

CHAPTER 2.

Legal Analysis

As a United States Department of Transportation (USDOT) fund recipient, the Los Angeles County Metropolitan Transportation Authority (Metro) implements the Federal Disadvantaged Business Enterprise (DBE) Program. The Federal DBE Program is governed by 49 Code of Federal Regulations (CFR) Part 26 and related federal regulations. BBC Research & Consulting (BBC) presents a Legal Analysis for the 2017 Metro Disparity Study in two parts:

- A. Program elements; and
- B. Legal standards.

A. Program Elements

The Federal DBE Program is designed to encourage the participation of minority- and woman-owned businesses in an agency's contracting, and more specifically, in its USDOT-funded contracts.¹ As part of the Federal DBE Program, every three years, an agency is required to set an overall goal for DBE participation in its USDOT-funded contracts.² Although an agency is required to set the goal every three years, the overall DBE goal is an *annual* goal in that the agency must monitor DBE participation in its USDOT-funded contracts every year. If DBE participation for a particular year is less than the overall DBE goal for that year, then the agency must analyze the reasons for the difference and establish specific measures that will address the difference and enable the agency to meet the goal in the next year.

Definition of DBE. According to 49 CFR Part 26, a DBE is a business that is owned and controlled by one or more individuals who are socially and economically disadvantaged according to the guidelines in the Federal DBE Program. The following groups are presumed to be socially and economically disadvantaged according to the Federal DBE Program:

- Asian Pacific Americans;
- Black Americans;
- Hispanic Americans;
- Native Americans;
- Subcontinent Asian Americans; and
- Women of any race or ethnicity.

A determination of economic disadvantage includes assessing businesses' gross revenues and business owners' personal net worth (maximum of \$1.32 million excluding equity in a home and

¹ BBC considers a contract as USDOT-funded if it includes at least one dollar of USDOT funding.

² <http://www.gpo.gov/fdsys/pkg/FR-2011-01-28/html/2011-1531.htm>

in the business). Some minority- and woman-owned businesses do not qualify as DBEs because of gross revenue or net worth requirements. Businesses owned by non-Hispanic white men can be certified as DBEs if those businesses meet the requirements in 49 CFR Part 26.

Certification requirements. Businesses seeking DBE certification in California are required to submit an application to a certifying agency of the California Unified Certification Program (CUCP). Metro is a certifying agency for CUCP. The application is available online and requires businesses to submit various information including business name; contact information; tax information; work specializations; and race/ethnicity and gender of the owners through an online portal. CUCP reviews each application for approval. The review process involves on-site meetings and additional documentation to confirm required business information.

Measures to encourage DBE participation. Regulations that govern an agency's implementation of the Federal DBE Program require that the agency meets the maximum feasible portion of its overall DBE goal through the use of *race- and gender-neutral measures*.³ Race- and gender-neutral measures are designed to encourage the participation of all businesses—or, all small businesses—in an agency's contracting. Participation in such measures is not limited to minority- and woman-owned businesses or to certified DBEs. If an agency cannot meet its overall DBE goal solely through race- and gender-neutral means, then it is required to consider using *race- and gender-conscious measures* as part of its implementation of the Federal DBE Program. Race- and gender-conscious measures are designed to specifically encourage the participation of minority- and woman-owned businesses in an agency's contracting (e.g., using DBE goals on individual USDOT-funded contracts). Given that context, there are several approaches that agencies could use to implement the Federal DBE Program.

1. Using a combination of race- and gender-neutral and race- and gender-conscious measures with all DBEs considered eligible. Many agencies use a combination of race- and gender-neutral and race- and gender-conscious measures when implementing the Federal DBE Program with all certified DBEs being considered eligible to participate in the race- and gender-conscious measures. Those agencies use various measures that are designed to encourage the participation of small and emerging businesses in their contracting. In addition, they also use DBE contract goals on individual contracts, and the participation of all certified DBEs—regardless of race/ethnicity or gender—count toward meeting those goals.

2. Applying a combination of race- and gender-neutral and race- and gender-conscious measures with only certain DBEs considered eligible. Some agencies limit DBE participation in race- and gender-conscious measures to certain racial/ethnic or gender groups based on evidence of those groups facing discrimination within the agencies' respective relevant geographic market areas (*underutilized DBEs, or UDBEs*). For example, the California Department of Transportation (Caltrans) has previously set DBE contract goals for which only UDBEs—which did not include all DBE groups—were considered eligible. During this time, Caltrans counted the participation of all DBEs toward meeting its overall DBE goal, but only UDBE participation counted toward prime contractors meeting DBE contract goals on individual

³ 49 CFR Section 26.51.

contracts. Caltrans determined which DBE groups were UDBEs by examining results of a disparity study for individual racial/ethnic and gender groups. The Colorado Department of Transportation and the Oregon Department of Transportation, among other agencies, have also implemented the Federal DBE Program in similar ways.

3. Applying a combination of race- and gender-neutral and more aggressive race- and gender-conscious measures in extreme circumstances. The Federal DBE Program provides that an agency may not use more aggressive race- and gender-conscious program measures—such as setting aside contracts exclusively for DBE bidding—except in limited and extreme circumstances. An agency may only use set asides when no other method could be reasonably expected to redress egregious instances of discrimination.⁴ Specific quotas for DBE participation are strictly prohibited under the Federal DBE Program.

4. Operating an entirely race- and gender-neutral program. Some agencies have implemented the Federal DBE Program without the use of DBE contract goals or other race- and gender-conscious measures. Instead, those agencies only use race- and gender-neutral measures as part of their implementations of the Federal DBE Program. For example, the Florida Department of Transportation and the Port of Seattle implement the Federal DBE Program using only race- and gender-neutral program measures.

Metro implemented the Federal DBE Program using different approaches during the study period (i.e., January 1, 2011 through Dec 31, 2015). Between January 1, 2011 and May 31, 2013, Metro operated an entirely race- and gender-neutral program. However, beginning on June 1, 2013, Metro began using DBE contract goals in awarding many of its USDOT-funded contracts.

B. Legal Standards

Metro's use of DBE contract goals is considered a race- and gender-conscious measure. Prime contractors can meet DBE contract goals by either making subcontracting commitments with certified DBE subcontractors at the time of bid or by showing that they made all reasonable good faith efforts to meet the goals but could not do so. The United States Supreme Court has established that government programs that include race- and gender-conscious measures must meet the *strict scrutiny* standard of constitutional review.⁵ The two key U.S. Supreme Court cases that established the strict scrutiny standard for such measures are:

- The 1989 decision in *City of Richmond v. J.A. Croson Company*, which established the strict scrutiny standard of review for race-conscious programs adopted by state and local governments;⁶ and
- The 1995 decision in *Adarand Constructors, Inc. v. Peña*, which established the strict scrutiny standard of review for federal race-conscious programs.⁷

⁴ 49 CFR Section 26.43.

⁵ Certain Federal Courts of Appeals apply the *intermediate scrutiny* standard to gender-conscious programs. Appendix B describes the intermediate scrutiny standard in detail.

⁶ *City of Richmond v. J.A. Croson Company*, 488 U.S. 469 (1989).

Strict scrutiny standard. An agency must meet both the *compelling governmental interest* and the *narrow tailoring* components of the strict scrutiny standard. A program that fails to meet either component is unconstitutional. Many programs have failed to meet the strict scrutiny standard, because they have failed to meet the compelling governmental interest requirement, the narrow tailoring requirement, or both. However, many other programs have met the strict scrutiny standard and courts have deemed them to be constitutional. Appendix B provides detailed discussions of the related case law.

Compelling governmental interest. An agency must demonstrate a *compelling governmental interest* in remedying past identified discrimination in order to use race- or gender-conscious measures. An agency that uses race- or gender-conscious measures as part of a minority- or woman-owned business program has the initial burden of showing evidence of discrimination—including statistical and anecdotal evidence—that supports the use of such measures. Agencies cannot rely on national statistics of discrimination in an industry to draw conclusions about the prevailing market conditions in their own regions. Rather, they must assess discrimination within their own relevant market areas.⁸ It is not necessary for a government agency itself to have discriminated against minority- or woman-owned businesses for it to act. In *City of Richmond v. J.A. Croson Company*, the Supreme Court found, “if [the governmental entity] could show that it had essentially become a ‘passive participant’ in a system of racial exclusion practiced by elements of the local construction industry ... [i]t could take affirmative steps to dismantle such a system.”

Many agencies have used information from disparity studies—specifically, evidence of disparities between the participation and availability of minority- and woman-owned businesses—as part of determining whether their contracting practices are affected by race-or gender-based discrimination. In *City of Richmond v. J.A. Croson Company*, the U.S. Supreme Court held 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 locality or the locality’s prime contractors, an inference of discriminatory exclusion could arise.” Lower court decisions since *City of Richmond v. J.A. Croson Company* have held that a compelling governmental interest must be established for each racial/ethnic and gender group to which race- and gender-conscious measures apply.

Narrow tailoring. In addition to demonstrating a compelling governmental interest, an agency must also demonstrate that its use of race- and gender-conscious measures is *narrowly tailored*. There are a number of factors that courts consider when determining whether the use of such measures is narrowly tailored including:

- The necessity of such measures and the efficacy of alternative, race- and gender-neutral measures;
- The degree to which the use of such measures is limited to those groups that actually suffer discrimination in the local marketplace;

⁷ *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200 (1995).

⁸ See e.g., *Concrete Works, Inc. v. City and County of Denver* (“Concrete Works I”), 36 F.3d 1513, 1520 (10th Cir. 1994).

- The degree to which the use of such measures is flexible and limited in duration, including the availability of waivers and sunset provisions;
- The relationship of any numerical goals to the relevant business marketplace; and
- The impact of such measures on the rights of third parties.⁹

Proposition 209. In addition to USDOT-funded contracts, Metro awards transportation contracts that are solely funded through local sources. The Federal DBE Program does not apply to those contracts. Many agencies apply minority- and woman-owned business goals to locally-funded contracts in a manner that is very similar to how they set DBE goals on individual federally-funded contracts. For example, the Texas Department of Transportation operates a Historically Underutilized Business Program that includes contract goals on certain state-funded contracts. The North Carolina Department of Transportation and the Indiana Department of Transportation both use goals programs in place for to their locally-funded contracts that mirror the race- and gender-conscious aspects of the Federal DBE Program.

Metro does not apply minority- and woman-owned business goals to its locally-funded contracts because of Proposition 209, which California voters passed in November 1996. Proposition 209 amended state law to prohibit discrimination and the use of race- and gender-based preferences in public contracting, public employment, and public education. However, Proposition 209 did not prohibit those actions if an agency is required to take them “to establish or maintain eligibility for any federal program, if ineligibility would result in a loss of federal funds to the state.” Thus, Proposition 209 prohibits government agencies in California from applying race- and gender-conscious measures to locally-funded contracts but not necessarily to federally-funded contracts.

⁹ See, e.g., *AGC, SDC v. Caltrans*, 713 F.3d at 1198-1199; *Rothe*, 545 F.3d at 1036; *Western States Paving*, 407 F.3d at 993-995; *Sherbrooke Turf*, 345 F.3d at 971; *Adarand VII*, 228 F.3d at 1181; *Eng’g Contractors Ass’n*, 122 F.3d at 927 (internal quotations and citations omitted).