programs in which such entities receive funds from federal agencies (*e.g.*, the Disadvantaged Business Enterprise program that the Department of Transportation administers pursuant to the Intermodal Surface Transportation Efficiency Act of 1991, Pub. L. No. 102-240, section 1003(b), 105 Stat. 1919-1922, and the Airport and Airway Improvement Act of 1982, 49 U.S.C. 47101, *et seq.*).

owner's net worth of $250,000 compared to $750,000 for SDB programs). Participants in the program are required to establish business development plans and are eligible for technical, financial, and practical assistance, and may compete in a sheltered market for a limited time before graduating from the program. Each of these aspects of the program is designed to assist the business in developing the technical and practical experience necessary to become viable without assistance. By contrast, the general SDB program is a procurement program, designed to assist the government in finding firms capable of providing needed services, while, at the same time, helping to address the traditional exclusion of minority-owned firms from contracting opportunities.

The operation of the 8(a) program will become subject to the overall limitations in the measures described below. In addition, the SBA is working to strengthen safeguards against fraud and to ensure that the 8(a) program serves its purpose of assisting the development of businesses owned by individuals who are socially and economically disadvantaged.

Because the proposed reforms are broad and cover a number of different subjects related to affirmative action in federal procurement, the Justice Department is seeking comments on each of the aspects of the proposal. Comments will be taken into account in the formulation of revised procurement regulations.

Overview of Structure

The SDB reform outlined herein involves five major topics: (1) Certification and eligibility; (2) benchmark limitations; (3) mechanisms for increasing minority opportunity; (4) the interaction of benchmark limitations and mechanisms; and (5) outreach and technical assistance. The proposed structure incorporates these elements into a system that furthers the President's commitment to ensuring equal

opportunity in contracting, responds to the courts' narrow tailoring requirements, and is faithful to statutory authority.

I. Eligibility and Certification

At present, while a concern must have its eligibility certified by the SBA to participate in the 8(a) program, there is no similar certification requirement for participation in SDB programs. Under current practice, firms simply check a box to identify themselves as SDB's when bidding for federal contracts or 8(d) subcontracts. Reform of this certification process is needed to assure that programs meet constitutional and statutory objectives. While the basic elements of eligibility under these programs are statutorily determined, agencies have discretion to impose significant additional controls and to establish mechanisms to assure that the statutory criteria are in fact met.

The SBA will continue as the sole agency with authority to certify firms for the 8(a) program. The following discussion, therefore, concerns only certification of SDB's that are not participants in the 8(a) program.

Each bid that an SDB submits to an agency, or to a prime contractor seeking to fulfill 8(d) subcontracting obligations, will have to be accompanied by a form certifying that the concern qualifies as a small disadvantaged business under eligibility standards that will be published by the SBA. The standards and certification form will allow 8(a) participants to qualify automatically for SDB programs. Others will be required to establish their eligibility by submitting required statements and documentation.

When a concern has been certified by an agency as eligible for SDB programs, its name will be entered into a central online register to be maintained by SBA. That certification will be valid for a period of up to three years during which time registered firms will have only to complete a portion of

the form confirming the continued validity of that certification to participate in SDB programs at any agency. A full application will have to be submitted to an agency every three years to maintain eligibility.

A. Social and Economic Disadvantage

Members of designated minority groups seeking to participate in SDB and 8(d) programs will continue to fall within the statutorily mandated presumption of social and economic disadvantage.[6] This presumption is rebuttable as to both forms of disadvantage. The form will ask the applicant to identify the group identification triggering a presumption of social and economic disadvantage.[7] In addition, the form will enumerate the objective criteria constituting economic disadvantage according to SBA standards and advise the applicant that the presumption of such disadvantage is rebuttable and any challenge to the individual's SDB status will be resolved on the basis of these criteria. Challenges would be processed through existing SBA challenge mechanisms.

Individuals who do not fall within the statutory presumption will be required to establish social and economic disadvantage by answering a series of questions demonstrating such disadvantage. Questions regarding social disadvantage will be included in the standard certification form. Pursuant to current practice, individuals who do not fall

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[6] Both FASA and 10 U.S.C. 2323 incorporate by explicit reference the definition of social and economic disadvantage contained in section 8(d) of the Small Business Act. Pursuant to section 8(d), members of designated groups are presumed to be both socially and economically disadvantaged; those presumptions are rebuttable. By contrast, for the 8(a) program, members of identified groups are rebuttably presumed to be socially disadvantaged, but must establish that they are economically disadvantaged.

[7] Members of minority groups do not have to participate in the SDB program in order to bid on federal contracts.

within a presumption must prove their social disadvantage by clear and convincing evidence. That standard will be changed to permit proof by a preponderance of the evidence.

The SBA currently has criteria for evaluating social disadvantage. SBA will conduct training seminars designed to instruct personnel from other agencies on the procedures for making eligibility determinations. Individuals who do not fall within the statutory presumption will also be required to demonstrate that they are economically disadvantaged according to the criteria established by SBA.

Agencies will have discretion to decide which official within the agency will have authority to determine whether "non-presumed" individuals are socially and economically disadvantaged.[8] In most instances, the contracting officer should not have final authority to make the determination; the procedure must, however, facilitate quick decisions so that the procurement process will not be delayed and applicants will have a fair opportunity to compete. An agency may wish to assign this responsibility to its Office of Small and Disadvantaged Business Utilization. The SBA will answer inquiries regarding eligibility determinations and the procuring agency will retain the ability to refer applications to the SBA for final eligibility determinations through the protest procedures now in place. In the alternative, an agency may enter into an agreement with SBA to have SBA make all determinations, including the initial determination of eligibility.

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[8] The form that such individuals are to complete will ask whether they previously have applied for SDB certification and been rejected or accepted. A rejected firm will not be permitted to re-apply for certification for one year after rejection, unless it can show changed circumstances.

B. Ownership and Control

In addition to submitting the form described above, every applicant will be required to submit with each bid a certification that the business is owned and controlled by the designated socially and economically disadvantaged individuals as those terms are defined by the SBA's standards for ownership and control at 13 C.F.R. 124.103 and 124.104.[9] Such a certification must come from an SBA approved organization, a list of which will be maintained by the SBA. In order to be approved by the SBA to certify ownership and control, (1) the entity must certify ownership and control according to the standards established by the SBA for the 8(a) program (13 C.F.R. 124.103 and 124.104); (2) the entity's certifications must have been accepted by a state or local government or a major private contractor; and (3) the entity must not have been disqualified by any government authority from making certifications within the past five years. Such entities may include private organizations, the SBA (*i.e.*, through the 8(a) program), entities that provide certifications for participation in the Department of Transportation's disadvantaged business enterprise ("DBE") program, or states or localities, so long as the certification addresses the standards for ownership and control promulgated by the SBA.

This procedure is intended to take advantage of the extensive network of certifying entities already in existence. At present, firms may have to obtain several different certifica-

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[9] The standard certification form will accommodate one eligibility criterion peculiar to the DoD's SDB program under 10 U.S.C. 2323—that the majority of earnings must directly accrue to the socially and economically disadvantaged individuals that own and control the concern. The standard certification form will accommodate this criterion by including a DoD-specific section requiring the concern to attest that the majority of the firm's earnings do flow in this manner.

tions as they pursue a mix of private and public contracts. While it is clear that a control mechanism is needed to protect against fraud, it makes little sense to create a new federal bureaucracy to perform work that is already being done and to erect another hurdle that an SDB must clear before qualifying for a federal contract. The limited resources of the federal government and of SDBs make creation of such a bureaucracy counterproductive.

To police the quality of certifications, SBA will conduct periodic audits of certifying organizations. Any entity may submit information to the SBA in an effort to persuade the agency to initiate such an audit.

As a means of ensuring that the identified socially and economically disadvantaged individuals retain ownership and control of a firm, a certification of ownership and control will be valid for a maximum of three years from the date it was issued. Certified firms will be required to recertify their eligibility by submitting a full application, including an updated certification of ownership and control, every three years.

C. Challenges

Where an SDB is the apparent successful offeror on a contract, the name of that firm and of the entity that certified its ownership and control will be a matter of public record. SBA regulations currently allow any concern that submitted an offer to protest the eligibility of an SDB that receives a contract through an SDB program. The procuring agency or SBA may also protest the eligibility of an SDB. Individuals or organizations that did not submit a bid for the contract in question may submit information to the procuring agency in an effort to convince the agency to initiate a

protest.[10] The SBA's Division of Program Certification and Eligibility will process any protest that contains specific factual allegations that the concern is not eligible for the program.

Grounds for an eligibility protest may include, but are not limited to, evidence that:

- The owners of the firm are not in fact socially or economically disadvantaged;
- The firm is not owned and controlled by the individuals who meet the definition of social and economic disadvantage;
- The disadvantaged firm has acted, or is acting, as a front company by failing to complete required percentages of the work contracted to the concern.[11]

Upon receiving a protest supported by specific factual information, the SBA will make an eligibility determination by examining documentation from the SDB including, for example, personal and business financial statements, business records, ownership certifications, and other information deemed necessary to permit a determination as to the eligibility of the firm. Current regulations require the SBA to make a determination concerning the eligibility of

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[10] The protests contemplated in the discussion here relate only to certification and eligibility. The discussion does not relate to protests to other features of the proposed reforms that might be raised through existing bid protest procedures or through actions under the Administrative Procedure Act.

[11] The basis for such a challenge would be 48 C.F.R. 19.508, which requires completion of a minimum percentage of contract activities by the firm awarded a contract through a small business set aside or the 8(a) program. A clause must be inserted in such contracts that limits the amount of work that can be subcontracted. 48 C.F.R. 52.219-14. These requirements will be expanded to include contracts awarded through the reformed SDB program as well.

the firm within 15 days of the filing of the challenge or notify the contracting officer of any delay.

D. Enforcement

Finally, there must be a concerted effort to enforce the law against individuals who present fraudulent information to the government. The existence of a meaningful threat of prosecution for falsely claiming SDB status, or for fraudulently using an SDB as a front in order to obtain contracts, will do much to ensure that the program benefits those for whom it is designed. To this end, there will be an enhanced effort by SBA and the Department of Justice to identify and pursue individuals fraudulently misrepresenting information in order to obtain contracts through an SDB program. Any individual may forward specific factual information suggesting such a misrepresentation to the procuring agency contracting officer or the agency's inspector general. Similarly, the Inspector General of SBA will refer evidence of misrepresentation that emerges through the challenge procedure or otherwise to the Department of Justice. In its enforcement, the Department of Justice will ensure that it pursues to the extent permitted by law all of the parties responsible for fraudulent or sham transactions.

Penalties for misrepresentations in this area were increased by the Business Opportunity Development and Reform Act of 1988 and include:

(1) A fine of up to $500,000, imprisonment of up to 10 years, or both;

(2) Suspension and debarment from Federal contracting (48 C.F.R. pt. 9.4);

(3) Ineligibility to participate in any program or activity conducted under the authority of the Small Business Act or

the Small Business Investment Act of 1958 for a period of up to three years; and

(4) Administrative remedies prescribed by the Program Fraud Civil Remedies Act of 1986 (31 U.S.C. 3801-3812).

Knowing and willful fraudulent statements or representations may subject an individual to criminal penalties, including imprisonment for up to five years, pursuant to 18 U.S.C. 1001. In addition, knowing misrepresentations to obtain payment from the federal government may violate the False Claims Act, 31 U.S.C. 3729, and subject the claimant to civil penalties and treble damages.

II. Benchmark Limits

Although Congress has made the judgment that affirmative race-conscious measures are needed in federal contracting, the use of race must be narrowly tailored. The federal government operates under a general statutory mandate to achieve the "maximum practical opportunity" for SDB participation and that overall mandate is translated into specific agency-by-agency goals. Some specific programs operate under statutorily prescribed goals.[12] To the extent that race-conscious measures (going beyond outreach and technical assistance) are utilized to obtain these objectives, limitations must be established to comply with narrow tailoring requirements.

To this end, the proposal relies on development of a set of specific guidelines to limit, where appropriate, the use of race-conscious measures in specific areas of federal procurement. The limits, or "benchmarks", will be set for each in-

[12] See, *e.g.*, 10 U.S.C. 2323 (5% goal for DoD contracting with SDBs); Intermodal Surface Transportation Efficiency Act of 1991, Pub. L. No. 102-240, 105 Stat. 1914 (10% goal for highway construction projects carried out directly by the Department of Transportation).

dustry for the entire government. The Department of Commerce, in consultation with the General Services Administration (GSA) and SBA, will establish appropriate benchmark limitation figures for each industry and report them to the Office of Federal Procurement Policy (OFPP), which will publish and disseminate the final benchmark figures. Each industry benchmark limitation will represent the level of minority contracting that one would reasonably expect to find in a market absent discrimination or its effects. Benchmark limitations will provide the basis for comparison with actual minority participation in procurement in that industry (and, where appropriate, in a region).

In establishing the benchmark limitations, the first step is to define whether industries operate according to regional or national markets. In general, industries will be defined according to two-digit Standard Industrial Classification (SIC) codes. Based on the evidence, it appears that most federal contracting is conducted on a national basis. We also start from the view, reflected in a variety of federal policies, that federal contracting should encourage the development of national markets wherever feasible. Where data indicate, however, that an industry operates regionally, the benchmark limitations will be established by region.

After identifying the markets, the system will then measure, using primarily census data, the capacity of firms operating in each market that are owned by minorities. In estimating capacity, a number of factors will be examined. Most significant, of course, will be the number of minority SDBs available and qualified to perform government contracts.[13] In general, it appears appropriate to look at the

[13] For these purposes, the calculation of the number of minority-owned firms will not include corporations owned by federally-recognized Native American tribes and Alaskan Native villages. Bidding credits for such corporations are not subject to the *Adarand* strict scrutiny standard.

industry in question and identify the smallest firm that has won a government contract in that industry in the last three years. Firms that are significantly smaller would be presumed to be unqualified to perform government contracts in that industry. While keeping in mind that capacity is not fixed, it will also be important to look at measures such as the number of employees and amount of revenues.

In addition to calculating the capacity of existing minority firms, the proposed system will examine evidence, if any, demonstrating that minority business formation and operation in a specific industry has been suppressed by discrimination. This evidence may include direct evidence of discrimination in the private and public sectors in such areas as obtaining credit, surety guarantees and licenses. It may also include evidence of discrimination in pricing and contract awards. In addition, the evidence may include the results of regression analysis techniques similar to those used in state studies of discrimination in procurement. That form of analysis holds constant a variety of variables that might affect business formation so that the effect of race can be isolated.

The combination of existing minority capacity and, where applicable, the estimated effect of race in suppressing minority business activity in the industry will form the benchmark limitation. Although there is no absolutely precise way to calculate the impact of discrimination in various markets, the benchmark limitations represent a reasonable effort to establish guidelines to limit the use of race-conscious measures and to meet the requirement that such measures be narrowly tailored to accomplish the compelling interest that Congress has identified in this area.

Benchmark limitations will be adjusted every five years, as new data regarding minority firms are made available by

the Census Bureau. Generally, census regions will be used indefining the scope of regional markets.

III. Mechanisms for Increasing Minority Opportunity

Under the reformed structure, the federal government will generally have authority, subject to the limitations discussed in the next section, to use several race-conscious contracting mechanisms: SBA's 8(a) program; a bidding credit for SDB prime contractors; and an evaluation credit for non-minority prime contractors that use SDBs in subcontracting. In addition, at all times, agencies must engage in a variety of outreach and technical assistance activities designed to enhance contracting opportunities for SDBs (but that are not subject to strict scrutiny). Those efforts will be expanded as described more fully below.

The 8(a) program will continue to provide for sole source contracting and sheltered competition for 8(a) firms. However, the program will be monitored; and where the benchmark limitations described more fully below warrant adjustments to the SDB program, corresponding adjustments will be made to the 8(a) program to ensure that its operation is subject to those limitations.

A second available race-conscious measure will be a bidding credit in prime contracting for SDBs. Statutory authority for the use of such a credit exists for DoD in 10 U.S.C. 2323 and for the remainder of the government in FASA. Each statute permits use of such a credit so long as the final price does not exceed a fair market price by more than 10%.

The use of the term "credit" is not meant to restrict utilization by agencies of this mechanism to contracts where price is the primary factor in selecting the successful bidder. Where the successful bidder is selected based on other factors—such as the ability to produce a contract that provides the "best value" to the agency—agencies may build

the value of increasing the participation of SDB contractors into the evaluation of offers. For some contracts, a numerical credit may be appropriate; in others, some form of non-numerical assignment may make more sense to the agency. This proposal does not restrict such options. However, regardless how it operates, any bidding credit will be subject to the overall limitations on race-conscious mechanisms described herein.

Pursuant to 10 U.S.C. 2323 and FASA, agencies will also be permitted to use, as a third race-conscious mechanism, an evaluation credit with respect to the utilization by non-minority prime contractors of SDBs as subcontractors. Such goals would be set by the agency for each prime contract based on the availability of minority firms to perform the work. The award of evaluation credits for prime contractors that use SDBs as subcontractors will supplement the existing statutory SDB subcontracting requirements in Section 8(d) of the Small Business Act.[14] In order to certify their eligibility as SDBs, subcontractors will submit the same certification form to the prime contractor that is described in the certification section of this proposal.

Such an evaluation credit can take a number of different forms, depending on the circumstances of a solicitation.[15] For example, where it is practical for bidders to secure enforceable commitments from SDB subcontractors prior to

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[14] For certain types of procurement, Section 8(d) requires agencies to negotiate an SDB subcontracting plan with the successful bidder for the prime contract. The statute provides that each such plan shall include percentage goals for the utilization of SDB subcontractors.

[15] As was the case with respect to the use of the term "credit" in connection with bids from SDBs as prime contractors, the use of that term here in connection with SDB subcontracting is not intended to restrict the utilization of this mechanism to the evaluation of prime contract bids for which price is the primary factor in selecting the successful bidder.

the submission of bids, agencies should establish an SDB subcontracting goal for the contract, and award an evaluation credit to bidders who demonstrate that they have entered into such commitments as a means of achieving the goal. Where that is not practical, agencies can award an evaluation credit to a bidder that specifically identifies in a subcontracting plan those SDB subcontractors that it intends to use to achieve the agency's SDB subcontracting goal.[16] Agencies may also award an evaluation credit based on demonstrable evidence of a bidder's past performance in using SDB subcontractors. Agencies may also grant bonus awards to prime contractors to encourage the use of SDB subcontractors.[17] This proposal is not intended to limit agencies in developing or using additional mechanisms to increase SDB subcontracting, but any such mechanism will be subject to the limitations on race-conscious mechanisms described herein.

In applying these bidding and evaluation credits, race will simply be one factor that is considered in the decision to award a contract—in contrast to programs in which race is the sole factor.

IV. Interaction of Benchmark Limits and Mechanisms

In determining how benchmark limitations will be used to measure the appropriateness of various forms of race-conscious contracting, the objective has been to develop a sys-

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[16] In either case, a successful prime contractor should notify the contracting officer of any substitution of a non-SDB subcontractor for an SDB firm with which the prime contractor had entered into enforceable commitments or that had been specifically identified in the prime contractor's subcontracting plan.

[17] See, *e.g.*, Department of Transportation Incentive Subcontracting Program for Small and Small Disadvantaged Business Concerns, 48 C.F.R. 52 .219-10.

tem that can operate with a sufficient degree of clarity, consistency and simplicity over the range of federal agencies and contracting activities. Where the use of all available tools, including direct competition and race-neutral outreach and recruitment efforts, results in minority participation below the benchmark, race-based mechanisms will remain available. Their scope, however, will vary and be recalculated depending on the extent of the disparity between capacity and participation. Where participation exceeds the benchmark, and can be expected to continue to do so with reduced race-conscious efforts, adjustments will be made.

At the close of each fiscal year, the Department of Commerce will review data collected by its GSA's Federal Procurement Data Center for the three preceding fiscal years to determine the percentage of contracting dollars that has been awarded to minority-owned SDBs in each two-digit SIC code. Commerce will analyze minority SDB participation for all transactions that exceed $25,000. This review will include minority-owned SDBs participating through direct contracting (including full and open competition), the 8(a) program, and SDB prime and subcontracting programs.[18] Data regarding minority participation will be reviewed annually, but will include the past three fiscal years of experience. Examining experience over three year

[18] In order to measure accurately SDB subcontracting participation, it will be necessary to have information regarding SDB subcontracting participation by two-digit SIC code. At the same time, however, it is important to minimize the amount of new record-keeping and reporting that these reforms may require. Prime contractors such as commercial vendors that report SDB participation through company-wide annual subcontracting plans will continue to be able to use this reporting method, with some modification that serves to facilitate SIC code reporting. Under one approach, prime contractors could require all subcontractors to identify their primary SIC code and then track, as most primes do now, the amount of dollars that flows to each subcontractor.

stretches should produce a more accurate picture of minority participation, given short-term fluctuations and the fact that the process of bidding and awarding a contract may span more than a single fiscal year.

Commerce will analyze the data and, after consultation with SBA, report to OFPP regarding which mechanisms should be available in each industry and the size of the credits that can be applied. OFPP will publish and disseminate the mechanisms that can be used by the agencies in the upcoming year.

Pursuant to 15 U.S.C. 644(g), each agency now negotiates goals for SDB participation with SBA for each year. Commerce would inform SBA and agencies of the appropriate benchmark limits for the industries in which the agency contracts and of the mechanisms available.

Where Commerce determines that participation by SDBs in government contracting in an industry is below the relevant benchmark limitation, it may report to OFPP that agencies should be authorized to grant credit to SDB bidders and to prime contractors for SDB subcontracting. Commerce will set a percentage cap of up to ten percent on the amount the credit can allow the price of a contract to deviate from the fair market price. That percentage will represent the maximum credit that each agency may use in the evaluation of bids from SDBs and prime contractors who commit to subcontracting with SDBs. The size of the credit will depend, in part, on the extent of the disparity between the benchmark limitations and minority SDB participation in federal procurement and industry. It also will depend on an assessment of pricing practices within particular industries to indicate the effect of credits within that industry. Commerce's determinations would be published and disseminated by OFPP.

Where the bidding and evaluation credits have been used in an industry and the percentage of dollars awarded to SDBs in that industry exceeds the benchmark limit, Commerce, in consultation with SBA, must estimate the effect of curtailing the use of race-conscious contracting mechanisms and report to OFPP. If Commerce determines that the minority participation rate would fall substantially below the benchmark limit in the absence of race-conscious measures,[19] it need not require agencies to stop using such measures, but may, as described below, require agencies to adjust their use.

Agencies will report the number of contracts that were awarded using a bidding or evaluation credit as well as the amount of those credits. These figures will allow an estimate of the effect on SDB participation of adjusting or removing the credit. In the absence of that objective measure, Commerce will have to estimate and report to OFPP how much minority contracting resulted from the application of these race-conscious measures. One indication may be the success of minorities in winning contracts through direct competition in which race is not used in the decision to award a contract. It may also be useful to examine comparable experience in private industries operating without affirmative action programs.

Even when agencies are not required to terminate bidding and evaluation credits, they may be required to adjust their size in order to ensure that the credits do not lead to the award of a disproportionately large number[ ] of contracts to

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[19] More than three "standard deviations" will generally be viewed as "substantial" for these purposes. Under applicable Supreme Court decisions, a disparity in the range of two or three standard deviations is strong evidence of a prima facie case of discrimination in the employment context. A standard deviation is a measure of the departure from the level of activity that one would expect in the absence of discrimination.

SDBs. Statutory authority for this adjustment exists in both FASA and section 2323. Because the size of credits will affect industries differently, it is impossible to prescribe a set of specific rules to govern adjustments. Responsibility will rest with Commerce to analyze the impact of credits by industry category and make adjustments where appropriate, which would then be published and disseminated by OFPP.

In addition, in some circumstances, an agency may use *less* than the authorized bidding or evaluation credit where necessary to ensure that use of the credits by a specific agency does not unfairly limit the opportunities of non-SDB contractors seeking contracts from that agency. While the size of the maximum credits will be determined on an industry-wide basis and apply across all agencies, it remains important to maintain flexibility at the agency level to ensure against any undue concentrations of SDB contracting and unnecessary use of race-conscious credits. Thus, for example, where an agency has been particularly successful in reaching out to SDB contractors, it may find its use of the full credits unnecessary to achieve its goals, in which event it could, subject to approval by Commerce, depart downward from the authorized credits. The exercise of this discretion will be particularly important to avoid geographic concentrations of SDB contracting that unduly limit opportunities for non-SDBs.

When Commerce concludes that the use of race-conscious measures is not justified in a particular industry (or region), the use of the bidding credit and the evaluation credit will cease. Suspending the use of race-conscious means will not affect the continued use of race-neutral contracting measures. The limits imposed by the benchmarks also would not affect the applicability of statutorily mandated goals, but would limit the extent to which race-conscious means could be used to achieve those goals. For example, DoD would

retain its five percent overall statutory goal and would continue to exhort prime contractors to achieve goals for subcontracting with SDBs. Prime contractors, however, would no longer receive credit in evaluation of their bids for signing up or identifying SDB subcontractors. Likewise, outreach and technical assistance efforts would continue and minority bidders on prime contracts would continue to seek and win competitive awards; but there would no longer be any bidding credit for minority firms.

It should be emphasized that the benchmarks are not a limit on the level of minority contracting in any industry that may be achieved without the use of race-conscious measures. Conversely, there is, of course, no assurance that minority participation in particular industries will reach the benchmark limitations through the available race conscious measures. Minority participation will depend on the availability of qualified minority firms that successfully win contracts through open competition, subcontracting, the 8(a) program or through the application of price or evaluation credits. The system described herein is a good faith effort to remedy the effect of discrimination, but it is not a guarantee of any particular result.

The affirmative action structure described herein does not utilize the statutory authorization under FASA to allow federal agencies (or in the case of DoD its direct authorization under 10 U.S.C. 2323) to set contracts aside for bidding exclusively by SDBs. If federal agencies use race-conscious measures in the manner outlined above, together with concerted race-neutral efforts at outreach and technical assistance as described below, we believe the use of this additional statutory authority should be unnecessary. Following the initial two-year period of the reformed system's operation (and at regular intervals thereafter), however, Commerce, SBA and DoD will evaluate the operation of the

system and determine whether this statutory power to authorize set-asides should be invoked. In making that determination, those agencies will take into account whether persistent and substantial underutilization of minority firms in particular industries or in government contracting as a whole is the result of the effects of past or present discriminatory barriers that are not being overcome by this system.

Such periodic reviews should also consider whether, based on experience, further limitation of the use of race-conscious measures is appropriate beyond those outlined herein. In that regard, it should be noted that the reformed structure is inherently and progressively self-limiting in the use of race-conscious measures. As barriers to minority contracting are removed and the use of race-neutral means of ensuring opportunity succeeds, operation of the reformed structure will automatically reduce, and eventually should eliminate, the use of race in decisionmaking. In addition, the statutory authority upon which the use of bidding and evaluation credits is based expires at the end of fiscal year 2000. Congress will determine whether that authority should be extended. See 10 U.S.C. 2323; FASA, § 7102.

Section 8(a) Program

Contracts obtained by minority firms through the 8(a) program will count toward the calculation whether minority participation has reached or exceeded the benchmark in any industry.[20] The Administrator of SBA will be under an obligation to monitor the use of the 8(a) program in relation to the benchmark limits. Thus, where Commerce advises that the use of race-conscious measures must be curtailed in a specific industry on the basis of the benchmarks, the Admini-

[20] As with calculation of the benchmark limitations, see n. 13, *supra*, corporations owned by federally-recognized Native American tribes and Alaskan Native villages will not be included in this calculation.

strator would take appropriate action to limit the use of the program through one or more of the following techniques: (1) Limiting entry into the program in that industry; (2) accelerating graduation for firms that do not need the full period of sheltered competition to satisfy the goals of the program; and (3) limiting the number of 8(a) contracts awarded in particular industries or geographic areas.

These same techniques should be used by the Administrator in carrying out existing authority to ensure that 8(a) contracting is not concentrated unduly in certain regions. Even where a market is defined as national in scope, and 8(a) is being used within applicable national benchmark limits, efforts should be made to guard against excessive use of 8(a) contracting in a limited region.

As noted earlier, the 8(a) program is distinct from the general SDB program in that it is animated by its own distinct purpose—to assist socially and economically disadvantaged individuals to overcome barriers that have suppressed business formation and development. Consistent with its unique nature, the 8(a) program has features that already reflect some of the factors that make up the narrow tailoring requirement. Unlike other SDB's, individuals seeking admission to the 8(a) program must establish economic disadvantage without the benefit of any presumption. The Small Business Act defines economically disadvantaged individuals as "those 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 in the same business area who are not socially disadvantaged." Furthermore, SBA employs objective criteria to measure whether an individual is economically disadvantaged. In this sense, the statute and regulations are targeted toward victims of discrimination; the SBA is proposing to clarify the regulations implementing the

program to emphasize this fact. In addition, individuals are admitted to the 8(a) program for a limited period—nine years—and their performance is reviewed throughout. An individual may be required to leave the program prior to the nine year graduation period if the review reveals that the individual is no longer economically disadvantaged or the firm meets other graduation criteria determined by the SBA.

SBA has under consideration additional program changes designed to ensure that the 8(a) program focuses on its central mission of assisting businesses to develop and concentrates it[s] resources on its intended beneficiaries. These changes would further ensure that the 8(a) program is narrowly tailored to serve the compelling interest for which it was enacted by Congress.

V. Outreach and Technical Assistance

At present, agencies undertake a variety of activities designed to make minority firms aware of contracting opportunities and to help them take advantage of those opportunities. As a general proposition, these activities are not subject to strict scrutiny. The structure outlined above for the use of race-conscious measures assumes that agencies will continue such outreach and technical assistance efforts at all times, so that race-conscious measures will be used only to the minimum extent necessary to achieve legitimate objectives. Our review indicates that, while there are a variety of good programs of this nature operated by various federal agencies, there is a lack of consistency and sustained energy and direction to these efforts.

SBA operates several assistance programs that are targeted toward minority firms, but are also available to qualifying nonminority firms. Notably, pursuant to section 7(j) of the Small Business Act, SBA provides financial

assistance to public and private organizations to provide technical and management assistance to qualifying individuals. 13 CFR 124.403, 404. SBA also operates a program to provide assistance to socially and economically disadvantaged businesses in preparing loan applications and obtaining pre-qualification from SBA for loans. See 13 CFR 120. SBA also operates a surety bond program pursuant to which it provides up to a 90% guarantee for bonds required of small contractors.

The Department of Commerce, through the Minority Business Development Administration, sponsors several programs to provide information, training and research that are targeted toward minority-owned businesses. These programs include Minority Business Development Centers around the country to provide hands on assistance to minority businesses.

DoD has operated since 1990 the Mentor-Protege Pilot Program, which provides incentive for DoD prime contractors to furnish SDBs with technical assistance. See 10 U.S.C. 2301. Mentor firms provide a variety of assistance, including progress payments, advance subcontract payments, loans, providing technical and management assistance and awards of subcontracts on a noncompetitive basis to the protege. DoD reimburses the mentor firm for its expenses. The award of subcontracts under this program is subject to strict scrutiny, but other portions of the program are not.

The following are among the efforts that should be actively pursued:

1. A race-neutral version of the mentor-protege program (that does not guarantee the award of subcontracts on a noncompetitive basis) should be encouraged at all agencies.

2. DoD has proposed—and other agencies should follow DoD's lead—eliminating the impact of surety costs from bids. Because SDB's generally incur higher bond costs, this race-neutral change would assist SDB's and address one of the most frequently cited barriers to minority success in contracting. In this regard, agencies should also examine the use of irrevocable letters of credit in lieu of surety bonds.

3. Where agencies use mailing lists, a minimum goal should be set for inclusion of SDB's on agency mailing lists of bidders.

4. The function of the Procurement Automated Source System (PASS), currently maintained by SBA, should be continued. The system provides contracting officers with a continuously updated list of SDB firms, classified by interest and region.

5. A uniform system for publishing agency procurement forecasts on SBA Online should be established. In addition, SBA should develop a systematic means for publishing upcoming subcontracting opportunities.

6. Agencies should target outreach and technical assistance efforts, including mentor-protege initiatives, toward industries in which SDB participation traditionally has been low. Agencies should continue to pursue strategies in which minority-owned firms are encouraged to become part of joint ventures or form strategic alliances with non-minority enterprises.

7. The SBA should enhance its technical assistance initiatives to enhance the ability of SDBs to use the tools of electronic commerce.

8. Pursuant to Executive Order 12876, which directs agencies to seek to enter into contracts with Historically Black Colleges and Universities, agencies should attempt to increase participation by such institutions in research and

development contracts as means of assisting the development of business relationships between the institutions and SDBs.

9. Each agency should review its contracting practices and its solicitations to identify and eliminate any practices that disproportionately affect opportunities for SDBs and do not serve a valid and substantial procurement purpose.

The foregoing is merely a partial list of possible measures. What is required—both as a matter of policy and constitutional necessity—is a systematic and continuing government-wide focus on encouraging minority participation through outreach and technical assistance. It is proposed in contracting, therefore, that agencies should report annually to the President on their outreach and technical assistance practices. These reports should present the actual practices and experiences of federal agencies and include recommendations as to approaches that can and should be adopted more broadly. The maximum use of such race-neutral efforts will reduce to a minimum the use of race-conscious measures under the benchmark limits described above.

Conclusion

The structure outlined above has been crafted with regard for each of the six factors that courts have identified as relevant in determining whether race-based decisionmaking is narrowly tailored to meet an identified compelling interest. While courts have identified these six factors as relevant in determining whether a measure is narrowly tailored, they have not required that race-conscious enactments satisfy each element or satisfy any particular element to any specific degree. The structure proposed herein for SDB procurement, however, measures up favorably with respect to each of the six factors.

The proposal requires that agencies at all times use race-neutral alternatives to the maximum extent possible. An annual review mechanism is established to ensure maximum use of such race-neutral efforts. Only where those efforts are insufficient to overcome the effects of past and present discrimination can race-conscious efforts be invoked.

The system is flexible in that race will be relied on only when annual analysis of actual experience in procurement indicates that minority contracting falls below levels that would be anticipated absent discrimination. Moreover, the extent of any credit awarded will be adjusted annually to ensure that it is closely matched to the need for a race-based remedial effort in a particular industry.

Race will not be relied upon as the sole factor in SDB procurement decisions. The use of credits (instead of set-asides) ensures that all firms have an opportunity to compete and that in order to obtain federal contracts minority firms will have to demonstrate that they are qualified to perform the work.[21]

Application of the benchmark limits ensures that any reliance on race is closely tied to the best available analysis of the relative capacity of minority firms to perform the work in question—or what their capacity would be in the absence of discrimination.

The duration of the program is inherently limited. As minority firms are more successful in obtaining federal contracts, reliance on race-based mechanisms will decrease automatically. When the effects of discrimination have been

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[21] The SBA's 8(a) program contains a variety of elements that help to target the program on firms in need of special assistance, including a requirement that applicants affirmatively demonstrate economic disadvantage. Furthermore, the program is not limited to minority-owned firms. These features of the program ensure that race is not the sole factor in determining entry into the program.

eliminated, as demonstrated by minority success in obtaining procurement contracts, reliance on race will terminate automatically. The system as a whole will be reexamined by the executive branch at the end of two years and at regular intervals thereafter. In addition, the principal enactments that this proposal implements, FASA and the Department of Defense Authorization Act, expire at the end of the fiscal year 2000. Congress will have to examine the functioning of this system and make a determination whether to extend the authority to continue its operation.

Finally, the proposal avoids any undue burden on nonbeneficiaries of the program. As a practical matter, the overwhelming percentage of federal procurement money will continue to flow, as it does now, to nonminority businesses. Furthermore, implementation of the benchmark limitations will ensure that race-based decisionmaking cannot result in concentrations of minority contracting in particular industries or regions and will thereby limit the impact on nonminorities.

The structure of affirmative action in contracting set forth herein will not be simple to implement and will undoubtedly be improved through further refinement. Agencies will have to make judgments and observe limitations in the use of race-conscious measures, and make concentrated race-neutral efforts that are not required under current practice. The Supreme Court, however, has changed the rules governing federal affirmative action. This model responds to principles developed by the Supreme Court and lower courts in applying strict scrutiny to race-based decisionmaking. The challenge for the federal government is to satisfy, within these newly-applicable constitutional limitations, the compelling interest in remedying the effects of discrimination that Congress has identified.

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Appendix—The Compelling Interest for Affirmative Action in Federal Procurement: A Preliminary Survey

Under the Supreme Court's ruling last year in *Adarand Constructors, Inc.* v. *Peña*, 115 S. Ct. 2097 (1995), strict scrutiny applies to federal affirmative action programs that provide for the use of racial or ethnic criteria as factors in procurement decisions in order to benefit members of minority groups. Such programs satisfy strict scrutiny if they serve a "compelling interest," and are "narrowly tailored" to the achievement of that interest. Strict scrutiny is the most exacting standard of constitutional review. It is the same standard that courts apply when reviewing laws that discriminate against minority groups. The Supreme Court in *Adarand* did not decide whether a compelling interest is served by the procurement program at issue in the case (or by any other federal affirmative action program), and remanded the case to the lower courts, which had not applied strict scrutiny.[1] Nevertheless, a strong majority of the Court—led by Justice O'Connor, who wrote the majority opinion—admonished that even under strict scrutiny, affirmative action by the federal government is constitutional in appro-

[1] *Adarand* involved a constitutional challenge to a Department of Transportation ("DOT") program that compensates prime contractors if they hire subcontractors certified as small businesses controlled by "socially and economically disadvantaged" individuals. The legislation on which the DOT program is based, the Small Business Act, establishes a government-wide goal for participation of such concerns at "not less than 5 percent of the total value of all prime contract and subcontract awards for each fiscal year." 15 U.S.C. § 644(g)(1). The Act further provides that members of designated racial and ethnic minority groups are presumed to be socially and economically disadvantaged. *Id.* § 637(a)(5)(6), § 637(d)(2),(3). In *Adarand*, the Supreme Court stated that the presumption constitutes race-conscious action, thereby triggering application of strict scrutiny. 115 S. Ct. at 2105.

priate circumstances.[2] Without spelling out in precise terms what those circumstances are, the Court stated that the government has a compelling interest in remedying "[t]he unhappy persistence of both the practice and the lingering effects of racial discrimination against minority groups in this country." 115 S. Ct. at 2117.

At bottom, after *Adarand*, the compelling interest test centers on the nature and weight of evidence of discrimination that the government needs to marshal in order to justify race-conscious remedial action. It is clear that the mere fact that there has been generalized, historical societal discrimination in the country against minorities is an insufficient predicate for race-conscious remedial measures; the discrimination to be remedied must be identified more concretely. The federal government would have a compelling interest in taking remedial action in its procurement activities, however, if it can show with some degree of specificity just how "the persistence of both the practice and the lingering effects of racial discrimination"—to use Justice O'Connor's phrase in *Adarand*—has diminished contracting opportunities for members of racial and ethnic minority groups.[3]

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[2] *Adarand*, 115 S. Ct. at 2117. The Court emphasized that point in order to "dispel the notion that strict scrutiny is 'strict in theory, but fatal in fact.'" *Id.* Seven of the nine justices of the Court embraced the principle that it is possible for affirmative action by the federal government to meet strict scrutiny. This group included: (i) Justice O'Connor and two other justices in the majority, Chief Justice Rehnquist and Justice Kennedy; and (ii) the four dissenting justices (Stevens, Souter, Ginsburg, and Breyer). Only Justices Scalia and Thomas, both of whom concurred in the result in the case, advocated a position that approaches a near blanket constitutional ban on affirmative action.

[3] *Adarand* did not alter the principle that the government may take race-conscious remedial action in the absence of a formal judicial or administrative determination that there has been discrimination against

In coordinating the review of federal affirmative action programs that the President directed agencies to undertake in light of *Adarand*, the Justice Department has collected evidence that bears on that inquiry. The evidence is still being evaluated, and further information remains to be collected. As set forth below, that evidence indicates that racially discriminatory barriers hamper the ability of minority-owned businesses to compete with other firms on an equal footing in our nation's contracting markets. In short, there is today a compelling interest to take remedial action in federal procurement.[4]

The purpose of this memorandum is to summarize the evidence that has been assembled to date on the compelling interest question. Part I of the memorandum provides an overview of the long legislative record that underpins the acts of Congress that authorize affirmative action measures

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individual members of minorit[y] groups (or minorities as a class). The test is whether the government has a "strong basis in evidence" for the conclusion that such action is warranted. *City of Richmond* v. *J.A. Croson Co.*, 488 U.S. 469, 500 (1989). *Adarand* also did not alter the principle that the beneficiaries of race-conscious remedial measures need not be limited to those individuals who themselves demonstrate that they have suffered some identified discrimination. See *Local 28, Sheet Metal Workers' Int'l Ass'n* v. *EEOC*, 478 U.S. 421, 482 (1986); *Wygant* v. *Jackson Bd. of Educ.*, 476 U.S. 267, 277-78 (1986) (plurality opinion); *id.* at 287 (O'Connor, J., concurring).

[4] The term "federal procurement" refers to goods and services that the federal government purchases directly for its own use. This is to be distinguished from programs in which the federal government provides funds to state and local governments for use in their procurement activities. As part of those programs, Congress has authorized recipients of federal funds to take remedial action in procurement. Those programs are not the focus of this memorandum. However, much of the evidence discussed herein that supports the use of remedial measures in the federal government's own procurement also supports the use of congressionally-authorized remedial measures in state and local procurement.

in procurement—a record that is entitled to substantial deference from the courts, given Congress' express constitutional power to identify and redress, on a nationwide basis, racial discrimination and its effects. The remaining sections of the memorandum survey information from various sources: (1) Congressional hearings and reports that bear on the problems that discrimination poses for minority opportunity in our society, but that are not strictly related to specific legislation authorizing affirmative action in government procurement; (2) recent studies from around the country that document the effects of racial discrimination on the procurement opportunities of minority-owned businesses at the state and local level; and (3) works by social scientists, economists, and other academic researchers on the manner in which the various forms of discrimination act together to restrict business opportunities for members of racial and ethnic minority groups.[5]

All told, the evidence that the Justice Department has collected to date is powerful and persuasive. It shows that the discriminatory barriers facing minority-owned businesses are not vague and amorphous manifestations of historical societal discrimination. Rather, they are real and concrete, and reflect ongoing patterns and practices of exclusion, as well as the tangible, lingering effects of prior discriminatory conduct.[6]

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[5] It is well-established that the factual predicate for a particular affirmative action measure is not confined to the four corners of the legislative record of the measure. See, *e.g.*, *Concrete Works* v. *City and County of Denver*, 36 F.3d 1513, 1520-22 (10th Cir. 1994), cert. denied, 115 S. Ct. 1315 (1995); *Contractors Ass'n* v. *City of Philadelphia*, 6 F.3d 990, 1004 (3d Cir. 1993); *Coral Constr. Co.* v. *King County*, 941 F.2d 910, 920 (9th Cir. 1991), cert. denied, 502 U.S. 1033 (1992).

[6] Congress has also adopted affirmative action measures in federal procurement, as well as in programs that fund the procurement activities of state and local governments, that are intended to assist women-owned

It is important to emphasize that, even though the government has a compelling interest in taking race-conscious remedial measures in its procurement, their use must be limited. Under the requirements of the "narrow tailoring" prong of strict scrutiny, the federal government may only employ such measures to the extent necessary to serve the compelling interest in remedying the impact of discrimination on minority contracting opportunity. The Justice Department's proposed reforms to affirmative action in federal procurement (to which this memorandum is attached) are intended to target race-conscious remedial measures to markets in which the evidence indicates that discrimination continues to impede the participation of minority firms in contracting. Thus, the proposal seeks to ensure that affirmative action in federal procurement operates in a flexible, fair, limited, and careful manner, and hence will satisfy the requirements of narrow tailoring.

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businesses. At present, such measures are subject to intermediate scrutiny, not the *Adarand* strict scrutiny standard. Therefore, they have not been the focus of the post-*Adarand* review that the Justice Department is coordinating. However, some of the evidence collected by the Justice Department bears on the constitutional justification for affirmative action programs for women in government procurement. See, *e.g.*, Interagency Committee on Women's Business Enterprise, *Expanding Business Opportunities for Women* (1996); National Foundation for Women Business Owners and Dunn & Bradstreet Information Services, *Women-Owned Businesses: A Report on the Progress and Achievement of Women-Owned Enterprises—Breaking the Boundaries* (1995); *Problems Facing Minority and Women-Owned Small Businesses in Procuring U.S. Government Contracts: Hearing Before the Subcomm. on Commerce, Consumer and Monetary Affairs of the House Comm. on Government Operations*, 103d Cong., 2d Sess. (1994).

I. Survey of the Legislative Record

In evaluating the evidentiary predicate for affirmative action in federal procurement, it is highly significant that the measures have been authorized by Congress, which has the unique and express constitutional power to pass laws to ensure the fulfillment of the guarantees of racial equality in the Thirteenth and Fourteenth Amendments.[7] These explicit constitutional commands vest Congress with the authority to remedy discrimination by private actors, as well as state and local governments.[8] Congress may also exercise its constitutionally grounded spending and commerce powers to ensure that discrimination in our nation is not inadvertently perpetuated through government procurement practices.[9] In exercising its remedial authority, Congress need not target only deliberate acts of discrimination. It may also strive to eliminate the effects of discrimination that continue to impair opportunity for minorities, even in the

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[7] See *Croson*, 488 U.S. at 488 (plurality opinion); *Fullilove* v. *Klutznick*, 448 U.S. 448, 483 (1980) (plurality opinion); *id.* at 500 (Powell, J., concurring); see also *Adarand*, 115 S. Ct. at 2114; *Metro Broadcasting, Inc.* v. *F C C*, 497 U.S. 547, 563 (1990); *id.* at 605-06 (O'Connor, J., dissenting); cf. *Seminole Tribe of Florida* v. *Florida*, 116 S. Ct. 1114, 1125 (1996) (reaffirming that broad grant of remedial power under Section 5 of the Fourteenth Amendment enables Congress to override state sovereign immunity).

[8] See *Croson*, 488 U.S. at 490 (plurality opinion); *Fullilove*, 448 U.S. at 476-78 (plurality opinion); *id.* at 500 (Powell, J., concurring); *Runyon* v. *McCrary*, 427 U.S. 160, 179 (1976); see also *Adarand*, 115 S. Ct. at 2126 (Stevens, J., dissenting); *Metro Broadcasting*, 497 U.S. at 605 (O'Connor, J., dissenting).

[9] See *Croson*, 488 U.S at 492 (plurality opinion) ("It is beyond dispute that any public entity, state or federal, has a compelling interest in assuring that public dollars, drawn from the tax contributions of all citizens, do not serve to finance the evil of private prejudice."); see also *Metro Broadcasting*, 497 U.S. at 563-64; *Fullilove*, 448 U.S at 473-76 (plurality opinion).

absence of ongoing, intentional acts of discrimination.[10] Furthermore, in combatting discrimination and its effects, Congress has the latitude to develop national remedies for national problems. Congress need not make findings of discrimination with the same degree of precision as do state or local governments. Nor is it obligated to make findings of discrimination in every industry or region that may be affected by a remedial measure.[11]

Congress has repeatedly examined the problems that racial discrimination poses for minority-owned businesses. A complete discussion of the entire record of Congress in this area is beyond the scope of this memorandum.[12] The

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[10] See *Adarand*, 115 S. Ct. at 2117 (Congress may adopt affirmative action to remedy "both the practice and the lingering effects of discrimination"). Accord *id.* at 2133 (Souter, J., dissenting) (government may act to redress effects of discrimination "that would otherwise persist and skew the operation of public systems even in the absence of current intent to practice any discrimination").

[11] *Croson*, 488 U.S. at 490, 504; *Fullilove*, 448 U.S. at 502-03 (Powell, J., concurring).

[12] Congressional hearings on the subject from 1980 to the present include the following: *The Small Business Administration's 8(a) Minority Business Development Program: Hearing Before the Senate Comm. on Small Business*, 104th Cong., 1st Sess. (1995); *Discrimination in Surety Bonding: Hearing Before the Subcomm. on Minority Enterprise, Finance and Urban Development of the House Comm. on Small Business*, 103d Cong., 1st Sess. (1993); *Department of Defense: Federal Programs to Promote Minority Business Development: Hearing Before the Subcomm. on Minority Enterprise, Finance and Urban Development of the House Comm. on Small Business*, 103d Cong., 1st Sess. (1993); *SBA's Minority Business Development Program: Hearing Before the House Comm. on Small Business*, 103d Cong., 1st Sess. (1993); *Problems Facing Minority and Women-Owned Small Businesses in Procuring U.S. Government Contracts: Hearing Before the Subcomm. on Commerce, Consumer and Monetary Affairs of the House Comm. on Government Operations*, 103d Cong., 1st Sess. (1993); *Fiscal Economic and Social Crises Confronting American Cities: Hearings Before the Senate Comm. on Banking*,

Housing and Urban Affairs, 102d Cong., 2d Sess. (1992); *Small Disadvantaged Business Issues: Hearing Before the Investigations Subcomm. of the House Comm. on Armed Services*, 102d Cong., 1st Sess. (1991); *Federal Minority Business Programs: Hearing Before the House Comm. on Small Business*, 102d Cong., 1st Sess. (1991); *To Amend the Civil Rights Act of 1964: Permitting Minority Set-Asides: Hearing Before the Senate Comm. on Governmental Affairs*, 101st Cong., 2d Sess. (1990); *City of Richmond v. J.A. Croson: Impact and Response: Hearing Before the Subcomm. on Urban and Minority-Owned Business Development of the Senate Comm. of Small Business*, 101st Cong., 2d Sess. (1990); *Minority Business Set-Aside Programs: Hearing Before the House Comm. on the Judiciary*, 101st Cong., 1st Sess. (1990); *Minority Construction Contracting: Hearing Before the Subcomm. on SBA, the General Economy and Minority Enterprise Development of the House Comm. on Small Business*, 101st Cong., 1st Sess. (1989); *Surety Bonds and Minority Contractors: Hearing Before the Subcomm. on Commerce, Consumer Protection and Competitiveness of the House Comm. on Energy and Commerce*, 100th Cong., 2d Sess. (1988); *Twenty Years after the Kerner Commission: The Need for a New Civil Rights Agenda: Hearing Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 100th Cong., 2d Sess. (1988); *Disadvantaged Business Set-Asides in Transportation Construction Projects: Hearings Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 2d Sess. (1988); *Barriers to Full Minority Participation in Federally Funded Highway Projects: Hearings Before a Subcomm. of the House Comm. on Government Operations*, 100th Cong., 2d Sess. (1988); *The Small Business Competitiveness Demonstration Program Act of 1988: Hearings on S. 1559 Before the Senate Comm. on Small Business*, 100th Cong., 2d Sess. (1988); *Small Business Problems: Hearings Before the House Comm. on Small Business*, 100th Cong., 1st Sess. (1987); *Minority Business Development Act: Hearing Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 1st Sess. (1987); *A Bill to Reform the Capital Ownership Development Program: Hearings on H.R. 1807 Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 1st Sess. (1987); *To Present and Examine the Result of a Survey of the Graduates of the Small Business Administration Section 8(a) Minority*

theme that emanates from this record is unequivocal: Congress has adopted race-conscious remedial measures in procurement directly in response to its findings that "widespread discrimination, especially in access to financial credit, has been an impediment to the ability of minority-owned business to have an equal chance at developing in our economy."[13] Furthermore, Congress has recognized that expanding opportunities for minority-owned businesses in government procurement helps to bring into mainstream public contracting networks firms that otherwise would be excluded as a result of discriminatory barriers. In light of Congress' expansive remedial charter, it is a fundamental

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Business Development Program: Hearings Before the Senate Comm. on Small Business, 100th Cong., 1st Sess. (1987); *Minority Enterprise and General Small Business Problems: Hearings Before the Subcomm. on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems of the Senate Comm. on Small Business*, 99th Cong., 2d Sess. (1986); *The State of Hispanic Small Business in America: Hearings Before the Subcomm. on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems of the House Comm. on Small Business*, 99th Cong., 1st Sess. (1985); *Federal Contracting Opportunities for Minority and Women-Owned Businesses: An Examination of the 8(d) Subcontracting Program: Hearings Before the Senate Comm. on Small Business*, 98th Cong., 1st Sess. (1983); *Minority Business and Its Contribution to the United States Economy: Hearing Before the Senate Comm. on Small Business*, 97th Cong., 2d Sess. (1982); *Small Business and the Federal Procurement System: Hearings Before the Subcomm. on General Oversight of the House Comm. on Small Business*, 97th Cong., 1st Sess. (1981); *Small and Minority Business in the Decade of the 1980's (Part 1): Hearings Before the House Comm. on Small Business*, 97th Cong., 1st Sess. (1981); *Small Business and the Federal Procurement System: Hearings Before the Subcomm. on General Oversight of the House Comm. on Small Business*, 97th Cong., 1st Sess. (1981); *To Amend the Small Business Act to Extend the Current SBA 8(a) Pilot Program: Hearings on H.R. 5612 Before the Senate Select Comm. on Small Business*, 96th Cong., 2d Sess. (1980).

[13] *Affirmative Action Review: Report to the President* 55 (1995).

principle that courts must accord a significant degree of deference to those findings and the attendant judgment of the Congress that remedial measures in government procurement are warranted.[14]

The relevant congressional findings encompass a broad range of problems confronting minority-owned businesses. They include "deficiencies in working capital, inability to meet bonding requirements, disabilities caused by an inadequate 'track record,' lack of awareness of bidding opportunities, unfamiliarity with bidding procedures, pre-selection before the formal advertising process, and the exercise of discretion by government procurement officers to disfavor minority businesses."[15]

For example, in a report that led to the legislation that created what has become known as the "8(a)" program at the Small Business Administration,[16] and that established goals for participation in procurement at each federal agency by firms owned and controlled by socially and economically disadvantaged individuals (SDBs),[17] a congressional committee found that the difficulties facing minority-owned businesses were "not the result of random chance." Rather, the

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[14] See *Croson*, 488 U.S. at 488-90 (plurality opinion); *Fullilove*, 448 U.S. at 472-73 (plurality opinion); *id.* at 508-10 (Powell, J., concurring); see also *Metro Broadcasting*, 497 U.S. at 563; *id.* at 605-07 (O'Connor, J., dissenting). This principle was not disturbed by the Supreme Court's ruling in *Adarand*; thus, it continues to have force, even under strict scrutiny. See *Adarand*, 115 S. Ct. at 2114; *id.* at 2126 (Stevens, J., dissenting); *id.* at 2133 (Souter, J., dissenting).

[15] *Fullilove*, 448 U.S. at 467 (plurality opinion).

[16] That program targets federal procurement opportunities for small firms owned and controlled by individuals who are socially and economically disadvantaged. See 15 U.S.C. 637(a). Members of certain minority groups are presumed to be socially disadvantaged. 13 C.F.R. Pt. 124.

[17] 15 U.S.C. 644(g).

committee stated, "past discriminatory systems have resulted in present economic inequities."[18] In connection with the same legislation, another committee concluded that a pattern of discrimination "continues to deprive racial and ethnic minorities * * * of the opportunity to participate fully in the free enterprise system."[19] Eventually, when it adopted the 8(a) legislation, Congress found that minorities "have suffered the effects of discriminatory practices or similar invidious circumstances over which they have no control," and that "it is in the national interest to expeditiously ameliorate" the effects of this discrimination through increased opportunities for minorities in government procurement.[20]

When revamping the 8(a) program in the late 1980s, Congress again found that "discrimination and the present effects of past discrimination" continued to hinder minority business development. Congress concluded that the pro-

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[18] H.R. Rep. No. 468, 94th Cong., 1st Sess. 2 (1975).

[19] S. Rep. No. 1070, 95th Cong., 2d Sess. 14 (1978). See also H.R. Rep. No. 949, 95th Cong., 2d Sess. 8 (1978).

[20] Pub. L. No. 95-507, § 201, 92 Stat. 1757, 1760 (1978). See 124 Cong. Rec. 35,204 (1978) (statement of Sen. Weicker) (commenting on the introduction of the conference report on the 8(a) legislation and observing that the report recognizes the existence of a "pattern of social and economic discrimination that continues to deprive racial and ethnic minorities of the opportunity to participate fully in the free enterprise system"). In the same year it passed the 8(a) legislation, Congress considered an additional bill that sought to target federal assistance to minority-owned firms. In introducing that measure, Senator Dole remarked that "minority businessmen can compete equally when given equal opportunity. One of the most important steps this country can take to insure equal opportunity for its hispanic, black and other minority citizens is to involve them in the mainstream of our free enterprise system." 124 Cong. Rec. 7681 (1978).

gram required bolstering so that it would better "redress the effects of discrimination on entrepreneurial endeavors."[21]

In the same vein are congressional findings that underpin legislation that sets agency-specific goals for participation by disadvantaged businesses—including minority-owned firms—in procurement and grant programs administered by those agencies. For instance, in recommending the continued use of such goals as part of programs through which the Depart-

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[21] H.R. Rep. No. 460, 100th Cong., 1st Sess. 16, 18 (1987). See 133 Cong. Rec. 37,814 (1987) (statement of Sen. Bumpers) (discussing proposed revisions to 8(a) program and commenting that minorities "continue to face discrimination in access to credit and markets"); *id.* at 33,320 (statement of Rep. Conte) (discussing proposed revisions to 8(a) program and commenting that effects of discrimination continued to be felt, and that 8(a) amendments were needed to "create a workable mechanism to finally redress past discriminatory practices"). See generally S. Rep. No. 394, 100th Cong., 2d Sess. (1988); *The Small Business Competitiveness Demonstration Program Act of 1988: Hearings on S. 1559 Before the Senate Comm. on Small Business*, 100th Cong., 2d Sess. (1988); *Small Business Problems: Hearings Before the House Comm. on Small Business*, 100th Cong., 1st Sess. (1987); *Minority Business Development Act: Hearing Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 1st Sess. (1987); *A Bill to Reform the Capital Ownership Development Program: Hearings on H.R. 1807 Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 1st Sess. (1987); *To Present and Examine the Result of a Survey of the Graduates of the Small Business Administration Section 8(a) Minority Business Development Program: Hearings Before the Senate Small Business Comm.*, 100th Cong., 1st Sess. (1987); *Minority Enterprise and General Small Business Problems: Hearings Before the Subcomm. on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems of the Senate Comm. on Small Business*, 99th Cong., 2d Sess. (1986); *The State of Hispanic Small Business in America: Hearings Before the Subcomm. on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems of the House Comm. on Small Business*, 99th Cong., 1st Sess. (1985).

ment of Transportation provides funds to state and local governments for use in highway and transit projects, a congressional committee observed that it had considered extensive testimony and evidence, and determined that this action was "necessary to remedy the discrimination faced by socially and economically disadvantaged persons attempting to compete in the highway industry and mass transit construction industry."[22]

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[22] S. Rep. No. 4, 100th Cong., 1st Sess. 11 (1987). The DoT goals were initially established in the Surface Transportation Assistance Act of 1982, Pub. L. No. 97-424, § 105(f), 96 Stat. 2097 (1982). They were continued in the Surface Transportation and Uniform Relocation Assistance Act of 1987 ("STURAA"), Pub. L. No. 100-17, § 106(c)(1), 101 Stat. 132, 145 (1987). Congress held further hearings on the subject after passage of STURAA. See *Minority Construction Contracting: Hearing Before the Subcomm. on SBA, the General Economy and Minority Enterprise Development of the House Comm. on Small Business*, 101st Cong., 1st Sess. (1989); *Disadvantaged Business Set-Asides in Transportation Construction Projects: Hearings Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 2d Sess. (1988); *Barriers to Full Minority Participation in Federally Funded Highway Construction Projects: Hearing Before a Subcomm. of the House Comm. on Government Operations*, 100th Cong., 2d Sess. (1988). Congress subsequently reauthorized the goals in the Intermodal Surface Transportation Efficiency Act of 1991, Pub. L. No. 102-240, § 1003(b), 105 Stat. 1914, 1919 (1991). See 137 Cong. Rec. S7571 (June 12, 1991) (statement of Sen. Simpson) (expressing support for continuation of disadvantaged business program at Transportation Department).

Congress has established comparable initiatives to encourage disadvantaged business participation in grant programs administered by the Environmental Protection Agency (EPA). For example, recipients of grants awarded by EPA under the Clean Air Act are required to set disadvantaged business goals. See 42 U.S.C. § 7601 note; see also 42 U.S.C. § 4370d (establishing an SDB goal for recipients of EPA funds used in support of certain environmental-related projects); H.R. Rep. No. 226, 102 Cong., 1st Sess. 48 (1991).

Congress has also established goals for SDB participation in procurement at the Defense Department, and authorized that agency to use specific forms of remedial measures to achieve the goals.[23] The Defense Department program too is predicated on findings that opportunities for minority-owned businesses had been impaired.[24] More fundamentally, in establishing the program, Congress recognized that fostering contracting opportunities for minority-owned businesses at the Defense Department is crucial, because that agency alone typically accounts for more than two-thirds of the federal government's procurement activities. Therefore, affirmative action efforts at the Defense Department enable minority-owned businesses to demonstrate their capabilities to contracting officers at that important procuring agency and to the vast number of nonminority firms that provide goods and services to the Pentagon. In turn, minority-owned businesses can begin to break into the contracting networks from which they typically have been excluded.[25]

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[23] 10 U.S.C. § 2323.

[24] See H.R. Rep. No. 332, 99th Cong., 1st Sess. 139-40 (1985) (if disadvantaged firms had been able to "participate in the 'early' development of major Defense systems, they would have had an opportunity to gain the expertise required to bid on such contracts"); see also H.R. Rep. No. 450, 99th Cong., 1st Sess. 179 (1985); 131 Cong. Rec. 17,445-17,448 (1985); H.R. Rep. No. 1086, 98th Cong., 2d Sess. 100-01 (1984).

[25] See 131 Cong. Rec. 17,447 (1985) (statement of Rep. Conyers) (affirmative action needed to break down "buddy-buddy contracting" at the Defense Department, "which has the largest procurement program in the Federal Government"); *id.* (statement of Rep. Schroeder) (an "old boy's club" in Defense Department contracting excludes many minorities from business opportunities); see also *Department of Defense: Federal Programs to Promote Minority Business Development: Hearing Before the Subcomm. on Minority Enterprise, Finance and Urban Development of the House Comm. on Small Business*, 103d Cong., 1st Sess. 49 (1993) (statement of Rep. Roybal-Allard) ("Old attitudes and old habits die hard * * *. Defense contracting has, traditionally, been a closed shop. Only a

Opportunities for minority-owned businesses to participate in Defense Department procurement increased following the introduction of the affirmative action program there in the late 1980s. However, the effects of discrimination were still felt in federal procurement generally. Based on information it obtained through a 1993 hearing, a congressional committee reported the following year that this "lack of opportunity results primarily from discriminatory or economic conditions," and that "improving access to government contracts and procurement offers a significant opportunity for business development in many industry sectors."[26] In the Federal Acquisition Streamlining Act of 1994, Congress saw fit to make available to all agencies the remedial tools that previously had been granted to the Defense Department, in order to "improv[e] access to contracting opportunities for * * * minority-owned small businesses."[27]

Through its recurring assessments of the implications of discrimination against minority-businesses, Congress has concluded that, standing alone, legislation that simply proscribes racial discrimination is an inadequate remedy. Congress also has attempted to redress the problems facing minority businesses through race-neutral assistance to all small businesses.[28] Congress has determined, however, that those

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select few need apply. Since the passage of the minority contracting opportunity law, some progress has been made."); H.R. Rep. No. 1086, 98th Cong., 2d Sess. 100-101 (1984) (low level of participation by disadvantaged firms in Defense Department contracting indicated a need to expand procurement opportunities at that agency for such firms).

[26] H.R. Rep. No. 870, 103d Cong., 2nd Sess. 5 (1994).

[27] 140 Cong. Rec. H9242 (Sept. 20, 1994) (statement of Rep. Dellums).

[28] Beginning with the Small Business Act of 1953, Congress has authorized numerous programs to "aid, counsel, assist, and protect * * * the interests of small-business concerns" and "insure that a fair proportion of the total purchases and contracts for supplies and services for the government be placed with small-business enterprises." Pub. L. No. 163,

remedies, by themselves, are "ineffectual in eradicating the effects of past discrimination,"[29] and that race-conscious measures are a necessary supplement to race-neutral ones.[30] Finally, based on its understanding of what happens at the state and local level when use of affirmative action is severely curtailed or suspended outright, Congress has concluded that minority participation in government procurement tends to fall dramatically in the absence of at least some kind of remedial measures, the result of which is to

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§ 202, 67 Stat. 232 (1953). After recognizing in the 1960s the specific problems facing minority owned businesses, Congress attempted to address them through race-neutral measures. For example, in 1971, Congress amended the Small Business Investment Act to create a surety bond guarantee program to assist small businesses that have trouble obtaining traditional bonding. In 1972, Congress created a new class of small business investment companies to provide debt and equity capital to small businesses owned by socially and economically disadvantaged individuals. And over the years, Congress has continuously reviewed and strengthened programs to assist all small businesses through the Small Business Act. See *e.g.* Pub. L. No. 93-386, 88 Stat. 742 (1974); Pub. L. No. 94-305, 90 Stat. 663 (1976); Pub. L. No. 95-89, 91 Stat. 553 (1977).

[29] *Croson*, 488 U.S. at 550 (Marshall, J., dissenting). Accord *Fullilove*, 448 U.S. at 467 (plurality opinion); *id.* at 511 (Powell, J., concurring); see also *City of Richmond* v. *J.A. Croson: Impact and Response: Hearing Before the Subcomm. on Urban and Minority-Owned Business Development of the Senate Comm. on Small Business*, 101st Cong., 2d Sess. 48 (1990) (statement of Ray Marshall); H.R. Rep. No. 468, 94th Cong., 1st Sess. 32 (1975).

[30] It bears emphasizing that race-neutral programs for small businesses are important and necessary components of an overall congressional strategy to enhance opportunity for small businesses owned by minorities. For example, Congress has authorized contracting set asides for small businesses generally—minority and nonminority alike—as well as a host of bonding, lending, and technical assistance programs that are open to all small businesses. See 15 U.S.C. § 631 *et seq.*

perpetuate the discriminatory barriers that have kept minorities out of the mainstream of public contracting.[31]

The foregoing is just a sampling from the legislative record of congressionally-authorized affirmative action in government procurement. The remainder of the memorandum surveys evidence from other sources regarding the impact of discrimination on the ability of minority-owned businesses to compete equally in contracting markets. This evidence confirms Congress' determination that race-conscious remedial action is needed to correct that problem.

II. Discriminatory Barriers to Minority Contracting Opportunities

Developing a business that can successfully compete for government contracts depends on many factors. To begin with, technical or professional experience, which is typically attained through employment and trade union opportunities, is an important prerequisite to establishing any business. Second, obtaining financing is necessary to the formation of most businesses. The inability to secure the twin building blocks of experience and financing may prevent a business from ever getting off the ground. Some individuals overcome these initial obstacles and are able to form businesses. However, they subsequently may be shut out from important contracting and supplier networks, which can hinder their ability to compete effectively for contract oppor-

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[31] *The Meaning and Significance for Minority Businesses of the Supreme Court Decision in the City of Richmond v. J.A. Croson Co.: Hearing Before the Legislation and National Security Subcomm. of the House Comm. on Government Operations*, 101st Cong., 2d Sess. 57, 62-90 (1990); *City of Richmond v. J.A. Croson: Impact and Response: Hearing Before the Subcomm. on Urban and Minority-Owned Business Development of the Senate Comm. on Small Business*, 101st Cong., 2d Sess. 39-44 (1990) (statement of Andrew Brimmer).

tunities. And further barriers may be encountered when a business tries to secure bonding and purchase supplies for projects—critical requirements for many major government contracts.

While almost all new or small businesses find it difficult to overcome these barriers and become successful, these problems are substantially greater for minority-owned businesses. Empirical studies and reports issued by congressional committees, executive branch commissions, academic researchers, and state and local governments document the widespread and systematic impact of discrimination on the ability of minorities to carry out each of the steps that are required for participation in government contracting. This evidence of discrimination can be grouped into two categories:

(i) evidence showing that discrimination works to preclude minorities from obtaining the experience and capital needed to form and develop a business, which encompasses discrimination by trade unions and employers and discrimination by lenders;

(ii) evidence showing that discriminatory barriers deprive existing minority firms of full and fair contracting opportunities, which encompasses discrimination by private sector customers and prime contractors, discrimination by business networks, and discrimination by suppliers and bonding providers.

The following provides an overview of both categories of evidence.

A. Effects of Discrimination on the Formation and Development of Minority Businesses

A primary objective of affirmative action in procurement is to encourage and support the formation and development

of minority-owned firms as a remedy to the "racism and other barriers to the free enterprise system that have placed a heavier burden on the development and maturity of minority businesses."[32] That these efforts are necessary is evident from the recent findings by the U.S. Commission on Minority Business Development, appointed by President Bush. The Commission amassed a large amount of evidence demonstrating the marginal position that minority-owned businesses hold in our society:

• Minorities make up more than 20 percent of the population; yet, minority-owned businesses are only 9 percent of all U.S. businesses and receive less than 4 percent of all business receipts.[33]

• Minority firms have, on average, gross receipts that are only 34 [percent] of that of nonminority firms.[34]

• The average payroll for minority firms with employees is less than half that of nonminority firms with employees.[35]

President Bush's Commission undertook an extensive analysis of the barriers that face minority-owned business formation and development. It concluded that "minorities are not underrepresented in business because of choice or

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[32] *Small and Minority Business in the Decade of the 1980's (Part 1): Hearings Before the House Comm. on Small Business*, 97th Cong., 1st Sess. 4 (1981). See also H.R. Rep. No. 870, 103d Cong., 2d Sess. 5 (1994).

[33] United States Commission on Minority Business Development, *Final Report* 2-6 (1992). These statistics are based on 1987 census data, the most recent full data available regarding the status of minority-owned businesses. Preliminary reports from 1992 census data reveal that the status of minority firms has not significantly improved. For instance, African Americans are 12[%] of the population but, in 1992, owned only 3.6% of all businesses (up from 3.1% in 1987) and received just 1[%] of all U.S. business receipts (which is the same level as in 1987).

[34] *Id.* at 3.

[35] *Id.* at 4.

chance. Discrimination and benign neglect is the reason why our economy has been denied access to this vital resource."[36] Further evidence of the effect of discrimination on minority business development is revealed in recent studies showing that minorities are significantly less likely than whites to form their own business—even after controlling for income level, wealth, education level, work experience, age and marital status.[37] These findings strongly indicate that minorities "face barriers to business entry that non-minorities do not face."[38]

Since the inception of federal affirmative action initiatives in procurement, policy makers have recognized that there are two principal barriers to the formation and development of minority-owned businesses: limited technical experience and limited financial resources. President Nixon's Advisory Council on Minority Business Enterprise identified these barriers in 1973 when it reported that "a characteristic lack of financial and managerial resources has impaired any willingness to undertake enterprise and its inherent risk."[39] Two decades later, a congressional committee found that minorities continue to have "fewer opportunities to develop business skills and attitudes, to obtain necessary resources,

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[36] *Id.* at 60.

[37] See Division of Minority and Women's Business Development, *Opportunity Denied: A Study of Racial and Sexual Discrimination Related to Government Contracting in New York State*, Appendix D, 53-75 (1992) (finding that minorities in New York were 20% less likely to enter self-employment than similarly situated whites); Timothy Bates, *Self-employment Entry Across Industry Groups*, Journal of Business Venturing, Vol. 10, at 143- 56 (1995).

[38] Timothy Bates, *Self-employment Entry Across Industry Groups*, Journal of Business Venturing, Vol. 10, 149 (1995).

[39] Samuel Doctors & Anne Huff, *Minority Enterprise and the President's Council* 4-6 (1973) (quoted in Tuchfarber *et al.*, *City of Cincinnati: Croson Study* 150 (1992)).

and to gain experience, which is necessary for the success of small businesses in a competitive environment."[40] Discrimination in two sectors of the national economy accounts, at least in part, for the diminished opportunity: discrimination by trade unions and employers, which has prevented minorities from garnering crucial technical skills; and discrimination by lenders, which has prevented minorities from garnering needed capital.

1. Discrimination by Trade Unions and Employers

President Nixon's Advisory Council on Minority Business Enterprise determined that "the lack of opportunity to participate in managerial technical training has severely restricted the supply of [minority] entrepreneurs, managers and technicians."[41] A history of discrimination by unions and employers helps to explain this unfortunate phenomenon.

Prior to the civil rights accomplishments of the 1960s, labor unions and employers were virtually free to practice overt racial discrimination. Minorities were segregated into menial, low wage positions, leaving no minority managers or white collar workers in most sectors of our economy. Trade unions, which controlled training and job placement in many skilled trades, commonly barred minorities from membership. As a result, "whole industries and categories of employment were, in effect, all-white, all-male."[42] These practices left minorities unable to gain the experience needed to operate all but the smallest businesses, primarily consisting of small "mom and pop" stores with no employees, minimal

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[40] H.R. Rep. No. 870, 103d Cong., 2d Sess. 5 (1994).

[41] Samuel Doctors & Anne Huff, *Minority Enterprise and the President's Council* 4-6 (1973) (quoted in Tuchfarber *et al.*, *City of Cincinnati: Croson Study* 150 (1992)).

[42] *Affirmative Action Review: Report to the President* 7 (1995).

revenue, located in segregated neighborhoods, and serving an exclusively minority clientele.[43]

Discrimination by unions has been recognized as a major factor in preventing minorities from obtaining employment opportunities in the skilled trades. Title VII of the Civil Rights Act of 1964 (prohibiting employment discrimination) was passed, in part, in response to Congress's desire to halt "the persistent problems of racial and religious discrimination or segregation * * * by labor unions and professional, business, and trade associations."[44] Even after Title VII went on the books, however, unions precluded minorities from membership through a host of discriminatory policies, including the use of "tests and admissions criteria which [have] no relation to on-the-job skills and which [have] a differential impact" on minorities;[45] discriminating in the application of admission criteria;[46] and imposing admission

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[43] See, *e.g.*, Joseph Pierce, *Negro Business and Business Education* (1947); Andrew Brimmer, *The Economic Potential of Black Capitalism*, Public Policy Vol. 19, No. 2, at 289-308 (1971); Kent Gilbreath, *Red Capitalism: An Analysis of the Navajo Economy* (1973).

[44] S. Rep. No. 872, 88th Cong., 1st Sess. 1 (1964). See, *e.g.*, Brimmer & Marshall, *Public Policy and Promotion of Minority Economic Development: City of Atlanta and Fulton County, Georgia*, Pt. VII, 11-17 (1990) (in 1963, minorities were prohibited from joining Atlanta unions representing plumbers, electricians, steel workers and bricklayers); TEM Associates, *Minority/Women Business Study: Revised Final Report, Phase I*, Volume I 3-13 ("In 1963, not one of the 1,000 persons in apprenticeship training in Dade County was Black, and the Miami Sheet Metal Workers local, like most other trade unions, was all white.").

[45] *United States v. Iron Workers Local 86*, 443 F.2d 544, 548 (9th Cir.), cert. denied, 404 U.S. 984 (1971). See also *Hameed v. International Ass'n of Bridge, Structural & Ornamental Iron Workers*, 637 F.2d 506 (8th Cir. 1980) (selection criteria, including aptitude test, and the requirement of a high school diploma as a condition of eligibility were discriminatory).

[46] *United States v. Iron Workers Local 86*, 443 F.2d 544, 548 (9th Cir.) (differential application and admissions requirements between whites and

conditions, such as requiring that new members have a family relationship with an existing member, that locked minorities out of membership opportunities.[47] As a result, unions remained virtually all-white for some time after the enactment of Title VII:

- In 1965, the President's Commission on Equal Opportunity found that out of 3,969 persons selected for skilled trade union apprenticeships in 30 southern cities, only 26 were black.[48]

- In 1967, blacks made up less than 1 percent of the nation's mechanical union members (i.e. sheet metal workers, boilermakers, plumbers, electricians, ironworkers and elevator constructors).[49]

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blacks; spurious reasons given for rejections of blacks), cert. denied, 404 U.S. 984 (1971); *Sims v. Sheet Metal Workers Int'l Ass'n*, 489 F.2d 1023 (6th Cir. 1973) (union waived requirements for white applicants).

[47] *United States v. United Bhd. of Carpenters and Joiners of America*, 457 F.2d 210, 215 (7th Cir.), cert. denied, 409 U.S. 851 (1972) (family relation requirement excluded minorities from Carpenters trade); *United States v. International Ass'n of Bridge, Structural and Ornamental Iron Workers*, 438 F.2d 679, 683 (7th Cir.) (requiring family relationships between new and existing members "effectively precluded non-white membership"), cert. denied, 404 U.S. 830 (1971); *Asbestos Workers, Local 53 v. Vogler*, 407 F.2d 1047 (5th Cir. 1969) (rule restricting membership to sons or close relatives of current members perpetuated the effect of past exclusion of minorities).

[48] Jaynes Associates, *Minority and Women's Participation in the New Haven Construction Industry: A Report to the City of New Haven* 24 (1989) (citing findings of President's Commission on Equal Opportunity).

[49] Steve Askin & Edmund Newton, *Blood, Sweat and Steel*, Black Enterprise, Vol. 14, at 42 (1984).

• In 1969, only 1.6 percent of Philadelphia construction union members were minorities.[50]

Even when minorities were admitted to unions, discriminatory hiring practices and seniority systems often were used to foreclose job opportunities to them.[51] These actions were the subject of numerous civil rights suits, leading the Supreme Court to declare in 1979 that "judicial findings of exclusion from crafts on racial grounds are so numerous as to make such exclusion a proper subject for judicial notice."[52] Well into the 1980s, courts, committees of Congress, and administrative agencies continued to identify the "inability of many minority workers to obtain jobs" through unions because of "slavish adherence to traditional preference practices [and] also [ ] overt discrimination."[53]

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[50] Department of Labor Memorandum from Arthur Fletcher to All Agency Heads (1969) (cited in *Affirmative Action Review: Report to the President* 11 (1995)) (introducing the "Philadelphia Plan" requiring the use of affirmative action goals and timetables in construction, Secretary Fletcher noted that "equal employment opportunity in these trades in the Philadelphia area is still far from a reality. * * * We find, therefore, that special measures are required to provide equal opportunity in these seven trades").

[51] See *Pennsylvania* v. *Operating Eng'rs, Local 542*, 469 F. Supp. 329, 339 (E.D. Pa. 1978) (unions held liable for racial discrimination in employee referral procedures and practices); Waldinger & Bailey, *The Continuing Significance of Race: Racial Conflict and Racial Discrimination in Construction*, Politics and Society, Vol. 19, No. 3, at 299 (1991) ("Despite rules and formal procedures, informal relationships still dominate the union sector's employment processes."); Edmund Newton, *Steel, The Union Fiefdom*, Black Enterprise, Vol. 14, at 46 (1984) (discrimination in operation of hiring halls "operated as impenetrable barriers" to minority job seekers). See generally Barbara Lindeman Schlei & Paul Grossman, *Employment Discrimination Law* 619-28 (1983).

[52] *United Steelworkers of Am. v. Weber*, 443 U.S. 193, 198 n. 1 (1979).

[53] *Taylor v. United States Dept. of Labor*, 552 F. Supp. 728, 734 (E.D. Pa. 1982). See *Minority Business Participation in Department of Trans-*

The discriminatory conduct that was the subject of the Supreme Court's decision in *Local 28, Sheet Metal Workers v. EEOC*,[54] is illustrative of the pattern of racial exclusion by trade unions and its consequences for minorities. The union local operated an apprenticeship training program designed to teach sheet metal skills. Apprentices enrolled in the program received class-room training, as well as on-the-job work experience. As the Supreme Court described it, successful completion of the program was the principal means of attaining union membership. But by excluding minorities from the apprenticeship program through "pervasive and egregious discrimination,"[55] the local effectively excluded minorities from the union for decades. Such exclusion continued notwithstanding the passage of Title VII and a series of administrative and judicial findings in the 60s and 70s that the local had engaged in blatant discrimination in shutting minorities out of the program. Indeed, even into the 80s, the local persisted in violating court orders to open up the program to minorities.[56]

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portation Projects: Hearing Before a Subcomm. of the House Comm. on Government Operations, 99th Cong., 1st Sess. 201 (1985) (testimony of James Haughton) (minority contractors continue to "suffer[] heavily because they have been victims to that discrimination as practiced by the unions"); Division of Minority and Women's Business Development, *Opportunity Denied!: A Study of Racial and Sexual Discrimination Related to Government Contracting in New York State* 41 (1992) ("At least seven reports were issued by federal, state and city commissions and agencies between 1963 and 1982 documenting the pattern of racial exclusion from New York's skilled trade unions by constitution and by-law provisions, member sponsorships rules, subjective interview tests and other techniques, as well as the complicity of construction contractors and the acquiescence of government agencies in those practices.").

[54] 478 U.S. 421 (1986)

[55] *Id.* at 476.

[56] *Id.* at 433-34.

More recently, a Yale University economist prepared a report documenting the history of discrimination by New Haven unions that "confirms the nationwide pattern of discrimination."[57] Prior to the passage of the Civil Rights Act of 1964, New Haven's unions prohibited minority membership, and minority workers were almost completely segregated into jobs that whites would not take because they required working under conditions of extreme heat or discomfort.[58] After passage of the Civil Rights Act, minorities were prevented from entering unions by a rule requiring that at least three current members sponsor the application of any new member.[59] Although the policy was race-neutral on its face, "it was almost impossible to find three members who would nominate a minority [and] stand up for him in a closed meeting when other members would undoubtedly attack the candidate and his sponsors."[60] This and other discriminatory policies prevented all but five African Americans from joining the 1,216 white members of the highest paid skilled trade unions in 1967, and throughout the mid-70s, unions and apprenticeship programs remained virtually all-white.[61] The report concluded that the history of "blocked access to the skilled trades is the most important explanation of the low numbers of minority and women construction contractors today."[62]

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[57] Jaynes Associates, *Minority and Women's Participation in the New Haven Construction Industry: A Report to the City of New Haven* 25-26 (1989).

[58] *Id.* at 26-27.

[59] *Id.* at 28.

[60] *Id.* at 28.

[61] *Id.* at 33; New Haven Board of Aldermen, Minority and Women Business Participation in the New Haven Construction Industry: Committee Report 7 (1990).

[62] Jaynes Associates, *Minority and Women's Participation in the New Haven Construction Industry: A Report to the City of New Haven* 34

There is no doubt that trade unions have put much of the discriminatory past behind them, and they now provide an important source of opportunity for minorities. Some barriers to full opportunity remain, however.[63]

A parallel history of discriminatory treatment by employers has prevented minorities from rising into the private sector management positions that are most likely to lead to self-employment. In 1972, Congress found that only 3.5 percent of minorities held managerial positions compared to

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(1989). Comparable conclusions about the impact of trade union discrimination have been reached in studies from other jurisdictions around the country. See, *e.g.*, D.J. Miller & Associates, *et al.*, *The Disparity Study for Memphis Shelby County Intergovernmental Consortium* 11-46 (Oct. 1994) ("In Memphis, trade unions have historically discriminated against African Americans."); *Report of the Blue Ribbon Panel to the Honorable Richard M. Daley, Mayor of the City of Chicago* 43 (March 1990) ("The Task Force specifically notes the exclusion of minorities and women from the building trades."); National Economic Research Associates, *et al.*, *Availability and Utilization of Minority and Women-Owned Business Enterprises at the Massachusetts Water Resources Authority* 72 (Nov. 1990) ("A number of M/WBE owners complain that problems caused by unions are exacerbated by state bidding requirements that make it difficult or impossible for non-union firms to bid."); Coopers & Lybrand, *et al.*, *State of Maryland Minority Business Utilization Study* 9 (Feb. 1990) (discussing discriminatory union practices).

[63] See BPA Economics, *et al.*, *MBE/WBE Disparity Study of the City of San Jose* I-34 (1990) ("When trying to join unions, minorities may face testing and experience requirements that are waived in the case of relatives of current union members."); Waldinger & Bailey, *The Continuing Significance of Race: Racial Conflict and Racial Discrimination in Construction*, Politics and Society, Vol. 19, No. 3, at 296-97 (1991) ("In 1987, blacks averaged less than 80 percent of parity for all skilled trades with even lower levels of representation in the most highly paid crafts like electricians and plumbers."); *The Meaning and Significance for Minority Businesses of the Supreme Court Decision in the City of Richmond v. J.A. Croson Co.: Hearing Before the Legislation and National Security Subcomm. of the Comm. on Government Operations*, 101st Cong., 2d Sess. 111-15 (1990).

11.4 percent of white employees.[64] Congress attributed this underrepresentation to continued discriminatory conduct by "employers, labor organizations, employment agencies and joint labor-management committees."[65] Evidence derived from caselaw and academic studies shows a variety of discriminatory employment practices, including promoting white employees over more qualified minority employees;[66] relying on word-of-mouth recruiting practices that exclude minorities from vacancy announcements;[67] and creating promotion systems that lock minorities into inferior positions.[68]

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[64] H.R. Rep. No. 238, 92d Cong., 2d Sess. 3 (1972).

[65] *Id.* at 7.

[66] See, *e.g.*, *Winbush* v. *Iowa*, 69 FEP Cases 1348 (8th Cir. 1995) (evidence was "overwhelming" that employer had engaged in disparate treatment with respect to promotion of black employees); *United States* v. *N.L. Industries, Inc.*, 479 F.2d 354 (8th Cir. 1973) (99 percent white management structure caused, in part, by promoting lesser qualified white employees over more qualified minorities).

[67] See, *e.g.*, *EEOC* v. *Detroit Edison Co.*, 515 F.2d 301, 313 (6th Cir. 1975), vacated and remanded on other grounds, 431 U.S. 951 (1977) (finding discrimination in "the practice of relying on referrals by a predominantly white work force"); *Long* v. *Sapp*, 502 F.2d 34, 41 (5th Cir. 1974) (word-of-mouth recruitment serves to perpetuate all-white work force); *Thomas* v. *Washington County Sch. Bd.*, 915 F.2d 922 (4th Cir. 1990). See also Univ. of Mass., *Barriers to the Employment and Work-Place Advancement of Latinos: A Report to the Glass Ceiling Commission* 52 (Aug. 1994) (word-of-mouth recruiting methods that rely on social networks are a significant "exclusionary barrier" to employment opportunities for minorities); Roosevelt Thomas, *et al.*, *The Impact of Recruitment, Selection, Promotion and Compensation Policies and Practices on the Glass Ceiling*, submitted to U.S. Department of Labor Glass Ceiling Commission, 14 (April 1994) (noting that "recruitment practices primarily consist[ing] of word-of-mouth and employee referral networking * * * promote the filling of vacancies almost exclusively from within. If the environment is already homogenous, which many are, it maintains this same 'home-grown' environment"); Gertrude Ezorsky, *Racism and Justice: The Case for Affirmative Action 14- 18 (1991)*; U.S. Commission

A study published earlier this year surveyed a broad range of current labor market evidence and concluded that employment discrimination is "not a thing of the past."[69] Rather, race still matters when it comes to determining access to the best employment opportunities.[70] Progress has been made, of course. Yet, "more than three decades after the passage of the Civil Rights Act, segregation by race and sex continues to be the rule rather than the exception in the American workplace, and discrimination still reduces the pay and prospects of workers who are not white or male."[71] The exclusionary conduct frequently is not deliberate, and the people on top—who are mostly white and male—often believe that they are behaving fairly. But old habits die hard: reliance on outmoded stereotypes and group reputations, and the persistence of "invisible biases" work to perpetuate a system that creates disadvantages in employment for minorities today.[72]

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on Civil Rights, *Affirmative Action in the 1980s: Dismantling the Process of Discrimination* 8 (1981); Barbara Lindeman Schlei & Paul Grossman, *Employment Discrimination Law* 571 (1983).

[68] See, *e.g.*, *Paxton* v. *Union National Bank*, 688 F.2d 552, 565-566 (8th Cir. 1982), cert. denied, 460 U.S. 1083 (1983); *Sears* v. *Bennett*, 645 F.2d 1365 (10th Cir. 1981) (system requiring that porters, all of whom were black, forfeit seniority when changing jobs designed to prevent promotion of black employees), cert. denied, 456 U.S. 964 (1982); *Terrell* v. *U.S. Pipe and Foundry Co.*, 644 F.2d 1112 (5th Cir. 1981) (seniority system created for clearly discriminatory purposes), vacated on other grounds, 456 U.S. 955 (1982). See also Ella Bell & Stella Nkomo, *Barriers to Workplace Advancement Experienced by African Americans* 3 (1994) ("African Americans * * * are functionally segregated into jobs less likely to be on the path to the top levels of management.").

[69] Barbara Bergmann, *In Defense of Affirmative Action* 32-33 (1996).

[70] Id. at 33.

[71] *Id.* at 62.

[72] *Id.* at 63-82.

The results of recent "testing" studies—in which equally matched minorities and nonminorities seek the same job—are but one source of evidence supporting this conclusion. These studies show, for instance, that white males receive 50 percent more job offers than minorities with the same characteristics applying for the same jobs.[73] As Justice Ginsburg described them, the testing studies make it abundantly clear that "[j]ob applicants with identical resumes, qualifications, and interview styles still experience different receptions, depending on their race."[74]

Even when minorities are hired today, a "glass ceiling" tends to keep them in lower-level positions. This problem was recognized by Senator Dole who, in 1991, introduced the Glass Ceiling Act on the basis of evidence "confirming * * * the existence of invisible, artificial barriers blocking women and minorities from advancing up the corporate ladder to management and executive level positions."[75] That Act created the Federal Glass Ceiling Commission, which subsequently completed an extensive study of the opportunities available to minorities and women in private sector employment, and concluded that "at the highest levels of business, there is indeed a barrier only rarely penetrated by women or persons of color."[76] Evidence released by the Commission paints the following picture:

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[73] Cross *et al.*, *Employer Hiring Practices: Differential Treatment of Hispanic and Anglo Job Seekers* (1990); Turner *et al.*, *Opportunities Denied, Opportunities Diminished: Discrimination in Hiring* (1991).

[74] *Adarand*, 115 S. Ct. at 2135 (Ginsburg, J., dissenting).

[75] Federal Glass Ceiling Commission, *Good for Business: Making Full Use of the Nation's Human Capital* iii (1995) (citing 1991 statement by Senator Dole regarding 1991 Department of Labor *Report on the Glass Ceiling Initiative*).

[76] *Id.* at iii.

- 97 percent of the senior level managers in the nation's largest companies are white.[77]

- Black and Hispanic men are half as likely as white men to be managers or professionals.[78]

- In the private sector, most minority managers and professionals are tracked into areas of the company—personnel, communications, affirmative action, public relations—that are not likely to lead to advancement to the highest levels of experience.[79]

- Because private sector opportunities are so limited, most minority professionals and managers work in the public sector.[80]

In light of the evidence that it considered, the Commission concluded that, "in the private sector, equally qualified and similarly situated citizens are being denied equal access to advancement on the basis of gender, race, or ethnicity."[81]

In sum, there are two central means to gaining the experience needed to operate a business. One is to be taught by a parent, passing on a family-owned business. But the long history of discrimination and exclusion by unions and employers means there are very few minority parents with any such business to pass on.[82] The second avenue is to learn

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[77] *Id.* at 9.

[78] *Id.* at iv-vi.

[79] *Id.* at 15-16.

[80] *Id.* at 13.

[81] *Id.* at 10-11.

[82] See, *e.g.*, *The Meaning and Significance for Minority Business of the Supreme Court Decision in the City of Richmond v. J.A. Croson: Hearing Before the Legislative and National Security Subcomm. of the House Comm. on Government Operations*, 100th Cong., 2d Sess. 111 (1990) (statement of Manuel Rodriguez) ("[f]ew [minorities] today have families from whom they can inherit" a business); H.R. Rep. No. 870, 103d

the skills needed through private employment. But the effects of employment and trade union discrimination have posed a constant barrier to that entryway into the business world.[83]

2. Discrimination by Lenders

Without financing, a business cannot start or develop. There are two main methods for a new business to raise capital. One is to solicit investments from the public by selling stock in the company (public credit); the other is to solicit investments from banks or other lenders (private credit). Congress has heard evidence that "since small businesses have very limited or no access to public credit markets, it is critically important that these entities, especially minority-owned small businesses, have adequate access to bank credit on reasonable terms and conditions."[84] The rub

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Cong., 2d Sess. 15 n.36 (1994) ("[T]he construction industry is * * * family dominated. Many firms are in their second or third generation operating structures."); New Haven Board of Aldermen, *Minority and Women Business Participation in the New Haven Construction Industry* 10 (1990) ("The exclusion of minorities from construction trades employment before the 1970s resulted in an absence of a parent or family member owning a construction business.").

[83] National Economic Research Associates, *et al.*, *The Utilization of Minority and Women-Owned Businesses Enterprises by Alameda County* 176-77 (June 1992) ("A number of witnesses identified historic union discrimination as a major limitation to the formation and success of minority firms."); Jaynes Associates, *Minority and Women's Participation in the New Haven Construction Industry: A Report to the City of New Haven* 34 (1989) (discrimination has prevented minorities from "gain[ing] experience and skills" necessary to operate a business and therefore has "kept the pool of potential minority * * * contractors artificially small").

[84] *Availability of Credit to Minority and Women-Owned Small Businesses: Hearing Before the Subcomm. on Financial Institutions Supervision, Regulation and Deposit Insurance of the House Comm. on*

is that small businesses owned by minorities find it much more difficult than small firms owned by nonminorities to secure capital. Indeed, this is often cited as the single largest factor suppressing the formation and development of minority-owned businesses.[85] The sad fact is that, through countless hearings, Congress has learned that lending discrimination plays a major role in this regard.[86]

Banking, 103d Cong., 2d Sess. 6 (1994) (statement of Andrew Hove). One reason that minorities starting small businesses are especially reliant on bank lending is because they traditionally lack personal wealth or access to other sources of private credit, such as loans from family or friends. See generally Oliver & Shapiro, *Black Wealth/White Wealth* (1993).

[85] See *The Wall Street Journal Reports: Black Entrepreneurship* R.1 (1992) (Roper Organization poll of 472 minority business owners listed access to capital as the primary barrier to their business development); United States Commission on Minority Business Development, *Final Report* 12 (1992) ("One of the most formidable stumbling blocks to the formation and development of minority businesses is the lack of access to capital.").

[86] See *Availability of Credit to Minority and Women Owned Small Businesses: Hearing Before the Subcomm. on Financial Institutions Supervision, Regulation and Deposit Insurance of the House Comm. on Banking*, 103d Cong., 2d Sess. 27 (1994) (statement of Wayne Smith) (while perhaps more subtle than discrimination in mortgage lending, discrimination in business lending exists); H.R. Rep. No. 870, 103d Cong., 2d Sess. 7 (1994) ("There is a widespread reluctance on the part of the commercial banking * * * and capital markets to take the same risks with a [minority] entrepreneur that they would readily do with a white one."); *Disadvantaged Business Set-Asides in Transportation Construction Projects: Hearing Before the Subcomm. on Procurement, Innovation, and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 2d Sess. 26 (1988) (statement of Joann Payne) ("[b]ecause of the ethnic and sex discrimination practiced by lending institutions, it was very difficult for minorities and women to secure bank loans."); *The Disadvantaged Business Enterprise Program of the Federal-Aid Highway Act: Hearing Before the Subcomm. on Transportation of the Senate Comm. on Environment and Public Works*, 99th Cong. 1st Sess. 363 (1985) (statement of James Laducer) (North

Over and over again, studies show that minority applicants for business loans are more likely to be rejected and, when accepted, receive smaller loan amounts than nonminority applicants with *identical* collateral and borrowing credentials:

- The typical white-owned business receives three times as many loan dollars as the typical black-owned business with the same amount of equity capital.[87] In construction, white-owned firms receive *fifty* times as many loan dollars as black-owned firms with identical equity.[88]

- Minorities are approximately 20 percent less likely to receive venture capital financing than white firm owners with the same borrowing credentials.[89]

Dakota banks "refuse to lend monies to minority businesses from nearby Indian communities"); see also *Fiscal Economic and Social Crises Confronting American Cities: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 102d Cong., 2d Sess. (1992); *Federal Minority Business Programs: Hearing Before the House Comm. on Small Business*, 102d Cong., 1st Sess. (1991); *City of Richmond v. J.A. Croson: Impact and Response: Hearing Before the Subcomm. on Urban and Minority-Owned Business Development of the Senate Comm. on Small Business*, 101st Cong., 2d Sess. (1990); *Minority Construction Contracting: Hearing Before the Subcomm. on SBA, the General Economy and Minority Enterprise Development of the House Comm. on Small Business*, 101 Cong., 1st Sess. (1989).

[87] Timothy Bates, *Commercial Bank Financing of White and Black Owned Small Business Start-ups*, Quarterly Review of Economics and Business, Vol. 31, No. 1, at 79 (1991) ("The findings indicate that black businesses are receiving smaller bank loans than whites—not because they are riskier, but, rather, because they are black-owned businesses.").

[88] Grown & Bates, *Commercial Bank Lending Practices and the Development of Black-Owned Construction Companies*, Journal of Urban Affairs, Vol. 14, No. 1, at 34 (1992).

[89] Bradford & Bates, *Factors Affecting New Firms Success and their Use in Venture Capital Financing*, Journal of Small Business Finance, Vol. 2, No. 1, at 23 (1992) ("The venture capital market * * *

- All other factors being equal, a black business owner is approximately 15 percent less likely to receive a business loan than a white owner.[90]
- The average loan to a black-owned construction firm is $49,000 less than the average loan to an equally matched nonminority construction firm.[91]

A comparable pattern of disparity appears in the most recent study on lending to minority firms, which was released earlier this year. That study surveyed 407 business owners in the Denver area. It found that African Americans were 3 times more likely to be rejected for business loans than whites.[92] The denial rate for Hispanic owners was 1.5 times as high as [for] white owners.[93] Disparities in the denial rate remained significant even after controlling for other factors that may affect the lending rate, such as the size and net worth of the business.[94] The study concluded that "despite the fact that loan applicants of three different racial/ethnic backgrounds in this sample (Black, Hispanic and Anglo) were not appreciably different as businesspeople,

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differentially restricts minority entrepreneurs from obtaining venture capital.").

[90] Faith Ando, *Capital Issues and the Minority-Owned Business*, The Review of Black Political Economy, Vol. 16, No. 4, at 97 (1988).

[91] Grown & Bates, *Commercial Bank Lending Practices and the Development of Black-Owned Construction Companies*, Journal of Urban Affairs, Vol. 14, No. 1, at 34 (1992).

[92] The Colorado Center for Community Development, University of Colorado at Denver, *Survey of Small Business Lending in Denver v.* (1996*)*. See Michael Selz, *Race-Linked Gap is Wide in Business-Loan Rejections*, Wall St. J., May 6, 1996, at B2.

[93] The Colorado Center for Community Development, University of Colorado at Denver, *Survey of Small Business Lending in Denver v.* (1996*)*.

[94] *Id.*

they were ultimately treated differently by the lenders on the crucial issue of loan approval or denial."[95]

In sum, capital is a key to operating a business. Without financing, no business can form. Once formed, restricted access to capital impedes investments necessary for business development. Minority-owned firms face troubles on both fronts. And in large part, those troubles stem from lending discrimination.[96] As President Bush's Commission on Minority Business Development explained, the result is a self-fulfilling prophecy:

> Our nation's history has created a "cycle of negativity" that reinforces prejudice through its very practice; restraints on capital availability lead to failures, in turn, reinforce a prejudicial perception of minority firms as inherently high-risks, thereby reducing access to even more capital and further increasing the risk of failure.[97]

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[95] *Id.*

[96] There is also evidence that minorities face discrimination in mortgage lending. See Munnell *et al.*, *Mortgage Lending In Boston: Interpreting the HMDA Data*, 86 Am. Econ. Rev. 25 (1996) (finding that minority applicants were 60 percent more likely to be rejected for a mortgage loan than white males with identical characteristics, including age, income, wealth, and education). This serves to aggravate the problems that minorities face in seeking business loans, because an important source of collateral for such loans to a new firm is the home of the owner of the firm. Thus, mortgage discrimination that impedes the ability of minorities to obtain loans to purchase homes (or drives them to purchase less valuable homes than they otherwise would) diminishes their ability to post collateral for business loans.

[97] United States Commission on Minority Business Development, Final Report 6 (1992). While the nation has made great strides in overcoming racial bias, the Commission's apt characterization of the debilitating effects of lending discrimination mirrors the description of the problem in a landmark monograph written over one-half century ago:

B. Discrimination in Access to Contracting Markets

Even when minorities are able to form and develop businesses, discrimination by private sector customers, prime contractors, business networks, suppliers, and bonding companies raises the costs for minority firms, which are then passed on to their customers. This restricts the competitiveness of minority firms, thereby impeding their ability to gain access to public contracting markets.

1. Discrimination by Prime Contractors and Private Sector Customers

In the private sector, minority business owners face discrimination that limits their opportunities to work for prime contractors and private sector customers. All too often, contracting remains a closed network, with prime contractors maintaining long-standing relationships with subcontractors with whom they prefer to work.[98] Because

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> The Negro Businessman encounters greater difficulties than whites in securing credit. This is partially due to the marginal position of negro business. It is also partially due to prejudicial opinions among whites concerning business ability and personal reliability of Negroes. In either case a vicious circle is in operation keeping Negro business down.

Gunnar Myrdal, *An American Dilemma: The Negro and Modern Democracy* 308 (6th ed. 1944).

[98] See New Haven Board of Aldermen, *Minority and Women-Business Participation in the New Haven Construction Industry* 10 (1990) ("The construction industry in New Haven remains to a large extent a closed network of established contractors and subcontractors who have close long-term relationships and are highly resistant to doing business with 'outsiders.'"); Brimmer & Marshall, *Public Policy and Promotion of Minority Economic Development: City of Atlanta and Fulton County, Georgia*, Pt. II, 61 (1990) (member of trade association testified that "contractors develop good working relationships with certain subcontractors

minority-owned firms are new entrants to most markets, the existence and proliferation of these relationships locks them out of subcontracting opportunities. As a result, minority-owned firms are seldom or never invited to bid for subcontracts on projects that do not contain affirmative action requirements.[99] In addition, when minority firms are per-

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and tend to use them repeatedly, even in a few cases when their prices are just a little bit higher than other subcontractors").

[99] See National Economic Research Associates, *The State of Texas Disparity Study: A Report to the Texas Legislature as Authorized by H.B. 2626, 73rd Legislature* 148 (1994) ("African American owner * * * told by an employee of a prime contractor that the contractor prefers to work with [nonminority-owned firms] and works with [minority-owned firms] only when required to do so."); D.J. Miller & Associates, *Disparity Study for Memphis/Shelby County Intergovernmental Consortium* VII-10 (1994) ("Majority companies will not do business with [minority-owned businesses] because they lack confidence in [them] and are not willing to go beyond those businesses with whom they have a 10 to 15 year relationship."); Brown, Botz & Coddington, *Disparity Study: City of Phoenix* VIII-10 (July 1993) ("From the responses of a number of MBE/WBEs, another form of marketplace discrimination that severely hampers their access to the marketplace is denial of the opportunity to bid. This may occur in a variety of ways, including, but not limited to, the use of non-competitive procurement and selection procedures, as well as intentional acts of rejection."); National Economic Research Associates, *The Utilization of Minority and Woman-Owned Businesses by Contra Costa County: Final Report* ix, xiii (1992) (70 percent of minority-owned firms reported seldom or never being used for contracts that do not contain affirmative action requirements); National Economic Research Associates, *The Availability and Utilization of Minority-Owned Business Enterprises at the Massachusetts Water Resources Authority* 74 (1992) (55 percent of minority-owned construction firms reported that prime contractors that use their firms on contracts with affirmative action requirements seldom or never used their firms on projects that do not contain such requirements); *A Study to Identify Discriminatory Practices in the Milwaukee Construction Marketplace* 125 (Feb. 1990) ("Only 18% of black contractors currently have private sector contracts with primes with which they have worked on public sector contracts with MBE require-

mitted to bid on subcontracts, prime contractors often resist working with them. This sort of exclusion is often achieved by white firms refusing to accept low minority bids or by sharing low minority bids with another subcontractor in order to allow that business to beat the bid (a practice known as "bid shopping").[100] These exclusionary practices have been the subject of extensive testimony in congressional hearings.[101]

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ments."); see also *Coral Constr. Co.* v. *King County*, 941 F.2d 910, 916 (9th Cir. 1991), cert. denied, 502 U.S. 1033 (1992) (noting reports that non-minority firms in the county refused to work with minority firms); *Cone Corp. v. Hillsborough County*, 908 F.2d 908, 916 (11th Cir.), cert. denied, 498 U.S. 983 (1990) (noting reports that when minority contractors in the county "approached prime contractors, some prime contractors either were unavailable or would refuse to speak to [the minority contractors]").

[100] See *Associated Gen. Contractors v. Coalition for Economic Equity*, 950 F.2d 1401, 1416 (9th Cir. 1991), cert. denied, 503 U.S. 985 (1992) (noting reports that local minority firms were "denied contracts despite being the low bidder," and "refused work even after they were awarded the contracts as low bidder"); *Cone Corp. v. Hillsborough County*, 908 F.2d 908, 916 (11th Cir.), cert. denied, 498 U.S. 983 (1990) ("[c]ontrary to their practices with non-minority subcontractors," local prime contractors would take minority subcontractors' bids "around to various non-minority subcontractors until they could find a non-minority to underbid [the minority firm]"); BBC Research and Consulting, *Regional Disparity Study: City of Las Vegas* IX-12 (1992) (low bidding Hispanic contractor told that he was not given subcontract because the prime contractor "did not know him" and that the prime "had problems with minority subs in the past"); BPA Economics, *MBE/WBE Disparity Study for the City of San Jose (Vol. 1)* III-1 (1990) (describing practices contributing to low utilization in construction contracts as including "bid shopping, insufficient distribution of notices of contracts [and] insufficient lead time to prepare bids"); BBC Research and Consulting, *The City of Tucson Disparity Study* IX-9-IX-11 (June 1994) (same).

[101] See, *e.g.*, *How State and Local Governments Will Meet the Croson Standard: Hearing Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 100th Cong., 1st Sess. 54 (1989) (statement of Marc Bendick) ("[t]he same prime contractor who will

An Atlanta study revealed evidence of the effect of discrimination by private sector customers and prime contractors on minority contracting opportunities. The study found that 93 percent of the revenue received by minority-owned firms came from the public sector and only 7 percent from the private sector. In sharp contrast, the study found that nonminority firms receive only 20 percent of their revenue from the public sector and 80 percent from the private sector.[102] In addition, the study reported that nearly half of the black-owned firms worked primarily for minority customers, and minority firms rarely worked in a joint venture with a white-owned firm.[103]

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use a minority subcontractor on a city contract and will be terribly satisfied with the firm's performance, will simply not use that minority subcontractor on a private contract where the prime contractor is not forced to use a minority firm."); *The Meaning and Significance for Minority Businesses of the Supreme Court Decision in the City of Richmond v. J.A. Croson Co.: Hearing Before the Legislation and National Security Subcomm. of the Comm. on Government Operations*, 101st Cong., 2d Sess. 57 (1990) (statement of Gloria Molina); *id.* at 100-101 (statement of E.R. Mitchell); *id.* at 113 (statement of Manuel Rodriguez); *A Bill to Reform the Capital Ownership Development Program: Hearings on H.R. 1807 Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 1st Sess. 593 (1987) (statement of Edward Irons); *Small Disadvantaged Business Issues: Hearings Before the Investigations Subcomm. of the House Comm. on Armed Services*, 100th Cong., 1st Sess. 19-23 (1991) (statement of Parren Mitchell).

[102] Brimmer & Marshall, *Public Policy and Promotion of Minority Economic Development: City of Atlanta and Fulton County, Georgia*, Pt. I, 9-10 (1990). See also D.J. Miller & Associates, *City of Dayton: Disparity Study* 183 (1991) ("A small percentage of Black firms' revenues come from private sector projects.").

[103] Brimmer & Marshall, *Public Policy and Promotion of Minority Economic Development: City of Atlanta and Fulton County, Georgia*, Pt. III, 15, 34 (1990).

Customer prejudices are sometimes graphically expressed. African American business owners have reported arriving at job [s]ites to find signs saying "No Niggers Allowed,"[104] and "Nigger get out of here."[105] Other potential customers have simply refused to work with a business after discovering that its owner is a minority. In a recent encounter, a black business owner arriving at a home-site was told to leave by a white customer, who commented "you didn't tell me you were black and you don't sound black."[106]

2. Discrimination by Business Networks

Contrary to the common perception, contracting is not a "meritocracy" where the low bidder always wins. "(B)eneath the complicated regulations and proliferation of collective bargaining contracts lies a different reality, one dominated mainly by personal contacts and informal networks."[107] These networks can yield competitive advantages, because they serve as conduits of information about upcoming job opportunities and facilitate access to the decisionmakers (*e.g.*, contracting officers, prime contractors, lenders, bonding agents and suppliers). Simply put, in contracting, access

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[104] New Haven Board of Aldermen, *Minority and Women Participation in the New Haven Construction Industry* 10 (1990).

[105] National Economic Research Associates, *The Utilization of Minority and Women-Owned Businesses by the City of Hayward* 6-23 (1993).

[106] See BBC Research and Consulting, *City of Tuscon Disparity Study* IX-23 (1994).

[107] Bailey & Waldinger, *The Continuing Significance of Race: Racial Conflict and Racial Discrimination in Construction*, Politics and Society, Vol. 19, No. 3, 298 (1991). See Brimmer & Marshall, *Public Policy and Promotion of Minority Economic Development: City of Atlanta and Fulton County, Georgia*, Pt. II, 35 (1990) ("(M)ost job seekers find their jobs through informal channels. So too it is with construction markets, especially in the private sector.").

to information is a ticket to success; lack of information can be a passport to failure. Networks and contacts can help a business find the best price on supplies, facilitate a quick loan, foster a relationship with a prime contractor, or yield information about an upcoming contract for which the firm can prepare—all of which serve to make the firm more competitive.

What transforms the mere existence of established networks into barriers for minority-owned businesses is the extent to which they operate to the exclusion of minority membership. It has been recognized in Congress that private sector business networks frequently are off-limits to minorities: "institutional wall(s)," and "old-boy network(s) * * * make( ) it exceedingly difficult for minority firms to break into the private commercial sector."[108] Parallel descriptions appear in numerous state and local studies.[109]

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[108] *Minority Business Development Program Reform Act of 1987: Hearings on S. 1993 and H.R. 1807 Before the Senate Comm. on Small Business*, 100th Cong., 2d Sess. 127 (1988) (statement of Parren Mitchell). See H.R. Rep. No. 870, 103d Cong., 2d Sess. 15 n.36 ("The construction industry is close-knit; it is family dominated (and reflects an) old buddy network. Minorities and women, unless they are part of construction families, have been and will continue to be excluded whenever possible."); *Minorities and Franchising: Hearings Before the House Comm. on Small Business*, 102d Cong., 1st Sess. 54 (1991) (statement of Rep. LaFalce) (discussing "problems relating to exclusion of minorities or groups of minorities from franchise systems"); 131 Cong. Rec. 17,447 (1985) (statement of Rep. Schroeder) (an "old boy's club" excludes many minorities from business opportunities).

[109] See, *e.g.*, *Associated Gen. Contractors* v. *Coalition for Economic Equity*, 950 F.2d 1401, 1414 (1991) (municipal study showed that there "continued to operate an 'old boy network' in awarding contracts, thereby disadvantaging (minority firms)"), cert. denied, 503 U.S. 985 (1992); BBC Research & Consulting, *The City of Tuscon Disparity Study* 202 (1994) (citing "numerous detailed examples of the exclusionary operation of good old boy networks"); National Economic Research Associates, *The Utiliza-*

Ultimately, exclusion from business networks "isolate(s minorities) from the 'web of information' which flows around opportunities" thereby putting them at a distinct disadvantage relative to nonminority firms.[110] In government contracting, this disadvantage can be fatal: "(government) vendors who do get contracts, experts agree, have obtained vital bits of information their competitors either ignored or couldn't find. * * * (O)nly the well connected survive."[111]

Restricted access to business networks can particularly disadvantage minorities in the planning stages of government procurement. In designing contracts for public bidding, agencies commonly consult businesses to make sure that specifications match available services. Only bidders who meet the specifications may compete for the contract

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tion of Minority and Women Owned Business Enterprises by the Southeastern Pennsylvania Transportation Authority 107 (1993) (exclusion from 'old-boy' networks "was the most frequently cited problem" of minority and women-owned firms); National Economic Research Associates, *The Utilization of Minority and Women-Owned Business Enterprises by the City of Hayward* 6-14 (1993) ("75 percent of the witnesses cited problems breaking into established 'old-boy' networks".).

[110] *United States* v. *Georgia Power Co.*, 474 F.2d 906 (5th Cir. 1973) (finding that district court's "failure to order (word-of-mouth recruitment practices) to be supplemented by affirmative action * * * was clearly an abuse of power"). See National Economic Research Associates, *Availability and Utilization of Minority and Women Owned Business Enterprises at the Massachusetts Water Resources Authority* 74 (1990) (finding that minorities "need to spend much more time and money on marketing because they do not have established networks and reputations"); Minority Business Enterprise Legal Defense and Education Fund, *An Examination of Marketplace Discrimination in Durham County* 16 (1991) (citing "numerous allegations that black contractors * * * learned of bid opportunities much later than their white competitors that are tied into the 'good old boy' network").

[111] Kevin Thompson, *Taking the Headache Out of Government Contracts*, Black Enterprise 219 (1993).

and the exclusion of minority-owned businesses from planning and consultations can lead to specifications that are written so narrowly as to exclude minority bidders.[112] In addition, the failure to consult minority-owned businesses during the planning stages of procurement prevents them from mobilizing resources for the upcoming competition. As a committee of Congress recently reported, "(m)inorities and women are always left out in any kind of design or planning phase for these projects, and that is why when (they) first know about them * * * it is traditionally too late to get (their) forces and resources together to react."[113]

3. Discrimination in Bonding and By Suppliers

The competitiveness of bids on public and private contracts is not determined solely by the bidder's resources. Rather, competitiveness often hinges on the ability of the bidding company to obtain quality services from bonding companies and suppliers at a fair price. Here too, discrimination places minority firms at a disadvantage.

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[112] This is accomplished by, for example, specifying that bidders must use certain brand-name products available only to several companies, specifying a depth of contract experience that minority-owned firms can rarely provide, and bundling projects into large contracts that small minority-owned companies cannot perform. See, *e.g.*, H.R. Rep. No. 870, 103d Cong., 2d Sess. 14 (1994) (citing recommendation that agencies separate "contracts into smaller parts, so that M&WOSB's would be able to participate in those opportunities"); Mason Tillman Associates, *Sacramento Municipal Utility District: M/WBE Disparity Study* 146 (1992) (noting that, in many instances, contract specifications are written so narrowly that there are only a few firms that can do the job); Tuchfarber *et al.*, *City of Cincinnati: Croson Study* 153 (1992) ("Products specified in the Request for Proposals were so narrow that only one company that had exclusive distribution of the product specified could satisfy the contract.").

[113] H.R. Rep. No. 870, 103d Cong., 2d Sess. 13 (1994).

All contractors on federal construction, maintenance, and repair contracts valued at over $100,000 are required to secure a surety bond guaranteeing the performance of the contract.[114] To obtain bonding, most surety companies require that a firm present a record of experience to substantiate its ability to perform the job. This mandate often lands minorities in the middle of a vicious circle. Since a history of discrimination has prevented many minority companies from gaining experience in contracting, they cannot get bonding. And since they cannot get bonding, they cannot get experience. As Congress has recognized, this dilemma "serves to preclude equitable minority business participation in federal construction contracts."[115]

Congress also has realized that minorities are disadvantaged by their exclusion from business networks that facilitate bonding, because "firms tend to give performance and payment bonds to people they already know and not to the new business person, especially if the small business owner is a woman or of a racial or ethnic minority."[116] Furthermore, Congress has considered evidence indicating that bonding agents, like lenders, inject racial biases into the

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[114] 40 U.S.C. 270a-270e.

[115] United States Congress, *Federal Compliance to Minority Set-Asides: Report to the Speaker, U.S. House of Representatives, by the Congressional Task Force on Minority Set-Asides* 29 (1988). See also H.R. Rep. No. 870, 103d Cong., 2d Sess. 14 (1994) ("Inability to obtain bonding is one of the top three reasons that new minority small businesses have difficulty procuring U.S. Government contracts."); *Minority Business Participation in Department of Transportation Projects: Hearing Before a Subcomm. of the House Comm. on Government Operations*, 99th Cong., 1st Sess. 159 (1985) (statement of Sherman Brown) ("Virtually everyone connected with the minority contracting industry * * * apparently agrees that surety bonding is one of the biggest obstacles in the development of minority firms.").

[116] H.R. Rep. No. 870, 103d Cong. 2d Sess. 15 (1994).

bonding process.[117] Evidence of discrimination in bonding also has been accumulated in a number of state and local studies.[118] These problems have made minority businesses significantly less able to secure bonding on equal terms with

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[117] See *Discrimination in Surety Bonding: Hearing Before the Subcomm. on Minority Enterprise, Finance and Urban Development of the House Comm. on Small Business*, 103d Cong., 1st Sess. 2 (1993) (statement by Rep. Kweisi Mfume) ("Similarities between a banker's ability to make arbitrary credit decisions and a surety producer or an underwriter's capability of injecting personal prejudice into the bonding process are compelling indeed."); *City of Richmond* v. *J.A. Croson: Impact and Response: Hearing Before the Subcomm. on Urban and Minority-Owned Business Development of the Senate Comm. on Small Business*, 101st Cong., 2d Sess. 40 (1990) (statement of Andrew Brimmer); *id.* at 165-66 (statement of Edward Bowen); *Disadvantaged Business Set-Asides in Transportation Construction Projects: Hearings Before the Subcomm. on Procurement, Innovation and Minority Enterprise Development of the House Comm. on Small Business*, 100th Cong., 2d Sess. 107 (1988) (statement of Marjorie Herter) ("Discrimination against women and minorities in the bonding market is quite prevalent").

[118] See Division of Minority and Women's Business Development, *Opportunity Denied! A Study of Racial and Sexual Discrimination Related to Government Contracting in New York State*, Executive Summary 57 (1992) (noting that 47 witnesses reported "specific incidents of racial discrimination * * * in attempting to secure performance bonds"); National Economic Research Associates, *The Utilization of Minority and Women-Owned Business Enterprises by Alameda County* 202, 212 (June 1992) (nearly 50 percent of minority businesses reported experiencing bonding discrimination); National Economic Research Associates, *The Utilization of Minority and Women-Owned Businesses Enterprises by Costa County* 231, 241 (May 1992) (noting evidence of bonding discrimination); Board of Education of the City of Chicago, *Report Concerning Consideration of the Revised Plan for Minority and Women Business Enterprise Economic Participation* 316 (1991) ("Bonding is selectively and capriciously provided or denied with the decision being 85 percent subjective."); Mason Tillman Associates, *Sacramento Municipal Utility District, M/WBE Disparity Study* 119, 135-43 (1990) (noting evidence of bonding discrimination).

white-owned firms with the same experience and credentials. For example:

• A Louisiana study found that minority firms were nearly twice as likely to be rejected for bonding, three times more likely to be rejected for bonding for over $1 million, and on average were charged higher rates for the same bonding policies than white firms with the same experience level.[119]

• An Atlanta study found that 66 percent of minority-owned construction firms had been rejected for a bond in the last three years, 73 percent of those firms limited themselves exclusively to contracts that did not require bonding, and none of them had unlimited bonding capacity. By contrast, less than 20 percent of nonminority firms had unlimited bonding capacity.[120]

Another factor restricting the ability of minority-owned businesses to compete in both private and public contracting is discrimination allowing "non-minority subcontractors and contractors [to get] special prices and discounts from suppliers which [are] not available to [minority] purchasers."[121] This drives up anticipated costs, and therefore the bid, for minority-owned businesses. A recent survey reported that 56 percent of black business owners, 30 percent of Hispanic

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[119] D.J. Miller & Associates, *State of Louisiana Disparity Study* Vol. 2, pp. 35-57 (June 1991).

[120] Brimmer & Marshall, *Public Policy and Promotion of Minority Economic Development: City of Atlanta and Fulton County, Georgia*, Pt. III, 131-38 (1990).

[121] *Cone Corp. v. Hillsborough County*, 908 F.2d 908, 916 (11th Cir.) cert. denied, 498 U.S. 983 (1990). Evidence of pricing discrimination outside the contracting setting indicates that the problem cuts across the economy. For example, a recent testing study of automobile purchases showed that, on average, black men were charged nearly $1,000 more for cars than white men. Ian Ayres, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 Harv. L. Rev. 817 (1991).

owners, and 11 percent of Asian business owners had experienced known instances of discrimination in the form of higher quotes from suppliers.[122] Numerous other state and local studies have reported similar findings.[123]

In one glaring case, a firm in Georgia began sending white employees to purchase supplies posing as owners of a white-owned company. The "white-front" routinely received quotes on supplies that were two thirds lower than those

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[122] National Economic Research Associates, *The Utilization of Minority and Woman-Owned Businesses by the Regional Transportation District (Denver Colorado): Final Report* 16-23 (1992).

[123] See National Economic Research Associates, *The State of Texas Disparity Study: A Report to the Texas Legislature* as Authorized by H.B. 2626, 73rd Legislature 148 (1994) (Hispanic business owner denied credit by supplier who told him that "we only sell on a cash basis to people of your kind"); D.J. Miller & Associates, *Disparity Study for Memphis/Shelby County Intergovernmental Consortium* 117 (1994) ("Other frequent complaints pertaining to informal barriers included being completely stopped by suppliers' discriminatory practices."); BBC Research Associates, *Disparity Study for the City of Fort Worth* IX-20 (1993) (citing evidence that suppliers discriminate against minorities by "refus[ing] to sell or sell [ing] at higher prices than [to] whites"); Division of Minority and Women's Business Development, *Opportunity Denied! A Study of Racial and Sexual Discrimination Related to Government Contracting in New York State*, Executive Summary, 53 (1992) (53 witnesses reported "specific incidents of racial discrimination * * * where materials or equipment suppliers would not extend the same payment terms and discounts to them as they knew were being made available to white male owned contractors with the same financial histories"); National Economic Research Associates, *The Utilization of Minority and Women-Owned Business Enterprises by Alameda County* 187 (1992) (41% of minority-owned business respondents reported experiencing discrimination in quotes from suppliers); *City of Dayton, Disparity Study* 101 (1991) (citing evidence of discriminatory pricing); D.J. Miller & Associates, *City of St. Petersburg Disparity Study* 39-40 (1990) ("Discrimination by suppliers has also prevented [minority-owned businesses] from entering successful bids."); Mason Tillman Associates, *Sacramento Municipal Utility District, M/WBE Disparity Study* 135-43 (1990).

quoted to the minority-owned parent company.[124] Another firm entered into a joint venture with a white firm and each obtained quotes from the same supplier for the same project. When the two firms compared the quotes, they discovered that those given to the minority-owned firm were so much higher than those given to his white joint venture partner that they would have added 40 percent to the final contract price.[125]

C. Evidence of the Impact of Discriminatory Barriers on Minority Opportunity in Contracting Markets: State and Local Disparity Studies

In recent years, many state and local governments have undertaken formal studies to determine whether there is evidence of racial discrimination in their relevant contracting markets that would justify the use of race-conscious remedial measures in their procurement activities. These studies—many of which have been cited in the previous sections of this memorandum—typically contain extensive statistical analyses that have revealed gross disparities between the availability of minority-owned businesses and the utilization of such businesses in state and local government procurement. Under the rules established by the Supreme Court in its 1989 *Croson* decision, which held that affirmative action at the state and local level is subject to strict scrutiny, such disparities can give rise to an inference of discrimination that can serve as the foundation of race-

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[124] Brimmer & Marshall, *Public Policy and Promotion of Minority Economic Development: City of Atlanta and Fulton County, Georgia* Pt. II, 76 (1990).

[125] BBC Research and Consulting, *Regional Disparity Study: City of Las Vegas* IX-20 (1992).

conscious remedial measures in procurement.[126] The studies also generally contain anecdotal evidence and expert opinion, developed in hearings, surveys, and reports, that bring the statistical evidence to life and vividly illustrate the effects of discrimination on procurement opportunities for minorities.

The federal government obviously purchases some goods and services that state and local governments do not (*e.g.*, space shuttles, naval warships). For the most part, though, the federal government does business in the same contracting markets as state and local governments. Therefore, the evidence in state and local studies of the impact of discriminatory barriers to minority opportunity in contracting markets throughout the country is relevant to the question whether the federal government has a compelling interest to take remedial action in its own procurement activities.[127] Accordingly, the Justice Department asked the Urban Institute (UI) to analyze the statistical findings in the studies. On the strength of the findings in 39 studies that it considered, UI has reached the following conclusions:[128]

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[126] In describing what it takes for the government to establish a remedial predicate in procurement, the Court in *Croson* said that "[w]here there is a significant statistical disparity between the number of qualified minority contractors willing and able to perform a particular service and the number of such contractors actually engaged by the [government] or the [government's] prime contractors, an inference of discriminatory exclusion could arise." 488 U.S. at 509.

[127] The studies are also of particular relevance in assessing the compelling interest for congressionally-authorized affirmative action measures in programs that provide federal funds to state and local governments for use in their procurement.

[128] To date, UI has evaluated 56 of the studies. Ultimately, UI excluded 17 of the 56 studies from its analysis, on the grounds that those studies do not present disparity ratios; do not present tests of statistical significance or number of contracts; do not present separate results by industry; or do not present disparity ratios based on government contracting.

• The studies show underutilization by state and local governments of African American, Latino, Asian and Native American-owned businesses. The pattern of disparity across industries varies with racial and ethnic groups. However, the median disparity figures calculated by UI demonstrate disparities for all ethnic groups in every industry.[129]

• Minority-owned businesses receive on average only 59 cents of state and local expenditures that those firms would be expected to receive, based on their availability. The median disparities vary from 39 cents on the dollar for firms owned by Native Americans to 60 cents on the dollar for firms owned by Asian-Americans.

• Minority firms are underutilized by state and local governments in all of the industry groups examined: [c]onstruction, construction subcontracting, goods, professional services and other services. The largest disparity between availability and utilization was seen in the category of "other services," where minority firms receive 51 cents for every dollar they were expected to receive. The smallest disparity was in the category of construction subcontracting, where minority firms still receive only 87 cents for every dollar they would be expected to receive.

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[129] UI's findings of underutilization are predicated on two different measures: the median disparity ratio across all studies and the percent of studies reporting substantial underutilization (defined as a disparity ratio of less than 0.8). A disparity ratio is the proportion of government contracting received by minority-owned firms to the proportion of available firms that are minority-owned. Thus, a disparity ratio of 0.8 indicates that businesses owned by members of a minority group received only 80 cents of every dollar expected to be allocated to them based on their availability. UI's findings of disparity do not change substantially when analysis is limited to studies with either a large number of contracts or high availability. In fact, in most instances, the disparity between availability and utilization was greater in studies that involve large numbers of contracts.

An important corollary to UI's findings is the experience following the Supreme Court's 1989 ruling in *Croson*. In the immediate aftermath of that case, state and local governments scaled back or eliminated altogether affirmative action programs that had been adopted precisely to overcome discriminatory barriers to minority opportunity and to correct for chronic underutilization of minority firms. As a result of this retreat from affirmative action, minority participation in state and local procurement plummeted quickly. To cite just a few examples:

- After the court of appeals decision in *Croson* invalidating the City of Richmond's minority business program in 1987, minority participation in municipal construction contracts dropped by 93 percent.[130]

- In Philadelphia, public works subcontracts awarded to minority and women-owned firms declined by 97 percent in the first full month after the city's program was suspended in 1990.[131]

- Awards to minority-owned businesses in Hillsborough County, Florida, fell by 99 percent after its program was struck down by a court.[132]

- After Tampa suspended its program, participation in city contracting decreased by 99 percent for African American-owned businesses and 50 percent for Hispanic-owned firms.[133]

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[130] United States Commission on Minority Business Development, *Final Report* 99 (1992).

[131] *Id.*

[132] *Id.*

[133] *Id.*

• The suspension of San Jose's program in 1989 resulted in a drop of over 80 percent in minority participation in the city's prime contracts.[134]

Together, the information in the state and local studies, and the impact of the cut-back in affirmative action at the state and local level after *Croson*, provide strong evidence that further demonstrates the compelling interest for affirmative action measures in federal procurement. The information documents that the private discrimination discussed previously in part II of this memorandum—discrimination by trade unions, employers, lenders, suppliers, prime contractors, and bonding providers—substantially impedes the ability of minorities to compete on an equal footing in public contracting markets. And it these same discriminatory barriers that impair minority opportunity in federal procurement. The information also indicates that, without affirmative action, minorities would tend to remain locked out of contracting markets.

The information also helps to illuminate what it is that Congress is seeking to redress—and hence what interests are served—through remedial action in federal procurement. First, Congress has a compelling interest in exercising its constitutional power to remedy the impact of private discrimination on the ability of minority businesses to compete in contracting markets that is reflected in the studies. Second, Congress has a compelling interest in exercising its constitutional power to redress the statistical disparities reflected in the studies that give rise to an inference of discrimination by state and local governments, or at minimum suggest that those governments are compounding the impact of private discrimination through ostensibly neutral procurement prac-

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[134] BPA Economics, *et al.*, *MBE/WBE Disparity Study for the City of San Jose*, Vol. III, 118-19 (1990).

tices that perpetuate barriers to minority contracting opportunity.[135] Finally, Congress has a compelling interest in ensuring that expenditures by the federal government do not inadvertently subsidize the discrimination by private and public actors that is reflected in the studies.[136] Were that to occur, the federal government would itself become a participant in that discrimination through procurement practices that serve to sustain impediments to minority opportunity in national contracting markets.

III. Conclusion

As a nation, we have made substantial progress in fulfilling the promise of racial equality. In contracting markets throughout the country, minorities now have opportunities from which they were wholly sealed off only a generation ago. Affirmative action measures have played an important part in this story. However, the information compiled by the Justice Department to date demonstrates that racial dis-

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[135] The role of state and local governments in impeding contracting opportunities for minority firms is most directly addressed through federal programs that authorize recipients of federal funds to take affirmative action in their procurement activities. Those programs plainly are examples of the exercise of Congress' power under the Fourteenth Amendment to remedy discrimination by state and local governments. See *Adarand*, 115 S. Ct. at 2126 & n.9 (Stevens, J., dissenting). Since that same state and local conduct constitutes an impediment to minority opportunity in contracting markets in which the federal government does business, it also serves as a basis for affirmative action measures in the federal government's own procurement. Therefore, those measures too entail an exercise of Congress' authority under the Fourteenth Amendment. See *id.* at 2132 n.1 (Souter, J., dissenting) (for purposes of exercise of Congress' power under the Fourteenth Amendment, there is no difference between programs in which "the national government makes a construction contract directly" and programs in which "it funnels construction money through the states").

[136] See *Croson*, 488 U.S. at 492.

crimination and its effects continue to impair the ability of minority-owned businesses to compete in the nation's contracting markets.

The evidence shows that the federal government has a compelling interest in eradicating the effects of two kinds of discriminatory barriers: first, discrimination by employers, unions, and lenders that has hindered the ability of members of racial minority groups to form and develop businesses as an initial matter; second, discrimination by prime contractors, private sector customers, business networks, suppliers, and bonding companies that raises the costs of doing business for minority firms once they are formed, and prevents them from competing on an equal playing field with nonminority businesses. This discrimination has been, in many instances, deliberate and overt. But it also can take a more subtle form that is inadvertent and unconscious. Either way, the discrimination reflects practices that work to maintain barriers to equal opportunity.

The tangible effects of the discriminatory barriers are documented in scores of studies that reveal stark disparities between minority availability and minority utilization in state and local procurement. In turn, the disparities show that state and local governments themselves are tangled in this web through ostensibly neutral procurement actions that perpetuate the discriminatory barriers. The very same discriminatory barriers that block contracting opportunities for minority-owned businesses at the state and local levels also operate at the federal level. Without affirmative action in its procurement, the federal government might well become a participant in a cycle of discrimination.

Affirmative action in federal procurement is not the cure-all that will eliminate all the obstacles that racial discrimination presents for minority businesses. No one remedial tool can completely address the full dimension of this

problem. Laws proscribing discrimination and general race-neutral assistance to small businesses are critical to the achievement of these ends. But the evidence demonstrates that such measures cannot pierce the many layers of discrimination and its effects that hinder the ability of minorities to compete in our nation's contracting markets. Thus, there remains today a compelling interest for race-conscious affirmative action in federal procurement.

APPENDIX G

SELECTED HEARINGS AND REPORTS, 1972-1995

1. *Minority Small Business Enterprise: Report of the Subcomm. on Minority Small Business Enterprise to the House Select Comm. on Small Business*, H.R. Rep. No. 1615, 92d Cong., 2d Sess. (1972) (findings and conclusions leading to creation of a permanent select committee).

2. *Government Minority Enterprise Programs—Fiscal Year 197*: *Hearings Before the Subcomm. on Minority Small Business Enterprise and Franchising of the House Permanent Select Comm. on Small Business*, 93d Cong., 1st Sess. (1973).

3. *Government Minority Enterprise Programs—Fiscal Year 1974*: *Hearings Before the Subcomm. on Minority Small Business Enterprise and Franchising of the House Permanent Select Comm. on Small Business*, 93d Cong., 2d Sess. (1974).

4. *Minority Enterprise and Allied Problems of Small Business*: *A Report of the Subcomm. on SBA Oversight and Minority Enterprise of the House Comm. on Small Business*, H.R. Rep. No. 468, 94th Cong., 1st Sess. (1975).

5. *Summary of Activities*: *A Report of the House Committee on Small Business*, 94th Cong., 2d Sess. 182 (1977).

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

7. *To Amend the Small Business Act to Extend the Current SBA 8(a) Pilot Program*: *Hearings on H.R. 5612 Before the Senate Select Comm. on Small Business*, 96th Cong., 2d Sess. (1980).

8. *Small Business and the Federal Procurement System: Hearings Before the Subcomm. on General Oversight of the House Comm. on Small Business*, 97th Cong., 1st Sess. (1981).

9. *Small and Minority Business in the Decade of the 80's*: *Hearings Before the House Comm. on Small Business*, 97th Cong., 1st Sess. (Pt. 1 1981).

10. *Hearings on Minority Business and its Contributions to the U.S. Economy of the Senate Comm. on Small Business*, 97th Cong., 2d Sess. (1982).

11. *Hearings on Federal Contracting Opportunities for Minority and Women-Owned Businesses: An Examination of the 8(d) Subcontracting Program Before the Senate Comm. on Small Business*, 98th Cong., 1st Sess. (1983).

12. *Hearings on the State of Hispanic Small Business in America Before the Subcomm. on Small Business*, 99th Cong., 2d Sess. (1985).

13. *Minority Enterprise and General Small Business Problems*: *Hearings Before the Subcomm. on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems of the House Comm. on Small Business*, 99th Cong., 2d Sess. (1986).

14. *To Present and Examine the Result of a Survey of the Graduates of the Small Business Administration Section 8(a) Minority Business Development Program: Hearings Before the Senate Small Business Comm.*, 100th Cong., 1st Sess. (1987).

15. *A Bill to Reform the Capital Ownership Development Program*: *Hearings on H.R. 1807 Before the House Subcomm. on Procurement, Innovation, and Minority Enterprise Development of the House Comm. on Small Business*, 101st Cong., 1st Sess. (1987).

16. *Minority Business Development Act*: *Hearings Before the Subcomm. on Procurement, Innovation, and Minority Enterprise Development of the House Comm. on Small Business*, 101st Cong., 1st Sess. (1987).

17. *Small Business Problems: Hearings Before the House Comm. on Small Business*, 100th Cong., 1st Sess. (1987).

18. *The Small Business Competitiveness Demonstration Program Act of 1988*: *Hearings on S. 1559 Before the Senate Comm. on Small Business*, 100th Cong., 2d Sess. (1988).

19. *Twenty Years After the Kerner Commission: The Need for a New Civil Rights Agenda*: *Hearing Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 100th Cong., 2d Sess. (1988).

20. *Surety Bonds and Minority Contractors: Hearing Before the Subcomm. on Commerce, Consumer Protection and Competitiveness of the House Comm. on Energy and Commerce*, 100th Cong., 2d Sess. (1988).

21. *Minority Construction Contracting: Hearing Before the Subcomm. on SBA, the General Economy, and Minority Enterprise Development of the House Comm. on Small Business*, 101 Cong., 1st Sess. (1989).

22. *Implementation of Small Business Subcontracting Program: Hearing Before the House Comm. on Small Business*, 100th Cong., 2d Sess. (1988).

23. City of Richmond *v.* J.A. Croson: Impact and Response: Hearing Before the Subcomm. on Urban and Minority-Owned Business Development of the Senate Comm. of Small Business, 101st Cong., 2d Sess. (1990).

24. *The Meaning and Significance for Minority Business of the Supreme Court Decision in the* City of Richmond *v.* J.A. Croson: *Hearing Before the Legislation and National*

Security Subcomm. of the House Comm. on Government Operations, 101st Cong., 2d Sess. (1990).

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APPENDIX H

HEARINGS ON THE SURFACE TRANSPORTATION ASSISTANCE ACT OF 1982

1. *Implementation of the Surface Transportation Assistance Act of 1982: Hearing Before the Senate Comm. on the Environment and Public Works*, 98th Cong., 2d Sess. (1984).

2. *Review of the 10-Percent Set Aside Program, Section 105(f) of the Surface Transportation Assistance Act of 1982: Hearing Before the House Comm. on Small Business*, 98th Cong., 2d Sess. (1984).

3. *Surface Transportation Issues: Hearing Before the House Comm. on Public Works and Transportation*, 98th Cong., 2d Sess. (1984).

4. *Review of 10-Percent Set Aside Program (Section 105(f)) of the Surface Transportation Assistance Act of 1982: Hearing Before the House Comm. on Small Business*, 99th Cong., 1st Sess. (1985).

5. *Minority Business Participation in Department of Transportation Projects: Hearing Before the House Comm. on Government Operations*, 99th Cong., 1st Sess. (1985).

6. *The Disadvantaged Enterprise Program of the Federal Aid Highway Act: Hearing Before the Subcomm. on Transportation of the Senate Comm. on Environment and Public Works*, 99th Cong., 1st Sess. 10 (1985).

7. *Minority Business Participation in Department of Transportation Projects: Hearing Before the House Comm. on Government Operations*, 99th Cong., 1st Sess. (1985).

APPENDIX I

HEARINGS AND REPORTS IN CONNECTION WITH ISTEA AND TEA-21

1. *Disadvantaged Business Set-Asides in Transportation Construction Projects: Hearing Before the House Comm. on Small Business*, 100th Cong., 2d Sess. (1988).

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3. *Surety Bonds and Minority Contractors: Hearing Before the House Comm. on Energy and Commerce*, 100th Cong., 2d Sess. (1988).

4. *Subcontracting with Small and Disadvantaged Businesses: GSA Subcontracting with Small and Disadvantaged Businesses: Hearing Before the House Comm. on Government Operations*, 100th Cong., 2d Sess. (1988).

5. *Minority Business Set-Aside Programs: Hearing Before the House Judiciary Comm.*, 101st Cong., 1st Sess. (1990).

6. *Problems with Equal Employment Opportunity and Minority and Women Contracting at Federal Agencies: Hearing Before the House Comm. Banking, Finance and Urban Affairs*, 102d Cong., 2d Sess. (1992).

7. *Discrimination in Surety Bonding: Hearing Before the House Comm. on Small Business*, 103d Cong., 1st Sess. (1993).

8. *Problems Facing Minority and Women-Owned Small Businesses in Procuring U.S. Government Contracts*: *Hearing Before the Subcomm. on Commerce, Consumer and Monetary Affairs of the House Comm. on Government Operations*, 103d Cong., 1st Sess. (1993)

9. *Discrimination in Surety Bonding: Hearing Before the Subcomm. on Minority Enterprise, Finance and Urban Development of the House Comm. on Small Business*, 103d Cong., 1st Sess. (1993).

10. *Access to Credit in Distressed Communities: Hearing Before the House Comm. on Small Business*, 103d Cong., 1st Sess. (1993).

11. *Availability of Credit to Minority and Women-Owned Business: Hearing Before the Subcomm. on Financial Institutions Supervision, Regulation and Deposit Insurance of the House Comm. on Banking*, 103d Cong., 2d Sess. (1994).

12. *Unconstitutional Set-Asides: ISTEA's Race-Based Set-Asides After Adarand: Hearing Before the Subcomm. on the Constitution, Federalism, and Property Rights of the Senate Judiciary Comm.*, 105th Cong., 1st Sess. (1997) (attaching "Proposed Reforms to Affirmative Action In Federal Procurement: A Preliminary Survey," 61 Fed. Reg. 26,041 (May 23, 1996)).

APPENDIX J

WEST DOLORES CONTRACT
[Excerpts]