received far more of their expected share of dollars than did African American-owned firms (31 percent).

One of the more common sources of discrimination was the disparate treatment HUBs faced in obtaining financing. In both personal interviews and our review of the literature, we obtained reports of financial institutions failing to extend loans or financing, even when the HUB had considerable collateral. Another problem frequently noted in interviews was discrimination by non-HUB prime contractors. HUB representatives also reported negative stereotyping of HUB firms, inability to obtain bonding and disparate pricing and treatment by suppliers as other sources of discrimination.

Table 6.18 summarizes the evidence of discrimination, by source, obtained from the surveys and the personal interviews. While this table reflects the scope of reports of discrimination we received, it does not show how many reports of discrimination were received from any particular group in any particular area. In the table, "S" indicates that we received a report of discrimination from the survey that fell into the indicated category, and "I" indicates that we received an anecdote of discrimination through a personal interview.

The last four chapters have presented both statistical evidence that HUBs have been underutilized in the public and private sectors in Texas and direct evidence that HUBs face discrimination in numerous business dealings. The next chapter explores possible remedies for the problems faced by HUBs.

TABLE 6.18

SUMMARY OF ANECDOTAL EVIDENCE OF DISCRIMINATION OBTAINED FROM SURVEYS AND INTERVIEWS

Industry & Source of Discrimination	African American	Hispanic	Asian & Other	White Women
Construction				
Prime Contractors	S	I, S	S	I,S
Bonding or Surety Companies	I, S	I, S	S	S
Banks & Other Financial Institutions	I, S	S	S	S
Suppliers	S	S	S	I, S
Public Agencies (including Obstacles Presented by the Bidding Process)	I, S	I, S	I, S	I, S
Commodity Purchasing				
Prime Contractors	I		I	
Bonding or Surety Companies			I	
Banks & Other Financial Institutions	S	S	I, S	I, S
Suppliers	S	S	S	S
Public Agencies (including Obstacles Presented by the Bidding Process)	S	I, S	S	I, S
Professional & Other Services				
Prime Contractors	I, S	I, S	I, S	I, S
Bonding or Surety Companies	S	I, S	I	I
Banks & Other Financial Institutions	I, S	I, S	I, S	I, S
Suppliers	I	I	I	
Public Agencies	I, S	S	I, S	I, S
Private Clients (Potential & Actual)	.I	I		I

Key: "S" indicates that evidence was obtained from the HUB survey.
"I" indicates that evidence was obtained from the personal interviews.

CHAPTER 7
METHODS FOR ASSISTING HISTORICALLY UNDERUTILIZED BUSINESSES

This chapter discusses remedies for some of the problems that make it difficult for HUBs to compete for public-sector procurements. In discussing these remedies, we address the following issues:

- What is the current case law concerning the types of remedies that public agencies can consider?
- What is the analytical framework that we use to evaluate alternative methods?
- What are the specific race/sex-neutral methods that the State may wish to consider?

- What are the race/sex-conscious award preferences such as goals-based programs that the State may wish to consider?

In responding to these questions, we discuss the advantages and disadvantages of race/sex-neutral remedies—i.e., remedies that do not provide a specific preference based on race/ethnicity or sex—and race/sex-conscious remedies—i.e., remedies that do provide preferences based on race/ethnicity or sex. We also report estimates of the actual and potential availability of HUBs; these estimates could be used by the State to establish HUB goals.

I. Legal Framework for Evaluating Remedies

According to current case law, the legal standard of review for preference programs depends on the type of entity granting the preference and whether the preference is based on race or some other characteristic. The strictest standard of review is reserved for state and local governments that have adopted race-based preference programs. A medium standard of review is applied to race-based preferences mandated by U.S. Congress and to sex-based preferences adopted at all governmental levels. An even weaker standard of review is applied to other preferences such as those for the disabled.

The Supreme Court first ruled on the constitutionality of race-based preference programs for government procurement in *Fullilove v. Klutznick* in 1980.[227] There, the plaintiff contended that the MBE goal program created by the Public Works Employment Act of 1977 violated the Equal Protection Clause of the Fourteenth Amendment of the Constitution. The Court held that Congress could use racial or ethnic criteria as a condition for receiving federal funds as long as the use of the criteria is "limited to accomplishing the remedial objectives contemplated by Congress and . . .

[227] 448 U.S. 448 (1980).

misapplications of the racial and ethnic criteria can be remedied." The Court subjected the federal program to what is known as the "intermediate scrutiny test," and the federal program passed.[228]

In 1989 the Supreme Court had another occasion to consider the constitutionality of minority set-asides. In *City of Richmond v. J.A. Croson*,[229] the Court ruled that Richmond's 30 percent minority set aside for City construction projects violated the Equal Protection Clause of the Constitution. In contrast to *Fullilove*, the Court held that the City could not establish a set-aside program in the absence of a factual finding that it formerly participated in discrimination against minorities in awarding City construction projects or that the City was a passive participant in discrimination generally affecting the construction industry in the City. Under *Croson*, a non-federal government may adopt race-based classifications if it demonstrates that the use of the classifications is justified by a compelling governmental interest and that the race-conscious remedies are narrowly tailored to remedy racial discrimination. The Court subjected Richmond's program to the "strict scrutiny test," and found that Richmond failed the stringent test.

The strict scrutiny test has not generally been applied to gender classifications. The Court has consistently used the weaker intermediate level of scrutiny to examine gender classifications.[230] The intermediate level of scrutiny requires classifications, such as gender, to be "substantially related" to the achievement of "important" government objectives.

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[228] See also *Adarand Constructors, Inc. v. Pena*, 16 F.3d 1537, 1543-44 (10th Cir. 1994) (*Fullilove* applies to goals set by federal administrative agencies if within the authority delegated them by Congress). The Supreme Court is going to review this decision during its 1995 term.

[229] 488 U.S. 469 (1989).

[230] See *Craig v. Boren*, 429 U.S. 190 (1976). But see *Brunet v. Columbus*, 1 F.3d 390, 404 (6th Cir. 1994); Note, *Strict Scrutiny For Gender, Via Croson*, 93 Colum. L. Rev. 508 (1993).

The courts have applied an even weaker test, known as the rational basis test, to preferences for the disabled.[231] The Third Circuit reviewed the City of Philadelphia's program for the disabled under the rational basis test. It relied on *Cleburne*, in which the Court rejected an effort to make mentally retarded persons a quasi-suspect class.[232] On the basis of testimony from four disabled people, the Third Circuit refused to grant summary judgment to the Contractors Association.

Thus, the courts have applied three principal tests to determine whether preference programs are constitutional depending upon the legal body granting the preference and the group that benefits from the preference. Table 7.1 summarizes the various tests that have been applied by the courts.

TABLE 7.1

SUMMARY OF THE TESTS APPLIED BY THE COURTS IN RULING ON THE CONSTITUTIONALITY OF DIFFERENT PREFERENCE PROGRAMS

	Level of Preference Program	
Basis for Preference	Federal	State/Local
Race	Intermediate Scrutiny	Strict Scrutiny
Sex	Intermediate Scrutiny	Intermediate Scrutiny
Other	Rational Basis	Rational Basis

To give the reader an understanding of the types of issues the courts consider in evaluating preferences we focus on the application by the courts of the strict scrutiny test. This test consists of two prongs: (1) whether the racial classification at issue is justified by a "compelling governmental interest," and (2) whether the means chosen by the state or municipality are narrowly tailored to

[231] See *Contractors Association v. Philadelphia*, 6 F. 3d 990 (3d Cir. 1993).

[232] 473 U.S. at 445,

effectuate that interest. The *Croson* Court concluded that the City of Richmond's 30 percent set-aside for minority contractors was invalid because the plan did not satisfy either prong of the "strict scrutiny" test. The Court ruled that Richmond had not shown: (1) that the race-conscious elements of the plan were justified by evidence of racial discrimination, or (2) that race-conscious measures were needed to remedy the problems that prevented minority contractors in Richmond from receiving a greater share of the dollars expended by that City to procure goods and services. The various factors that the courts have considered when determining whether the prongs of the "strict scrutiny" test have been satisfied are discussed below.

A. Compelling Governmental Interest

In *Croson*, a majority of the Supreme Court described the circumstances in which a race-conscious remedy could be properly adopted. According to the Court, a municipality has a compelling interest in remedying not only discrimination committed by the municipality itself, but also discrimination committed by private parties within the municipality's legislative jurisdiction, so long as the municipality in some way perpetuated the discrimination to be remedied by the program.[233] To satisfy this requirement, "the governmental actor need not be an active perpetrator of such discrimination; passive participation will satisfy this prong of strict scrutiny review."[234] The "mere infusion of tax dollars into a discriminatory industry may be sufficient governmental involvement to satisfy this prong."[235]

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[233] See 488 U.S. at 491-92 (plurality opinion of O'Connor, J., with Rehnquist, C.J. and White, J.); *id.* at 537-38 (Marshall, J., with Brennan and Blackmun, J.J., dissenting).

[234] *Coral Construction Co. v. King County*, 941 F. 2d 910, 916 (9th Cir. 1991).

[235] *Id.*

The governmental body proposing the affirmative-action program may establish a compelling interest by making a *prima facie* showing that identifiable discrimination has occurred within the local industry affected by the program.[236] In *Croson*, the Court stated that an inference of discrimination arises from a "significant 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 locality's prime contractors."[237] In calculating statistical disparity, "precise calculations of statistical significance" probably are not required. The public entity simply must demonstrate "a firm basis" for concluding that affirmative action is warranted.[238] It seems clear that the discrimination need not itself be on-going, as long as its effects remain. As Justice O'Connor phrased the test in her opinion in *Northeastern Florida AGC v. Jacksonville*, the entity must "determine whether past discrimination or its continuing effects [make] a preference program necessary."[239]

In *O'Donnell Construction Co. v. District of Columbia*, 963 F.2d 420 (D.C. Cir. 1992), the court of appeals reviewed the D.C. Minority Contracting Act, first enacted in 1977, which required that 35% of all construction contracts be awarded to local MBEs. The court held that the District's pre-*Croson* findings most likely were insufficient because there was no adequate analysis of

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[236] The defendant government must show only that it has "a strong basis in evidence for its conclusion that remedial action was necessary." *Edwards v. Houston*, 37 F.3d 1097 (5th Cir. 1994). The burden of persuasion then shifts to the plaintiff. *Concrete Works of Colorado, Inc. v. Denver*, 1994 U.S. App. LEXIS 26848, at *24-25 (10th Cir. 1994).

[237] 488 U.S. at 509.

[238] *Hazelwood School District v. United States*, 433 U.S. 299, 311 n.17 (1977); *see Wygant*, 476 U.S. at 292-93 (O'Connor, J., concurring). The disparity must be calculated on the basis of a proper definition of the available pool from which hiring or contracting could occur. See, e.g., *Maryland Troopers Ass'n, Inc. v. Evans*, 993 F.2d 1072 (4th Cir. 1993); *Peightal v. Metropolital Dade County*, 26 F.3d 1545 (11th Cir. 1994); *Bilbo Freight Lines, Inc. v. Morales*, No. H-93-3808 (S.D. Tex. Feb. 3, 1994).

[239] 113 S.C. 2297 (1993). In *Hopwood v. Texas*, 1994 U.S. Dist. LEXIS 11870 (W.D. Tex. 1994), the court held that "Texas' long history of discrimination against blacks and Mexican Americans in public education" and "some present effects" satisfied strict scrutiny.

availability or utilization of local MBEs. What information there was about MBEs did not answer such questions as "what types of construction work these firms performed; the race of the owners of the firms; the total volume of business they handled; whether they were in the private or public contracting sector; whether they were fully employed; or whether any of them had been unable to get work as a result of racial discrimination."[240] In addition, some of the evidence indicated that MBE utilization was in fact quite high.[241]

In addition to statistical evidence of disparity, the courts have closely examined historical and anecdotal evidence of discrimination because "bare statistical comparisons constitute a treacherous rationale for the installation of race preferences."[242] In *Croson*, the Court stated that "evidence of a pattern of individual discriminatory acts can, if supported by appropriate statistical proof, lend support to a local government's determination that broader [race-conscious] remedial relief is justified."[243] Subsequently, in *Coral Construction*, the Ninth Circuit endorsed this approach, stating that "a combination of convincing anecdotal and statistical evidence is potent."[244]

The Third Circuit also commented on the importance of anecdotal evidence of discrimination in *Contractors Association v. Philadelphia*.[245] In that case, although the testimony of 14 minority

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[240] 963 F.2d at 425.

[241] *Id.* at 426. Judge, now Supreme Court Justice, Ginsburg joined in the majority opinion but also noted that she subscribed to the more liberal approach of Justice Stevens in *Croson*. *Id.* at 429.

[242] *Maryland Troopers Ass'n, Inc. v. Evans*, 993 F.2d 1072, 1074 & 1077 (4th Cir. 1993).

[243] 488 U.S. at 509.

[244] 941 F.2d at 919. See also *Associated General Contractors, Inc. v. Coalition for Economic Equity*, 950 F.2d 1401 (9th Cir. 1991), *cert. denied*, 112 S. Ct. 1670 (1992); *Shuford v. Alabama State Board of Education*, 846 F.Supp. 1511, 1525 (N.D. Ala. 1994) ("individual instances illuminate both the historical evidence and statistical evidence").

[245] 6 F.3d 990 (3d Cir. 1993).

contractors regarding discriminatory practices alone was insufficient to withstand strict scrutiny review,[246] when augmented with statistical evidence the combination constituted a showing of discrimination against African American firms sufficient to withstand a motion for summary judgment.[247] Once there was statistical and anecdotal evidence of discrimination, the burden shifted to the challengers to show that there was a "neutral explanation" for the disparity, that the statistics were flawed, or that other statistical evidence was more compelling.[248] As to Hispanics, Asian Americans, and other minorities, the challengers showed that their availability was so low that the fact that they received no contracts did not create a sufficient statistical inference of discrimination.[249]

B. Narrowly Tailored Remedy

The second prong of the "strict scrutiny" test requires that race-conscious remedies be narrowly tailored to effectuate their purpose. The Court has identified several factors that should be considered in determining whether a race-conscious program is narrowly tailored.[250] In *Coral Construction*, the Ninth Circuit summarized these factors as follows:

> First, an MBE program should be instituted either after, or in conjunction with, race-neutral means of increasing minority business participation in public contracting. The second characteristic of a narrowly-tailored program is the use of minority utilization

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[246] *Id.* at 1002-03.

[247] *Id.* at 1007-08.

[248] *Id.* at 1007.

[249] *Id.* at 1008.

[250] *Wygant*, 476 U.S. at 274; *Croson*, 488 U.S. at 507-508. In addition, the dissenting opinion of Justice O'Connor in *Northeastern Florida Chapter of Associated General Contractors v. Jacksonville*, U.S. 113 S.Ct. 2297 (1993), provides some guidance because Justice O'Connor was the author of the *Croson* opinion. In the Jacksonville case, she dissented from a finding that a challenge to a set-aside program was not moot despite changes in the program after the litigation had commenced. Justice O'Connor identified a number of factors that she felt made the new program more narrowly tailored than the old: a ten-year sunset provision, the narrowing of the ethnic groups entitled to preference, and the adoption of a variety of techniques to be used in achieving "participation goals."

> goals set on a case-by-case basis, rather than upon a system of rigid numerical quotas. Finally, an MBE program must be limited in its effective scope to the boundaries of the enacting jurisdiction.[251]

State and local governments are required to undertake good faith consideration of race/sex-neutral measures. In *Croson*, the Court listed several race/sex-neutral alternatives it considered important. These included: (1) simplification of bidding procedures; (2) relaxation of bonding requirements; and (3) provision of training and financial aid for disadvantaged firms.[252] In *Bilbo Freight Lines, Inc. v. Morales,*[253] for example, the court found that the Texas Legislature had failed to examine such alternatives as deregulation or assistance to all small business applicants before it adopted a race-conscious program for issuance of certification of authority in the trucking industry.

As to the second factor in *Coral Construction*, flexibility in administering the race-conscious program, the Supreme Court in *Croson* indicated that it is important to determine whether the state or local government is attempting to enforce a rigid quota.[254] In examining this issue, courts following *Croson* have considered whether race-conscious programs incorporate: (1) case-by-case utilization goals; (2) a waiver provision that accounts for both the unavailability of qualified minority contractors and the failure of qualified minority contractors to submit competitive price quotes; and (3) a sunset clause providing definitive end dates.[255] All of these factors bear on whether the state

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[251] 941 F.2d at 932 (citations omitted). See also *Associated General Contractors*, 950 F.2d at 1417 (following and reiterating the narrow-tailoring factors discussed in *Coral Construction*).

[252] 488 U.S. at 507. For example, in *Contractors Association*, the approved race/sex-neutral precursors to the challenged set-aside program consisted of employment goals for public construction projects, revolving loan funds, training programs and bonding assistance efforts.

[253] No. H-93-3808 (S.D. Tex. Feb. 3, 1994).

[254] *Id.*

[255] E.g., *Coral Construction*, 941 F.2d at 924. With respect to selecting the appropriate goal, Justice O'Connor, dissenting in *Northeastern Florida*, stated that it must at least be "rationally related to [a] relevant statistic. . . ." 113 S.Ct. at 2307. The Third Circuit, in *Contractors Association v. Philadelphia*, 6 F.3d 990

or local government has reached the "difficult balance"[256] between "protection of individual rights" and "overcoming the effects of past discrimination."[257]

Third, the Court has considered whether a race-conscious program is limited in geographic scope to the boundaries of the enacting jurisdiction.[258] Applying this factor, the Ninth Circuit has said that race-conscious plans should be designed to benefit only those minority contractors that have in some way been victimized by discrimination in the enacting jurisdiction.[259] In localities where the presence of discrimination is shown, it appears that the courts will permit a rebuttable presumption that minority contractors who have done business or attempted to do business in the enacting jurisdiction are the victims of discrimination.[260] We discuss the implications of the case law for remedies in more detail later in this chapter.

II. Economic Framework

Discrimination affects minority and women entrepreneurs in three distinct but related ways. First, discrimination can reduce business profitability: discrimination may reduce revenues due to customers' refusal to deal with HUBs, and may increase business costs due to suppliers charging

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(3d Cir 1993), stated that "[w]e do not believe the goal must correspond precisely to the percentage of available contractors" and overturned a summary judgment ruling that a 15 percent goal could not be justified by a showing that only 2.4 percent of contractors were minority-owned. *Id.* at 1009.

[256] *Ensley Branch*, 1994 U.S. App. LEXIS 23275 at *67 ("special vigilance is required against unyielding racial quotas").

[257] *Hopwood v. Texas*, 1994 U.S. Dist. LEXIS 11870, at 93. In that case and in ***Bilbo Freight Lines, Inc.*** *v. Morales*, the courts expressed particular concern about approaches that do more than create a "plus factor" for minorities and instead effectively reserve all or a substantial number of opportunities for minorities.

[258] *Croson*, 488 U.S. at 508-09.

[259] *Coral Construction*, 941 F.2d at 922.

[260] *Id.* at 925.

HUBs more than they would charge non-HUBs. Second, this lower profitability limits the viability of HUBs. Most businesses start out small and expand over their life cycles.[261] Small businesses, especially, rely on profits to finance future growth.[262] Low profits will limit a firm's ability to grow and may make it more likely to fail. Third, the lower expected profitability of businesses operated by minorities and women will tend to discourage potential minority and woman entrepreneurs from starting businesses in the first place.[263] Thus, present discrimination can reduce the number of HUBs in existence at a given point, reduce the size of HUBs in existence at a given point, and limit the opportunities for existing HUBs to expand. These adverse effects on HUB development stem from the effects of contemporaneous discrimination on HUB revenues and costs.

In fashioning remedies for discrimination, we find it useful to identify the type of discrimination and proximity of discrimination to the state or local agency seeking a remedy. Discrimination could arise from disparate impact—the neutral application of criteria that minorities and women lack disproportionately—or disparate treatment—the application of different criteria to minorities and women than to similarly-situated non-minority men. This discrimination could arise from the state or local agency itself (e.g., its procurement officers), from parties with which HUBs deal directly (e.g., general contractors), and from third parties in the marketplace (e.g., banks). These

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[261] See David S. Evans, "Tests of Alternative Theories of Firm Growth," *Journal of Political Economy*, August 1987.

[262] For evidence and summaries of the literature see David S. Evans and Boyan Jovanovic, "An Estimated Model of Entrepreneurial Choice under Liquidity Constraints," *Journal of Political Economy*, August 1989 and William A. Brock and David S. Evans, "Small Business Economics," *Small Business Economics*, January 1990.

[263] See George Borjas and Stephen Bronars, "Consumer Discrimination and Self-Employment," *Journal of Political Economy*, June 1989 for evidence that discrimination by customers deters entry by African-American entrepreneurs and Evans and Jovanovic, *id.*, for evidence that the lack of availability of capital deters entry. See also, Bruce Meyer, "Why Are There So Few Black Entrepreneurs?" National Bureau of Economic Research, Working Paper No. 3537, 1990.

distinctions are important in determining whether legal sanctions, race-neutral or race-conscious remedies are most appropriate.

A. Implications of Legal and Economic Considerations for Program Design

1. When Are Race/Sex-Neutral Remedies Appropriate?

Race/sex-neutral remedies are especially appropriate when HUBs are underutilized because of the disparate impact of certain procurement requirements or practices. All small and new firms, for example, have difficulty obtaining bonding, working capital and experience. HUBs are more likely to experience these difficulties than non-HUBs because they are more likely to be small and new than are non-HUBs. That is, their difficulties might not necessarily be a result of race or sex discrimination.[264] On the other hand, disparate impacts of such requirements may arise from the disparate treatment of HUBs by second or third parties. Bonding requirements, for example, may have a disparate impact on HUBs because of disparate treatment by sureties. Agency awards would therefore be tainted by the secondary effects of such discrimination. Relaxing bonding requirements for all small firms, providing bonding-assistance programs for all small firms, or providing bid preferences for all small firms are appropriate race/sex-neutral remedies for the disparate impact of procurement requirements on HUBs.

Relaxing or eliminating procurement requirements or practices that have an adverse impact on HUBs may be problematic for at least two reasons. First, some requirements may be mandated by State or federal law and are therefore not within the purview of individual agencies to modify or

[264] For documentation that HUBs are smaller and younger firms than non-HUBs see, Bureau of the Census, *1987 Characteristics of Business Owners* (Washington, D.C.: U. S. Department of Commerce, Bureau of the Census, 1992).

eliminate.[265] Many of the bidding or bonding requirements for State agencies are prescribed by State law and, in the case of federally-funded procurements, by federal law.[266] These laws would have to be amended. Second, some requirements—such as bonding—may exist for valid business reasons. Reducing or eliminating bonding requirements for all firms could be a more costly remedy for discrimination than reducing or eliminating these requirements only for the likely victims of discrimination.

In considering remedies for disparate treatment, it is useful to distinguish between disparate treatment by the procuring entity itself that directly prevents HUBs from obtaining awards and disparate treatment by other marketplace actors that indirectly prevents HUBs from obtaining awards. The obvious remedy for disparate treatment by the entity itself is to stop engaging in it. For example, an entity could remove procurement officials who discriminate against HUBs or otherwise sanction these officials. Institutional and cultural constraints may make such remedies difficult. For example, if procurement officers or selection committees discriminated against HUB applicants, the agency could discipline such employees. However, the subtle ways in which discrimination manifests itself may make it difficult to prove that a particular employee engages in discrimination against HUBs.

Another obvious remedy is to impose sanctions on those who discriminate. Although the applicability of civil rights statutes to the subcontracting relationship may be uncertain, subcontractors who could prove discrimination would have some cause of action, if only under a general contract or tort theory. Unfortunately, it is extremely difficult to prove that discrimination occurred in an individual rejection by a prime contractor of a HUB subcontractor's bid. Even where there is

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[265] See *Coral Construction Co. v. King County*, 729 F.Supp. 734 (W.D. Wash. 1989), *aff'd in relevant part*, 941 F. 2d 910 (9th Cir. 1991) (race-neutral methods not available because of state bidding laws).

[266] See generally, 20 Tex. Civ. Stat. Section 3.11 (e) (9) and Section 5.265.

evidence of a pattern of discrimination of this sort, such evidence would not assist a particular subcontractor challenging the actions of a particular prime contractor. Moreover, the potential remedy—profit on the lost opportunity—would seldom justify the expense of this kind of litigation. We found no examples in which such litigation has been successfully pursued, and only a few instances in which it has been attempted.[267]

A further problem with imposing sanctions is that any particular state or local agency has, at best, a limited ability to expand the scope of sanctions to those areas in which discrimination may affect its procurement decisions. While an agency might impose penalties (e.g., debarment) on contractors that engage in discrimination, it would not have the authority or ability to impose penalties on secondary parties such as banks, unions, suppliers and bonding companies whose discrimination raises the costs of HUBs that currently bid on agency procurements or would do so in the absence of discrimination.

States have a greater ability than individual agencies to enact and enforce laws prohibiting discrimination against businesses by these types of secondary parties on the basis of race or sex. For example, an explicit civil rights statute that gave minority or woman-owned businesses the right to sue for discrimination and the possibility of collecting significant actual and punitive damages could curb discrimination. Likewise, giving the State Attorney General or some other agency the power to investigate discrimination against businesses and impose sanctions could help.

2. Which Race/Sex-Conscious Measures Are Appropriate?

Where it is not possible to check the agents of active discrimination, race/sex-conscious measures of some sort may be the more effective method for ensuring that a state or local agency

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[267] It might still be worthwhile to create additional civil remedies for discrimination in subcontracting on public contracts. Such remedies might be useful to a few subcontractors and might lead to records that would be useful in the future.

does not participate indirectly in discrimination by its contractors or secondary parties. To determine the appropriate form of race/sex-conscious measures, it is important to look at the impact of identified discrimination on the revenues and costs of affected HUBs. Some discrimination—such as the refusal of general contractors to use HUB subcontractors or the tendency of selection committees to award contracts to non-HUBs—denies HUBs opportunities for sales and revenues as well as for the experience needed to build a track record. When there is an outright refusal to deal with HUBs, the one solution is to earmark a portion of agency procurement for HUBs, and goals, in some form, may be the most appropriate remedy. When there is an aversion to HUBs, but not an outright refusal to deal with HUBs, goals are still an option, but an alternative solution is to give HUBs enough extra "points" (i.e., subsidize their bids) to offset the effects of discrimination.

Other discrimination—such as that by suppliers—raises the costs of doing business for HUBs and therefore denies them profits by preventing them from getting certain contracts and by lowering their profits on contracts that they do get. Although goals are one solution to this problem, a more direct solution would be to offset the higher costs of HUBs with a subsidy. Subsidies can be awarded either prior to bids or as part of bids. A pre-bid subsidy is one in which the procuring agent provides bonding, technical or financial assistance to HUBs who are potential suppliers. The agent makes a direct payment to HUBs in this case. A bid subsidy involves giving HUB bidders an incremental preference in evaluating their bids to offset their higher costs and to thereby make them more competitive with non-HUB bidders. For example, the State could evaluate awards exclusive of bonding costs to eliminate the effects of discrimination in bonding on award decisions; or it could give HUBs a percent preference (e.g., 5 percent off their bid in the case of contracts awarded to the lowest bidder or extra points in the case of contracts awarded on grounds other than cost). In this

case, the State makes an indirect "payment" to HUBs: if the selected HUB was not the lowest bidder before the added preference, the higher charges of selecting them will be passed on to the State.

3. The Direct and Indirect Costs of Remedies

Remedies differ not only in efficacy at alleviating the adverse effects of discrimination, but also in the direct and indirect costs to the entity implementing those remedies. The direct cost of a remedy includes the cost of administering the remedy (e.g., the cost of an affirmative action unit) and possible direct payments to HUBs (e.g., subsidized interest payments). The indirect cost of a remedy includes possible indirect payments to HUBs (higher contract costs as a result of not awarding projects to the lowest possible bidder) and inefficiencies introduced into the bidding process. More elaborate mechanisms for awarding preferences will have higher direct costs (more administrative staff) and indirect costs (possibly greater inefficiencies in the bidding process).

III. Race/Sex-Neutral Methods

In Chapter 6, we found that bonding, information access, financing, training deficiencies and competition from large firms all serve as obstacles to HUB participation in State contracts. In this section, we discuss race/sex-neutral solutions designed to overcome these obstacles and comment upon their relative effectiveness.[268] We also describe some of the programs that currently exist in different Texas cities and counties.

A. Bonding

Obtaining bonding is a common problem for HUBs, particularly for construction firms. The following race/sex-neutral actions can help HUBs overcome the difficulties associated with meeting bonding requirements.

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[268] For the purposes of this chapter, we consider a race/sex-neutral solution to be one that does not provide a bid or award preference based on race or sex.

Reduce Bonding Requirements for Bids under a Specified Dollar Value and Waive Performance Bonds on Smaller Contracts—Since the cost of bonds are ultimately passed on in the form of higher bid prices, bonding requirements in general should balance the cost of bonding requirements with the insurance that bonds provide against performance and payment default. Unfortunately, bonding thresholds adopted by state and local agencies are rarely based on a conscious tradeoff between costs and risks, but are rather the result of outdated statutory requirements. For example, the federal government and many state governments do not adjust bonding thresholds for inflation. Over time, the real value of bonding thresholds declines and smaller and smaller projects, after adjusting for inflation, become subject to bonding requirements. Unnecessarily high bonding requirements have a particularly adverse effect on HUBs for reasons we have already discussed.[269] Therefore, reducing bonding requirements would help increase HUB participation. As mentioned earlier, any program's ability to reduce bonding requirements may be limited by state law in general and federal law on federally-funded projects.

Refer HUBs to Bonding Assistance Programs—Federal, state and local organizations such as the Small Business Administration, the Department of Transportation and the National Minority Supplier Development Council all have programs designed to help small businesses meet bonding requirements. If these are not perceived as sufficient, an additional option would be to develop an independent bonding assistance program as well. The limitation of both of these solutions is the lack of available funds. A well-developed bonding assistance program of this type exists in Austin. Managed by the National Council of Contractors Association, this program provides bonding assistance through U.S. Treasury-listed bonding companies and has pioneered a bonding process that cuts the response time from "the usual four-to-six weeks down to only 24 to 72 hours."[270] Several cities assist small businesses by providing referrals and advice. For example, the San Antonio Department of Public Service maintains a list of insurance and bonding sources that it distributes to small businesses. The El Paso Purchasing Office conducts workshops for small businesses that cover issues including bonding and insurance; they also assist with referrals.

Enact an "Equal Surety Bond Opportunity Act"—State and local governments, such as the State of Texas, have the additional option of legislation at their disposal, which they could use to mandate that surety companies do not discriminate on the basis of race or sex when considering applications for bonds. To be effective, such legislation would have to include adequate provisions for enforcement and sanctions.

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[269] See pp. 169, *supra*.

[270] "Pathways," informational brochure from the National Council of Contractors Association.

B. Access to Information

HUBs also have problems obtaining information about potential projects. A variety of race-neutral solutions, such as those listed below, can be implemented to facilitate communication between the contracting agencies and HUBs. However, the effectiveness of these solutions to inform HUBs is difficult to measure and may increase administrative costs.

> ***Hold Focus Sessions and Pre-bid Conferences***—Such sessions would allow firms capable of providing specific goods and/or services to meet with the representatives of the administration responsible for a specific project. At these focus sessions or pre-bid conferences, the representatives would be prepared to discuss project requirements and respond to questions from potential bidders. The pre-bid conferences also provide HUB subcontractors with an opportunity to meet the prime contractors likely to bid on the project. In a related vein, the San Antonio Economic Development Department maintains a Business Information Center that provides information on the proper licenses and permits required to conduct business with the City. They also sponsor a Procurement Outreach Program that assists small businesses in reaching Federal, State and local government markets. The San Antonio Department of Public Service, the Austin Small Contractors Support Network and the Dallas Small Business Resource Council all offer various outreach programs designed to provide small businesses with information about contracting procedures and requirements and to stimulate networking and contact between vendors.
>
> ***Develop and Distribute Procurement Newsletters***—Such newsletters would give all firms advance notice of projects being planned. This lead time would give HUBs the opportunity to seek the bonding and financial assistance necessary to submit competitive bids.
>
> ***Establish a Hotline***—A procurement hotline would provide vendors and contractors with information on upcoming projects, pre-bid conferences and successful bidders. A hotline does require the development of a central depository for all bid information.

C. Obtaining Capital

HUBs may also have a hard time obtaining capital and discrimination may contribute to these difficulties. Below is a description of two possible race-neutral methods for increasing the availability

of working capital for HUBS. Once again, the effectiveness of these solutions is still largely unknown and they would involve additional administrative time and effort.[271]

> ***Adopt Prompt Payment Procedures for Subcontractors and Prime Contractors***—One way to improve the cash flow of emerging firms is to make prompt and frequent payments to prime contractors and to require prime contractors to make prompt and frequent payments to their subcontractors.[272] For example, the City of Philadelphia requires a prime contractor to pay subcontractors within ten days of receiving payment from the City. The State of California has a prompt payment program that imposes a fine for late payments to small businesses.[273]
>
> ***Provide Working Capital***—A program to make loans available, at least to HUB contractors who have experienced discrimination in obtaining commercial credit, could remedy a major problem faced by HUBs. The cost of providing working capital includes the direct administrative cost of developing and operating a working capital program. There could be additional costs to the extent that loan defaults exceed the expected level accounted for in establishing the interest rate. The San Antonio Economic Development Department, the Austin Department of Planning and Development's Community Development Corporation and the Austin Micro Lending/ Business in Growth Program all provide financing assistance to small businesses. The El Paso Purchasing Office refers small businesses to other sources of funding, as does the City of Austin.

D. Management, Training and Education

Disparate impact on HUBs often can be decreased by providing management training and education to HUBs through race-neutral programs. Two examples of such assistance are mentor-protege programs and joint venture programs. An example of a mentor-protege program is the Department of Defense (DOD) pilot program that reimburses non-HUB contractors for the costs

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[271] As one measure of effectiveness, in a recent NERA study conducted for the State of Maryland Department of Transportation, roughly 10 to 20 percent of 148 HUBs surveyed reported that the Maryland Small Business Development Financing Authority had made it easier for them to obtain contracts with the State.

[272] The federal government and a few states have addressed the need for prompt payment to subcontractors. As of April 1, 1989, the federal government requires its prime construction contractors to pay their subcontractors within seven days of receiving payment from the government or incur an interest penalty.

[273] This program is administered by the Office of Small and Minority Business and is the result of State Senate Bill 982, Chapter 91, Statutes of 1982.

incurred in training a DBE subcontractor on a DOD contract. However, insufficient funding often limits the scope of such mentor-protege programs. Joint ventures involve agreements between a contractor and a DBE that allow the small firm to learn from its partner while experiencing a share of the risk and responsibility associated with the project. The effectiveness of joint venture programs is largely unknown. The National Council of Contractors Association's Small Contractor Assistance Program in Austin brings together a staff of industry professionals to shepherd small businesses through their first bid process and also provides services and information at a variety of assistance levels.

E. Competition From Large Firms

There are a variety of race-neutral programs that can be used to help HUBs compete with larger, more established firms.

> ***Implement a Small Business Preference Program***—Such a program would provide some form of a direct preference mechanism that would offset small businesses' disadvantages in the market. For example, the State of California's Office of Small and Minority Businesses has a program under which five percent of the bid price is deducted from the bid of a small business before it is compared with bids from larger vendors or contractors.

> ***Develop Inreach Programs***—Under such a program, HUB department staff would work with purchasing departments to promote affirmative action in their purchasing activities. The University of California has developed a similar program which also includes business brunches to allow small businesses to meet informally with University purchasing personnel. The effectiveness of this type of program is unclear; the University of California has been criticized for underutilization of HUBs despite this program.[274]

> ***Refer HUBs to Small Business Assistance Programs***—These referrals could recommend small business assistance programs such as the one operated by the U.S. Department of Commerce. The U.S. Department of Commerce has a network of business development centers to provide assistance to small businesses in business planning, financial planning and other business practices.

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[274] Louis Freedberg, "U.C. Falling Short of Goals for Minority and Woman Contractors," *San Francisco Chronicle*, January 16, 1992, p. A20.

Require all Bidders to Document Good Faith Efforts—Such a program would require that all bidders demonstrate affirmative efforts to solicit bids from small businesses. A problem with this approach is that it places the responsibility of providing opportunities to small businesses on the contractor.[275] Alternatively, purchasing agents could adopt bid evaluation criteria that provide points for prime contractors who utilize small businesses as subcontractors.

IV. Race/Sex-Conscious Award Preferences

In *Northeastern Florida AGC v. Jacksonville*,[276] the Court identified five types of race-conscious programs:

1. sheltered markets in which only HUBs may compete;
2. subcontractor percentage utilization requirements (the most typical program);
3. direct or targeted negotiation;
4. bid or price preferences; and
5. a 'plus factor' plan where a firm gets extra credit in the evaluation process for minority or female ownership, subcontractor utilization, or employment.

To determine the appropriate form and scope of a program, it is important to look at how the identified discrimination affects HUBs and how a remedy might be designed to reduce the burden on "innocent" non-HUBs. The Court noted that the sheltered market approach was the most burdensome to non-HUBs.[277] Justice O'Connor, in dissent, noted from a more positive perspective that the use of a variety of methods was an example of narrow tailoring, even though the sheltered market plan might be used in some circumstances and was quite disadvantageous to non-HUBs.

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[275] The City of Richmond offered this race-neutral program in response to the Supreme Court's ruling in *Croson*, which rejected the Richmond plan in part because there was no consideration of these kinds of race-neutral methods for increasing minority participation. A race-sensitive program was adopted for construction contracts.

[276] 124 L.Ed.2d 586 (1993).

[277] *Id.* at 595 & n.3.

In developing a program that relies on race/sex preferences at least seven issues need to be addressed:

- What mechanism should be used to remedy discrimination? For example, should goals or price preferences be used to assist HUBs?
- Which race and sex groups should receive preferences?
- What utilization goals should be used for each race and sex group that receives preferences?
- How long should the preferences continue before being reviewed?
- Should the remedy be restricted to HUBs in a particular geographical area and, if so, what should that area be?
- How should HUB utilization be calculated in assessing whether and to what extent goals have been met?
- What efforts should be undertaken to ensure post-contract compliance with the program and to minimize fraud and other abuses of the program.

A. Preference Mechanism

The standard mechanism used in preference programs requires that contractors achieve a specified utilization of HUBs on their contract. The advantage of this approach is that it can guarantee that a particular level of utilization will be achieved. A disadvantage is that the courts generally consider quotas to be particularly suspect under the narrow tailoring requirement. Thus, this method, even if accompanied by provisions for waivers, faces some legal risks. Another disadvantage is that it does nothing to assure utilization of HUBs as prime contractors.

An alternative mechanism is to give HUBs, or those who utilize HUBs sufficiently, a percent-bid preference. The King County, Washington plan, for example, gives HUBs an automatic five percent bid preference on certain procurements of less than $10,000. An advantage of this approach is that it reduces the administrative burden of identifying goal requirements for small purchases. Another advantage is that, unlike targeting or set-asides, it limits preferences to HUBs that are within

the competitive range specified by the bid preference. A disadvantage is that it is difficult to justify a particular bid preference on objective grounds (i.e., it is difficult to document that discrimination has caused HUBs a 5 percent disadvantage); consequently, a court may find that the preference is not narrowly tailored to identified discrimination. State bidding laws, such as those in the State of Texas, often preclude this approach for construction for state and local agencies, and may require amendment.[278]

Another mechanism is to give preferences to contractors who can make a strong, affirmative case that they do not engage in discrimination. The affirmative case would be made by a combination of including HUBs on the project, documenting the use of HUBs in private-sector work, having an aggressive outreach program, documenting how subcontractor bids from HUBs were treated, and having a strong showing of using minorities and women in managerial positions. Awards would be based on the strength of this case, as well as price.[279,280]

The advantage of this approach is that it is flexible—the race or sex of the contractor or its subcontractors is not the sole criterion for receiving an award, but one of many factors. It is, therefore, less likely to be disapproved of by the Court. In fact, if the approach focuses just on

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[278] For example, 20 Texas Code Ann. § 5.20(c); 1 Texas Admin. Code § 123.19(a) dictates that the GSC or the administering state agency must award the project to the lowest and best bidder.

[279] The evaluation of the showing of nondiscrimination should be made before seeing the price quotations since knowledge of price could affect the evaluations.

[280] An illustration may be helpful. Give 100 points for the affirmative-action showing. Offerors would receive up to 60 points for achieving a specified goal for HUB participation. Offerors would get points in proportion to how close they come to meeting this goal. · Offerors would receive 20 points for documenting HUB participation on private-sector work or work not subject to goals; and 20 points for documentation that the offeror has minorities and women in managerial positions in general and on specific projects. The award would be based on a combination of price and the affirmative-action showing. (For example, the price could be reduced by up to 5 percent depending upon the strength of the affirmative-action showing. The price reduction applies only to the price comparison to decide the award, the price bid is still the price paid, not the reduced price.)