

RETHINKING MINORITY BUSINESS DEVELOPMENT STRATEGIES

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Introduction

Desegregating American society required a civil rights revolution and explicit federal legislation banning racial discrimination against blacks and other minorities in public accommodations and employment,¹ voting² and housing.³ Yet no federal statute has ever been specifically adopted to bar racial discrimination in private domestic commercial transactions between two business firms.⁴ While the fifth amendment⁵ bars direct⁶ racial discrimination by the federal government, and the four-

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¹ Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. 241 (codified at 28 U.S.C. § 1447; 42 U.S.C. §§ 1971, 1975a-1975d, 2000a to 2000h-6) (1982).

² Voting Rights Act of 1965, Pub. L. No. 89-110, 79 Stat. 437 (codified as amended by Voting Rights Act Amendments of 1970 at 42 U.S.C. §§ 1973 to 1973-bb (1982)); Voting Rights Act Amendments of 1982, Pub. L. No. 97-205, 96 Stat. 131 (codified at 42 U.S.C. §§ 1973, 1973b, 1973aa-1a, 1973aa-6 (1982)).

³ Civil Rights Act of 1968 (The Fair Housing Act), Pub. L. No. 90-284, 82 Stat. 73-92 (codified at scattered sections of titles 18, 25, 28 and 42 U.S.C.).

⁴ *Cf.* The Export Administration Act Amendments, 50 U.S.C. app. § 2407(a)(1)(A)-(B) (Supp. V 1987), which prohibit discrimination by one American business against another based on the race, religion, sex or national origin of the owners of that business, when the discrimination is intended to further an unsanctioned foreign boycott imposed by a foreign country against an ally of the United States, 15 C.F.R. § 769.2(b)(1)(ii) (1989) and example (vii) thereunder.

Some state and local governments have enacted business antidiscrimination laws, but if they exist in any number, the paucity of reported decisions in the field suggests the absence of significant enforcement. The city of Richmond, Virginia adopted such an ordinance in 1975, *City of Richmond v. J.A. Croson Co.*, 109 S. Ct. 706, 726 n.3 (1989), but the record was silent on its application. Such ordinances have proven ineffective in providing relief theoretically available under the fourteenth amendment. *See infra* notes 49-52 and accompanying text for a discussion of the practical difficulties of proving an individual instance of intentional discrimination.

⁵ U.S. Const. amend. V.

⁶ "Direct" discrimination refers to discriminatory action taken by the government as distinguished from discriminatory action taken by private intermediaries that perform government procurement contracts.

teenth amendment⁷ bars direct discrimination by states and subordinate governmental entities, Title VI of the Civil Rights Act of 1964⁸ bars discrimination only in federal financial assistance, failing to reach even commercial procurement by the federal government.⁹ Only a Reconstruction-era statute, the Civil Rights Act of 1870,¹⁰ might reach private commercial transactions, but no suit has ever succeeded on the merits.¹¹ The absence of effective prohibitions against discrimination in private business transactions means that minority-owned businesses, faced with the same racial barriers that confronted their owners in all other aspects of American life, have been left to the tender mercies of the marketplace. This undoubtedly has hindered both minority business development and the ability of minorities to advance economically.

State and federal governments have enacted programs to foster minority business development with the principal purpose of overcoming the continuing effects of earlier discrimination, rather than forbidding current discrimination. Worse still, the Supreme Court in *City of Richmond v. J.A. Croson Co.*¹² invalidated a municipal minority business set-aside program on equal protection grounds, casting into doubt the legal status of all set-asides.¹³

⁷ U.S. Const. amend. XIV, § 1.

⁸ 42 U.S.C. § 2000d (1982).

⁹ See 3 Cappalli, *Federal Grants and Cooperative Agreements, Law, Policy, and Practice* § 19:30 (1982) (citing 110 Cong. Rec. 13380 (1964); 110 Cong. Rec. 10076 (1964) (letter from Att'y Gen. Kennedy to Sen. Cooper)).

¹⁰ Pub. L. No. 94-559 § 1, 90 Stat. 2641 (codified at 42 U.S.C. § 1981 (1982)).

¹¹ For the most fully articulated decision applying this section to a business transaction, albeit one involving public procurement (public school lunch contract), see *T & S Assocs., Inc. v. Crenson*, 666 F.2d 722 (1st Cir. 1981); 505 F. Supp. 938 (D.R.I. 1981) where the court of appeals overturned a trial court's damage award; see also *Brant Constr. Co. v. Lumen Constr. Co.*, 515 N.E.2d 868 (Ind. Ct. App. 1987), where a prime contractor was held liable under 42 U.S.C. §§ 1981 and 1983 for \$233,000 in damages, \$155,000 in attorney's fees and \$20,000 in expenses and expert witness' fees. The plaintiff, a Hispanic-owned firm, claimed that once it had received a subcontract under a set-aside, the defendant interfered with its performance in violation of the civil rights laws.

The holding of *Patterson v. McLean Credit Union*, 109 S. Ct. 2363 (1989), that § 1981 coverage does not extend beyond the formation stage of a contract, substantially vitiates the *Brant* holding unless the result can be predicated on § 1983 alone, and if the scope of § 1983 is not limited by *Patterson*.

¹² 109 S. Ct. 706 (1989).

¹³ While the majority in *Croson* employed fourteenth amendment arguments to

The particular set-aside invalidated in *Croson* used the paradigmatic racial classification. The Richmond City Council adopted a five-year Minority Business Utilization Plan (the Plan) requiring prime contractors, to whom the city awarded construction contracts, to subcontract at least thirty percent of the dollar amount of the contract to one or more Minority Business Enterprises (MBEs).¹⁴ The Plan defined an MBE as a business at least fifty-one percent owned and controlled by minority group members and defined minorities as United States citizens "who are Blacks, Spanish-speaking, Orientals, Indians, Eskimos, or Aleuts."¹⁵ Both facially and as applied, the Plan allocated government benefits, that is construction subcontracts, according to the suspect criterion of race.¹⁶

The *Croson* Court rejected the argument that since the racial classifications benefited rather than burdened historically disadvantaged minorities, it should not apply strict scrutiny.¹⁷ In the Court's view, the only compelling governmental interest that justifies the use of suspect criteria is the remedying of past discrimination identified by judicial, legislative, or administrative findings of constitutional or statutory violations.¹⁸ The Court

distinguish *Fullilove v. Klutznick*, 448 U.S. 448 (1980) (upholding a federal set-aside without agreement upon a standard of review), the *Croson* opinion raises the question whether all federal set-asides will be subjected to strict scrutiny. For a reading of *Croson* as a positive endorsement of *Fullilove* by six Justices (as a special case resting on the broad congressional power under the fourteenth amendment) see Karst, *Private Discrimination and Public Responsibility: Patterson in Context*, _____ Sup. Ct. Rev. _____ (forthcoming).

¹⁴ *Croson*, 109 S. Ct. at 712-13.

¹⁵ *Id.* at 713.

¹⁶ The Court mentioned three possible reasons for considering race suspect: "Classifications based on race carry a danger of *stigmatic harm* They may in fact *promote notions of racial inferiority and lead to a politics of racial hostility*." *Id.* at 721 (emphasis added). By quoting the language from Powell's opinion in *Regents of the University of Cal. v. Bakke*, 438 U.S. 265 (1978), the Court made clear its concern that "preferential programs may only reinforce common stereotypes holding that certain groups are unable to achieve success without special protection" *Croson*, 109 S. Ct. at 721. This concern, however, is at odds with the Court's later assertion that strict scrutiny was especially appropriate since the set-aside had been enacted by a city council on which blacks held five of the nine seats. *Id.* at 722. This leaves only the newly identified factor of the "politics of racial hostility" as a possible justification for finding race a suspect classification. Unfortunately, the Court did not elaborate on this basis for its decision.

¹⁷ *Croson*, 109 S. Ct. at 721.

¹⁸ *Id.* at 723. This approach assumes that antidiscrimination law is sufficiently comprehensive that no discrimination could occur without violating some statute or

examined the evidence presented by the city and concluded it did not identify any discrimination in the Richmond construction industry. In the absence of identified discrimination, it ruled that the city had failed to demonstrate a compelling interest in apportioning public contracting opportunities on the basis of race.¹⁹ This lack of a compelling governmental interest provided sufficient grounds to invalidate the ordinance. But even if the city had established such an interest, it still would have had to show that its interest in remedying the discrimination identified

constitution. Yet neither existing civil rights legislation nor the state or federal constitutions may reach discrimination in the context of private commercial transactions.

Justice Stevens has identified other governmental interests that he might consider compelling.

[I]n our present society, race is not always irrelevant to sound governmental decisionmaking [I]n law enforcement, if an undercover agent is needed to infiltrate a group suspected of ongoing criminal behavior—and if the members of the group are all of the same race—it would seem perfectly rational to employ an agent of that race rather than a member of a different racial class. Similarly, in a city with a recent history of racial unrest, the superintendent of police might reasonably conclude that an integrated police force could develop a better relationship with the community and thereby do a more effective job of maintaining law and order than a force composed only of white officers.

In the context of public education, it is quite obvious that a school board may reasonably conclude that an integrated faculty will be able to provide benefits to the student body that could not be provided by an all-white, or nearly all-white, faculty. . . . It is one thing for a white child to be taught by a white teacher that color, like beauty, is only 'skin-deep'; it is far more convincing to experience that truth on a day-to-day basis during the routine, ongoing learning process.

Wygant v. Jackson Bd. of Educ., 476 U.S. 267, 314–15 (1986) (Stevens, J., dissenting) (footnotes omitted).

¹⁹ *Croson*, 109 S. Ct. at 727. The city failed to develop a convincing record of past discrimination. But the Court majority, in ignoring Richmond's recent history, displayed a blind hostility to the concept of affirmative action. It would not have stretched established doctrines for the Court to take judicial notice of the resistance to desegregation of the leadership elites in Richmond, which included the business establishment. In the context of construction industry employment the Court has taken a more realistic view, observing that "[j]udicial findings of exclusion from crafts on racial grounds are so numerous as to make such exclusions a proper subject for judicial notice." *United Steelworkers of Am. v. Weber*, 443 U.S. 193, 198 n.1 (1979), *reh'g denied*, 444 U.S. 889 (1979). Moreover, the *Croson* majority failed to realize the difficulty of demonstrating intentional discrimination by third parties. Pervasive societal discrimination alone easily accounts for the paucity and weak financial and operating condition of minority firms. These negative characteristics would justify their rejection as suppliers by white firms in most instances. But the Court also ruled that only Congress can remedy societal discrimination. *Croson*, 109 S. Ct. at 719. This leads to a perverse result. If local societal discrimination is sufficiently virulent and pervasive to disable minority firms so that facially neutral criteria explain their failure, then local government has no power to remedy this situation.

could be advanced only by its set-aside program. In other words, the set-aside must be the most narrowly tailored means of remedying past discrimination.²⁰ Before the city can reach this conclusion it must at least consider, and perhaps exhaust, race neutral alternatives.²¹ In considering these alternatives, the city cannot draw on or adopt the experience of other jurisdictions, since these necessarily reflect other times, other places and other patterns of discrimination.²² Moreover, the Court refused to allow Richmond to rely on the Congressional findings of nation-wide discrimination²³ which provided the basis to uphold the federal set-aside in *Fullilove v. Klutznick*.²⁴ This is the equal protection gauntlet that state and local government incentives based upon racial classifications must now survive.²⁵

The *Croson* decision²⁶ virtually eliminated one of the few types of programs with demonstrated effectiveness in breaching the racial barriers that minority businesses encounter.²⁷ In doing so, the Court acted without appreciation for the vulnerability of minority businesses to discrimination and with serious miscon-

²⁰ Given the hostility of much of the judiciary to affirmative action, the use of hindsight to identify a more narrowly tailored means than the one adopted would probably prevent the use of set-asides even when concededly racist behavior enables the past discrimination to be sufficiently identified.

²¹ *Croson*, 109 S. Ct. at 728.

²² *Croson*, 109 S. Ct. at 726 ("The scope of the problem [will] vary from market area to market area.").

²³ *Id.* ("The probative value of [the Congressional findings in *Fullilove*] for demonstrating the existence of discrimination in Richmond is extremely limited . . .").

²⁴ 448 U.S. 448 (1980).

²⁵ *See supra* note 14.

²⁶ While I do not agree with the *Croson* decision, I will only criticize it implicitly. The pragmatic purpose of this Article is to propose an alternative minority business development strategy that can survive even a conservative reading of that decision. For reasons discussed in parts I and II of this Article, I believe that regardless of the true state of facts, it will be extremely difficult to show the intentional discrimination required by the *Croson* test for a set-aside to survive judicial strict scrutiny. *See infra* notes 48-52 and accompanying text; *see infra* text accompanying note 64.

²⁷ Pursuant to legislative enactment or executive order, minority business set-aside programs require that a specified percentage of the dollar value of a governmental entity's procurement be obtained from privately owned business firms that are at least 51% owned and controlled by members of designated minority groups. Such programs have been justified as necessary to remedy the prior and/or continuing exclusion of these firms from government procurement. Exclusion can take two forms. A government may directly discriminate against minority firms in its selection of prime contractors, or nonminority prime contractors may discriminate in their selection of subcontractors. Prime contractors use subcontractors to perform portions of a contract that the prime contractor is neither staffed nor equipped to perform itself.

ceptions about the legal scope and practical effect of prohibitions against discrimination. While the Court theoretically left the door open for set-aside programs that can withstand the requirements of strict scrutiny, the Court's analysis makes this possibility remote at best.²⁸ With the exception of the cases arising from the wartime internment of Japanese American citizens,²⁹ no governmental use of a legislative racial classification not justified by the purpose of remedying specific acts of past discrimination has withstood strict scrutiny by the Supreme Court. The constitutional review of such classifications has been "scrutiny that is strict in theory, but fatal in fact."³⁰

In light of the precarious status of minority set-asides after *Croson*, the question is: What alternative programs can be developed that will survive constitutional scrutiny?

This Article proposes one alternative to minority business set-asides, which not only avoids the fatal flaw the Court found in *Croson*,³¹ but also offers several advantages over set-asides as a business development policy tool. The proposed approach relies on a nondiscrimination obligation provision that already exists in many government contracts as a check on employment discrimination. That provision could be expanded to cover an obligation not to discriminate in subcontracting as well.

Making the nondiscrimination obligation an effective tool requires the contracting jurisdiction to be able to assess in advance the likelihood of compliance with this provision. This critical assessment capability can be provided by creating an entity which collects information relevant to the bidder's past history of involvement with minority and nonminority firms. Akin to a credit rating agency, this entity would assign the bidder a letter grade, numerical score, or rating summarizing the bidder's prior history in both public and private sector contracts and representing its likely compliance with the nondiscrimina-

²⁸ "In the extreme case, some form of narrowly tailored racial preference might be necessary to break down patterns of deliberate exclusion." *Croson* 109 S. Ct. at 729.

²⁹ See *Korematsu v. United States*, 323 U.S. 214 (1944); *Hirabayashi v. United States*, 320 U.S. 81 (1943).

³⁰ *Fullilove v. Klutznick*, 448 U.S. 448, 519 (1980).

³¹ "Even in the absence of evidence of discrimination, the city has at its disposal a whole array of race-neutral devices to increase the accessibility of city contracting opportunities to small entrepreneurs of all races." *Croson*, 109 S. Ct. at 729.

tion obligation. This rating would then become a factor in the evaluation of competing bids. Bidders with a poor rating would be at a competitive disadvantage. They would have to offer significantly superior advantages with respect to other contract terms such as price, time of delivery, or service, in order to succeed. Drafting the market force of competition into the service of the nondiscrimination obligation creates a powerful incentive that rewards firms which act to remove racial and ethnic barriers that have traditionally thwarted the participation of some firms in the economy.

This Article begins by discussing the need for minority business development to close the economic disparities between minorities and the mainstream. The rating agency alternative is developed at length in Part II, and Part III of this Article demonstrates how the proposed alternative approach complies with the constitutional requirements set out in *Croson* and other decisions.

I. The Need for Minority Business Development

A. Economic Data

While progress undoubtedly has been achieved in the legal status of black Americans, little change has occurred in the relative level of black incomes.³² For decades black incomes have been about three-fifths of white incomes.³³ Between 1970 and 1983 the ratio of black incomes to white incomes actually fell from 61.3% to 56.3%.³⁴ But if wealth instead of income is compared, the picture is far bleaker. When mean net worth is considered, blacks own fewer than \$23 in assets for every \$100

³² This Article will generally refer to data on the status of blacks rather than minorities as a whole. Blacks are the largest minority group, and there are more data available on blacks, and over a longer time period, than on other minorities.

³³ Some Asian-American minorities have income levels above those of any white ancestry group. Hispanics as a whole tend to fall between blacks and whites, although Hispanic subgroups range from below blacks to the bottom of the lowest white groups. U.S. Bureau of the Census, *Census of Population: General Social and Economic Characteristics*, U.S. Summary, PC 80-1-C1, tables 164, 170, 180 (1983).

³⁴ U.S. Bureau of the Census, *Current Population Reports, Series P-60, No. 145, Money Income and Poverty Status of Families and Persons in the United States: 1983*, table 3 (1984).

in assets owned by whites, and if median net worth is compared, blacks own fewer than \$9 in assets for every \$100 owned by whites.³⁵

The disparity in business membership is even greater.³⁶ The black participation rate is only about one-quarter of the national average.³⁷ While blacks make up twelve percent of the population, they own only two percent of all business firms. Only \$16 of every \$10,000 in business receipts, less than 0.2%, come from black-owned firms.³⁸ Black business receipts would have to increase seventy-five fold before they would be proportionate to the black share of the total population.³⁹

Between 1972 and 1982 the inflation-adjusted size of aggregate black business revenues failed to grow. This trend of economic stagnation over a decade resulted from two smaller, conflicting trends which offset each other in the aggregate data.⁴⁰

³⁵ U.S. Bureau of the Census, Current Population Reports, Series P-70, No.7, *Household Wealth and Asset Ownership: 1984*, tables 3, 5 (1986).

³⁶ Other minorities are also underrepresented in business activity. The two other minority groups included in the business census, (1) Hispanics and (2) Asian, Indian and Other, are each significantly smaller in total population than blacks and have fewer numbers of business firms. However, businesses owned by each of these groups employ more paid employees and have greater total firm receipts than do black-owned firms. In 1982 black-owned firms accounted for about 40% of all minority-owned firms and for less than 30% of minority business revenues. Minority business revenues accounted for less than one percent of total business revenues. U.S. Bureau of the Census, *1982 Survey of Minority-Owned Business Enterprises*, MB82-1, MB82-2, MB82-3 (1985 & 1986).

³⁷ F. Fratoe & R. Meeks, *Business Participation Rates of the 50 Largest U.S. Ancestry Groups: A Preliminary Report* (Research Division, Office of Advocacy, Research and Information, Minority Business Development Agency, U.S. Dep't of Commerce 1985). The business participation rate is the number of self-employed persons within an ancestry group, divided by the total number of persons in the group, multiplied by 1000.

³⁸ R. Suggs, *Recent Changes in Black-Owned Business* 2, 6 (Joint Center for Political Studies, Washington, D.C. 1986).

³⁹ The increase needed if all minority business receipts are to be proportionate to population is somewhat smaller, about twenty-nine fold. *Id.* at 34, Appendix III. This ratio does not reflect the summary data which eliminates the double counting of some Hispanics.

It could be argued that this figure exaggerates the disparity because it compares mostly small, usually closely held firms to a group which includes the Fortune 500. But no Fortune 500 firm has evolved from a black-owned firm, nor has any Fortune 500 firm ever been headed by a black. The beneficial interest of blacks in pension funds that own shares in major firms would reduce the disparity somewhat. If only partnership revenues are considered, which eliminates major publicly held firms as well as sole proprietorships, few of which are more than part-time, incidental endeavors, then, in 1982, black partnership revenues would have had to increase by a factor of 27 to be proportionate to the black population. *Id.*

⁴⁰ For a fuller discussion see R. Suggs, *supra* note 37.

Certain industries, largely in personal services and retail trade, declined very rapidly, while other industries, such as some in wholesale trade and business services, showed strong growth. The growing industries were those in which few black firms had historically participated. The declining industries were those which, prior to the desegregation of public accommodations, serviced segregated markets—black customers who were barred from hotels, restaurants and other establishments by segregation. With the geographic dispersal of the most affluent blacks and the opening up to them of an expanded array of consumer choices, businesses that had relied on segregated markets were poorly equipped to compete in the general marketplace.

By contrast the newer, nontraditional firms represent efforts by black entrepreneurs, who are capitalizing on the knowledge, experience and contacts gained from their participation over the past two decades in the expanded employment opportunities created by civil rights legislation. They gained experience in markets and industries previously closed to them. Instead of expanding from the base developed under segregation, black businesses capable of competing in a unitary economy have been developing from the ground up.

B. Racial Attitudes

Opinion surveys, social science research, and judicial findings of discrimination in nonbusiness venues all document that racial discrimination continues to exist in our society. Negative stereotyping of blacks still remains a significant feature of black-white relations.⁴¹ So long as continuing discrimination can be identified in housing and employment opportunities, it seems fair to infer its persistence in the business world.⁴² Both current and historical discrimination in education,⁴³ voting,⁴⁴ housing⁴⁵

⁴¹ See H. Schuman, C. Steeh & L. Bobo, *Racial Attitudes in America: Trends and Interpretations* (1985); *A Common Destiny: Blacks and American Society* (G. Jaynes & R. Williams eds. 1989) [hereinafter *A Common Destiny*].

⁴² See *infra* notes 49–52 and accompanying text for explanation of the difficulty of showing direct evidence of intentional discrimination in a business transaction.

⁴³ See *A Common Destiny*, *supra* note 41.

⁴⁴ See *Thornburg v. Gingles*, 478 U.S. 30, 46 n.11 (1986); see also *Minority Vote Dilution* (C. Davidson ed. 1984); *A Common Destiny*, *supra* note 41.

⁴⁵ In the most recent national study of housing discrimination, conducted in 1977

and employment⁴⁶ are well documented. The sheer volume of current legal decisions finding discrimination in these areas suggests that race and ethnicity are pervasive⁴⁷ in their effects in American society. Absent some compelling evidence to the contrary, it would be disingenuous to assume that these factors play no role in business decisions and that they do not affect a firm's choice of its suppliers.⁴⁸ Such choices have a negative impact on the ability of minority-owned business firms to grow and prosper.

This adverse impact has never been documented, however, which provides a partial explanation for the low priority given to minority business development by the civil rights community. The lack of documentation also undercuts the ability to marshal widespread support for set-asides outside the minority community. Without dramatically clear evidence of such discrimination the wider public, comfortable with existing arrangements and practices, remains unconvinced that problems needing solutions exist.

There are a number of reasons why the kind of voluminous research documenting other kinds of discrimination does not exist for business discrimination. Researchers cannot collect anecdotal evidence from minority firms because in private commercial dealings, when a potential customer rejects a minority firm's solicitation or declines its bid, only the potential customer knows the reasons why. The minority firm has no independent

in 40 metropolitan areas, it was found that if a black visited four rental agents, one or more instances of racial discrimination would occur 72% of the time. If a black visited four sales agents, one or more instances of discrimination would be encountered 48% of the time. R. Wienk, C. Reid, J. Simonson & F. Eggers, *Measuring Racial Discrimination in American Housing Markets: The Housing Market Practices Survey* (1979).

⁴⁶ See generally *A Common Destiny*, *supra* note 41. In 1985 the estimated lifetime earnings of white male college graduates was \$1.42 million, \$450,000 more than black male graduates. *Id.* at 301.

⁴⁷ See Kluegel & Smith, *Whites' Beliefs About Blacks' Opportunity*, 47 *Am. Soc. Rev.* 518 (1982). In age groups 18-29, 30-39, 40-49, 50-59, and 60+, a significant number of subjects admitted to racist attitudes. Percentages of each age group, ranging from 17.6 to 51.3%, favored laws against interracial marriage, from 24.5 to 45.8% felt that whites have a right to racial segregation in housing, and 16.9 to 36.2% would object to a family member bringing a black friend home. *Id.* at 522, table 3.

⁴⁸ See Lawrence, *The Id, the Ego, and Equal Protection: Reckoning with Unconscious Racism*, 39 *Stan. L. Rev.* 317, 335 (1987); see also Welch, *Removing Discriminatory Barriers: Basing Disparate Treatment Analysis on Motive Rather Than Intent*, 60 *S. Cal. L. Rev.* 733, 744-45 (1987) (discussing racially selective sympathy and indifference).

knowledge of the terms of the competing offer, which the successful bidder usually keeps confidential. Even asking competitors for the terms of their bids raises serious antitrust problems.⁴⁹

Instances of discrimination in public accommodations become evident when a discriminator denies service to a minority while simultaneously providing it to a nonminority.⁵⁰ To unearth housing discrimination, pairs of minority and nonminority "testers," matched in terms of income, family status, housing needs and other relevant factors, seek housing, and researchers then compare their treatment.⁵¹ Personnel records can reveal employment discrimination by allowing one to compare the treatment of minority and nonminority applicants with equal qualifications. Similarly, one can compare the actual treatment of equivalent employees of different races in terms of pay, promotions and other conditions of employment. Racial gerrymandering of electoral districts may indicate voting discrimination, as will the adoption of voting qualifications or practices that have a disproportionate impact on minorities.

None of these techniques would develop aggregate data showing current discrimination against minority-owned business firms. Using testers will not work because the reputation and experience of a firm often determine a contract award, and it is next to impossible to concoct the appearance and history of a bona fide firm. Researchers cannot use data contrasting the experiences of minority and nonminority firms. Any representative sample of minority firms will reflect the effects of earlier discrimination and thus their experiences will not be comparable to those of nonminority firms. Samples of minority firms that

⁴⁹ See *United States v. Container Corp. of Am.*, 393 U.S. 333 (1969); *Sherman Antitrust Act*, 15 U.S.C. § 1 (1988).

⁵⁰ For example, an operator of more than 40 Washington, D.C. health spas recently signed a consent order agreeing not to discriminate. Evidence showed the spa had instructed its employees to discourage blacks from joining. Blacks who called the clubs for appointments were told that no times were available, and those who showed up without appointments were told that no one was available to give them a tour of the club. Blacks also received less favorable membership terms than whites. See *Area Spas Agree Not to Discriminate*, Wash. Post, Apr. 28, 1989, at C6.

⁵¹ For a fuller discussion of this strategy see U.S. Dep't of Housing and Urban Development, *Nat'l Comm. Against Discrimination in Housing, Guide to Fair Housing Enforcement* (1979); see also *Havens Realty Corp. v. Coleman*, 455 U.S. 363 (1982) ("testers" have standing to sue under the Fair Housing Act).

do not reflect such effects will be too small to provide a reasonable basis for generalization.

Differences between the experiences of minority firms and nonminority firms can readily be explained by factors produced by this earlier discrimination: small size, inexperience and inadequate capitalization.⁵² Since nondiscriminatory business judgments turn on factors such as size, capitalization and experience, comparing these differences cannot reveal current discrimination. Such comparisons reveal only the continuing effects of prior discrimination.

Without convincing data, marshalling public resources to increase the business wealth of minorities is difficult. But unless the quantity and quality of black and other minority business activity can be increased, the disparity in incomes and wealth, and the resulting social problems and tensions, are likely to persist. Encouraging minority business development requires resources, and in this era of fiscal stringency, budget cuts and deficits, the only successful strategy for targeting significant resources on minority business development has been to use government procurement through the mechanism of set-asides.

Set-asides have been enacted by federal, state, and local governments, and their agencies.⁵³ The federal government alone procures billions of dollars in goods and services through minority business set-asides.⁵⁴ Local government set-asides probably add several billion dollars more,⁵⁵ and the potential

⁵² See *Fullilove v. Klutznick*, 448 U.S. 448, 467 (1980).

⁵³ See *Days, Fullilove*, 96 Yale L.J. 453, 454 n.10 (1987) for a list of set-asides enacted by state and local governments and their agencies which have been the subject of litigation. Federal set-asides originated in the Small Business Administration's § 8(a) program, 15 U.S.C. § 637(a) (1988). They have subsequently been enacted in other legislation. See, e.g., Surface Transportation Assistance Act of 1982, Pub. L. No. 97-424, 96 Stat. 2098 (codified at 23 U.S.C. § 104 (1983)); Public Works Employment Act of 1977, Pub. L. No. 95-21, 91 Stat. 116 (codified in significant part at 42 U.S.C. §§ 6705(e)-6707(j) (1982)).

⁵⁴ In the 1986 fiscal year the federal government reported \$4.4 billion in contract awards to minority and disadvantaged businesses, including \$3 billion under the § 8(a) set-aside program, and \$1.2 billion in contract awards to firms owned by women. Federal Procurement Data System, Standard Report: Fiscal Year 1986, Fourth Quarter 21 (1987).

⁵⁵ From fiscal years 1979 to 1985, Washington, D.C.'s procurement from MBEs rose from \$52 million to \$170 million. See Minority Business Opportunity Commission, Annual Report: Fiscal Year 1985. Atlanta's procurement climbed from \$42,000 in 1973 to \$44 million in 1983 (with the completion of a major project) before declining to \$24 million in 1985. See Office of Contract Compliance, Draft Report on 1985 Contracting Activities (Apr. 2, 1986); letter to the author from Rodney Strong, Director, Office of Contract Compliance (July 3, 1986) (both on file with the author).

across the nation is even greater.⁵⁶ In terms of the impact on the economic status of minority-owned⁵⁷ businesses, set-asides have had the impact of a major government spending program.

Some data suggest that set-asides have played a vital role in providing minorities with access to the economic mainstream. For example, the highway construction revenues of black-owned firms rose 224% in constant dollars between 1977 and 1982.⁵⁸ This increase appears to reflect the continuing impact⁵⁹ of the one-year ten percent federal construction subcontracting set-aside contained in the Public Works Employment Act of 1977 (PWEA). The Court upheld this set-aside in *Fullilove v. Klutznick*.⁶⁰ The *Croson* decision, however, has jeopardized this progress. Previous attempts at remedying the effects of past discrimination on minority-owned businesses with race neutral policies have had no notable successes.⁶¹ Is it possible, at a time of limited governmental resources, to devise a minority business development policy which comports with both constitutional doctrine and the realities of the marketplace?⁶²

⁵⁶ The 1986 defense appropriations act contained a five percent set-aside. Pub. L. No. 99-661 § 1207, 100 Stat. 3973 (1986) (codified at 10 U.S.C. § 2301 note) (1988).

⁵⁷ The term "minority-owned" often includes firms majority-owned and -controlled by white women. A discussion of such firms is beyond the scope of this Article. While the historical treatment and current socioeconomic status of minorities and white women are often analogized in popular discussions, the social and family relationships between white men and women and the predominance of white women as a demographic group make this analogy misleading. The Ninth Circuit has applied an intermediate standard of review to constitutional challenges of gender based set-asides. *See* *Associated Gen. Contractors of Cal. v. City and County of San Francisco*, 813 F.2d 922 (9th Cir. 1987).

⁵⁸ *See* R. Suggs, *supra* note 39, at 27.

⁵⁹ Since the 1977 census of black-owned businesses occurred before the spending mandated by the 1977 Public Works Employment Act one year set-aside, the 1977 data were not inflated by this one-time expenditure. A similar set-aside was enacted in the Surface Transportation Assistance Act of 1982, Pub. L. No. 97-424, 96 Stat. 2098 (codified at 23 U.S.C. § 104 (1983)), which was not implemented until 1983, too late to affect the Census Bureau's 1982 survey of black-owned business. Thus the strong growth revealed by the 1977-1982 data shows the developmental impact of the first set-aside without reflecting the short term expenditures under either.

⁶⁰ 448 U.S. 448 (1980).

⁶¹ *Croson*, 109 S. Ct. at 751 (Marshall, J., dissenting) ("race neutral measures . . . , while theoretically appealing, have been discredited by Congress as ineffectual in eradicating the effects of past discrimination in this very industry").

⁶² It is not the purpose of this Article to add to the already vast equal protection commentary on MBE set-asides. A listing of those articles that principally treat business set-asides includes: Days, *Fullilove*, 96 Yale L.J. 453 (1987); Drabkin, *Minority Enterprise Development and the Small Business Administration's Section 8(a) Program: Constitutional Basis and Regulatory Implementation*, 49 Brooklyn L. Rev. 433 (1983); Levinson, *A Study of Preferential Treatment: The Evolution of Minority Business*

II. An Alternative Development Strategy

A. *The Contractual Nondiscrimination Obligation*

The essential problem confronting minority business firms is twofold. First, current constitutional doctrine has severely constrained the ability of government, especially local government, to redress the effects of earlier discrimination. Second, few, if any, legal avenues exist to redress current discrimination in business transactions. Jurisdictions where minorities are politically dominant frequently face the irony of spending large sums to procure construction services from prime contractors whose discriminatory practices inhibit or prevent the development of minority firms.

Given the pervasive, well-documented, and persistent discrimination in construction employment,⁶³ it is highly unlikely that construction subcontracting is devoid of discrimination against minorities. Nor is it likely that other procurement is free of discrimination. In addition to explicit discrimination, prime contractors may explain their unwillingness to grant subcontracts to minority firms on the facially neutral ground that they tend to be smaller, less experienced and less well capitalized than their majority-owned counterparts. Even if governments could prevent prime contractors from discriminating in public procurement, discrimination in private commercial transactions undermines the ability of minority firms to qualify as suitable prime contractors or subcontractors on government contracts. Government procurement is only a small part of the total market, notwithstanding the large size typical of government con-

Enterprise Assistance Programs, 49 Geo. Wash. U. L. Rev. 61 (1980); Weeden, *City of Richmond v. J.A. Croson and the Aborted Affirmative Action Plan*, 16 S.U.L. Rev. 73 (1989); Note, *Minority Business Enterprise Set-Aside: The Reverse Discrimination Challenge*, 45 Alb. L. Rev. 1139 (1981); Note, *New York City's Locally Based Enterprise Set-Aside: Legitimate Exercise of Mayoral Power or Unconstitutional Quota in Disguise*, 12 Fordham Urb. L.J. 703 (1984); Note, *The City of Houston's Minority and Women Business Enterprise Ordinance: Eleemosynary or Free Enterprise Promotion?*, 11 T. Marshall L.J. 393 (1986); Comment, *Constitutionality of State and Local Authority to Implement Minority Business Enterprise Set-Aside Upheld: South Florida Chapter of Associated General Contractors of America, Inc. v. Metropolitan Dade County, Florida*, 29 Wash. U. J. Urb. & Contemp. L. 247 (1985).

⁶³ See, e.g., *Local 28 of the Sheet Metal Workers' Int'l Assoc. v. EEOC*, 478 U.S. 421 (1986).

tracts and subcontracts. The goal of increased minority business involvement, therefore, has been impaled on the horns of a dilemma: minority firms first must have the opportunity to establish a solid footing of profitability and experience in smaller private transactions before they can be competitive on larger public contracts. Standing in their way are often subtle forms of discrimination in the private sector that are difficult to document.

Among the "boilerplate" provisions in many government contracts is a covenant prohibiting discrimination in employment by the prime contractor and various levels of subcontractors.⁶⁴ In federal procurement an analogous prohibition against discrimination in the selection of subcontractors by prime contractors does not exist.⁶⁵ Even if such a prohibition were imposed upon prime contractors, no practical mechanism or procedure exists to enforce such a nondiscrimination obligation. The basic problem is that even if a nondiscrimination obligation is imposed on the prime contractor, it will not be fully carried out until after the contract is awarded and commitments are made. Should a government come to view compliance as unsatisfactory, funds will already have been disbursed; and should it wish to enforce such a provision by replacing the offending contractor in midstream, it would incur the substantial costs and inconvenience of contract disruption with no guarantee that a replacement contractor would comply with the antidiscrimination covenant. A government would also find itself embroiled in litigation, since a contractor would likely contest any termination.

For a local government to contemplate such a course of action assumes that instances of discrimination in subcontracting can be identified with reasonable certainty. Discrimination, however, is virtually impossible to show for the purposes of a lawsuit. A prime contractor has no obligation to select the sub-

⁶⁴ See, e.g., Federal Highway Administration, Dep't of Transportation, Administration of Negotiated Contracts, 23 C.F.R. § 172.9(a) (1989) ("All contracts awarded by grantees, subgrantees, and the contractors shall contain provisions requiring compliance with Title VII of the Civil Rights Act of 1964, as amended.").

⁶⁵ Title VI of the Civil Rights Act of 1964 prohibits discrimination by prime contractors and subcontractors in the distribution of federal financial assistance, but does not reach federal commercial procurement. See *supra* note 9 and accompanying text.

contractor submitting the lowest bid, and nondiscriminatory reasons (such as previous working relationships, friendships, greater size or experience) readily explain a decision to stick with an established and known subcontractor. Even if the obligation is expanded to include a good faith obligation to seek out qualified MBEs—assuming such good faith obligations have survived *Croson*—the paucity of experienced, bonded MBEs in many industries provides an easy explanation for the lack of MBE participation.

When a prime contractor identifies an MBE in its bid as one that will receive a subcontract, even a failure actually to enter into a contract with the MBE can have an innocent explanation. A firm, whether a prime contractor or a subcontractor, must always bid on more work than it can possibly perform, because it can usually expect to win only a portion of the work on which it bids. If an MBE's prime contractors enjoy more success than the MBE had anticipated, perhaps winning two of three instead of the anticipated one of three contract awards, then the MBE must withdraw as a subcontractor on one of the projects. Only an investigation can distinguish this situation, when an MBE has been identified in good faith, from one when an MBE has been identified only as a ruse and the prime contractor has no intention of soliciting it for a bid.

Given the difficulty of showing discrimination by a contractor, it would be more efficient to try to predict future performance accurately, and award contracts only to firms that would not discriminate. Instead of trying to control the behavior of potentially recalcitrant firms by after-the-fact penalties, it is more effective to follow the model of the credit industry, where banks find it more efficient to predict their borrowers' future behavior than to rely exclusively on the legal process. Foreclosure on collateral and reliance on litigation are last resorts, used only when predictors have failed.

One of the best indicators of future discriminatory behavior is past behavior. In lending, for example, a bank will look to past defaults in repayment performance in order to determine whether a potential customer will repay the loan requested. Instead of requiring the government to make the nearly impossible showing of discrimination to terminate a noncomplying contractor, a better approach would be to shift the burden by

requiring the contractor to show, as a condition of awarding the contract, that it probably will not discriminate. What better indication of a contractor's proclivity to discriminate than its performance on earlier contracts? Thus, instead of an inquiry about the future, with all the excuses and justifications for suspicious behavior, the inquiry would be into past results.

Incorporating this approach into government procurement procedures would not entail major changes in procurement codes or require an augmentation of the procurement authority of local governments. States and localities already have the power to assign a determinative priority to performance of a covenant not to discriminate, despite their statutory obligation to take the lowest bid. Procurement statutes usually obligate government to accept the lowest responsible bid, but governments have considerable discretion to determine which bids are "responsible." For example, the Model Procurement Code for State and Local Governments, section 3-203(7), provides that the "[a]ward shall be made to the *responsible* offeror whose proposal is determined in writing to be the most advantageous to the [state] taking into consideration price and the evaluation factors set forth in the Request for Proposals."⁶⁶ If ability to perform the nondiscrimination obligation in subcontracting is a specified evaluation factor, then an evaluation of a factor other than price can result in the rejection of a lowest bid and an award to a higher bid. The same model code defines "Responsible Bidder or Offeror" as meaning "a person who has the capability in all respects to perform fully the contract requirements, and the integrity and reliability which will assure good faith performance."⁶⁷ A bidder whose past history of dealing with minority firms suggests an inability to perform the nondiscrimination obligation in good faith could be rated a "not responsible" bidder.

A number of courts have held that a bid failing to provide reasonable assurance of ability to comply with antidiscrimination obligations regarding employment can be rejected as not

⁶⁶ See Model Procurement Code for State and Local Gov'ts § 3-203(7) (1979) (emphasis added) [hereinafter Model Procurement Code]; see also *T & S Assocs., Inc. v. Crenson*, 666 F.2d 722, 725 n.4. (1st Cir. 1981).

⁶⁷ Model Procurement Code, *supra* note 66, § 3-101(6).

responsible. In *Weiner v. Cuyahoga Community College District*,⁶⁸ for example, the Ohio Supreme Court decided that "the capacity to assure a performance which complies with anti-discrimination laws is reasonably a part of the standard of a best or responsible bidder on a contract involving the expenditure of public funds." A low bidder, whose affirmative action plan for employment was deficient, was rejected.

For local governments willing to adopt this minority business development approach, no new delegation of state power will likely be required. New local ordinances would be necessary to impose the nondiscrimination obligation on subcontracting, to provide evaluative guidance to the procurement office and to establish administrative procedures for challenging a particular assessment of a bidder's ability to perform its nondiscrimination obligation. The most likely candidates to adopt such a program would be those jurisdictions with existing political commitments to minority business development, particularly, those that have previously enacted or at least considered enacting minority business set-asides.⁶⁹ For those places this approach would have a wider and more beneficial impact on minority business development than any other alternative.

B. Formulating the Ratings

It could prove burdensome for a particular jurisdiction to collect, verify and analyze on its own the information necessary to predict performance of the nondiscrimination obligation. If banks acted independently, they too would have difficulty obtaining credit ratings for their customers. Instead lenders pool information on the credit history of borrowers through the me-

⁶⁸ 19 Ohio St. 2d 35, 39, 249 N.E.2d 907, 910 (1969), *cert. denied*, 396 U.S. 1004 (1970). This decision has been followed by at least two others. In *S.N. Neilsen Co. v. Public Bldg. Comm'n*, 81 Ill. 2d 290, 410 N.E.2d 40 (1980), the Illinois Supreme Court decided that a contractor's affirmative action plan could be considered in determining whether it was the lowest responsible bidder. In *In re Appeal of Associated Sign & Post, Inc.*, 485 N.E.2d 917 (Ind. Ct. App. 1985), the court concluded that a municipal public works board could properly determine that a company which failed to submit an adequate affirmative action plan was not a responsible bidder and could deny it the contract.

⁶⁹ Other jurisdictions might choose not to participate unless federal legislation provided incentives, perhaps by tying receipt of certain types of federal funds to participation in such a program.

dium of a credit agency. The same model could be adapted to the needs of this proposal. For discussion purposes, I have called this proposal the "rating agency" or "rating program" approach.

Lenders collect credit histories by requiring such information in loan applications. Similarly, governments could require contractors to provide information on past dealings with minority firms when submitting bids.⁷⁰ A failure or refusal to provide such information could result in an incomplete bid, just as a refusal to provide a credit history on a mortgage application usually results in a loan denial. This information could be pooled among jurisdictions as lenders do and selectively confirmed for accuracy. A firm providing false or misleading information would suffer the same consequences as a borrower that falsifies a loan application: denial of the loan. Standard contractual language could provide that for falsification discovered after contract award and part performance, the falsification becomes an event of default and a liquidated damages provision would apply.⁷¹

A direct comparison among firms of the number of contracts and the size of these transactions with minority firms would lead to a preliminary competitive ranking.⁷² This ranking of results achieved assumes that the opportunities to transact with minority firms are equal across the economy. But such opportunities vary with the size of the firm, geographic location and the

⁷⁰ The inconvenience to businesses participating in a rating agency program would not be substantial. Those firms most sensitive to the inconvenience—presumably, those firms that have devoted little or no resources or effort to voluntarily developing minority suppliers—could simply enter whatever information they have in the appropriate bidding form where information about their suppliers is requested. Providing such limited information would place them at a competitive disadvantage relative to firms which are more willing to provide complete information. Firms providing little or no information would have to rely on substantially superior products or lower prices in order to succeed with this strategy.

⁷¹ Sham MBEs would expose themselves to serious financial risk under the treble damages provisions of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§ 1961–1968 (1988). Falsification of bid documents would probably satisfy current requirements for two predicate offenses, either mail or wire fraud.

⁷² This rating system would evaluate both minority and nonminority prime contractors with respect to their dealings with both minority and nonminority subcontractors, but for ease of discussion, I have limited my exposition to minority-owned business firms. This approach also could be adapted to include female-owned firms, and race and sex employment data might be incorporated as well.

variety of goods and services a firm decides to buy from external suppliers rather than to produce internally. To adjust the preliminary ranking and obtain final ratings, the rating agency would use census and other data. The number of available minority firms in business lines of the requisite size and sophistication that could potentially supply goods and services to the bidder in its geographic markets, would be compared to generate an "opportunity index." This index, when factored into the preliminary rankings and the relative size of the bidder, would yield a final rating.

To illustrate,⁷³ an "A" rated firm would be a shorthand assessment that such a firm would engage minority firms to the fullest extent possible, because in the past it had significantly outperformed the average in light of the opportunities available to it. A "D" rated firm would be one that had no history of engaging minority firms as suppliers of goods and services, despite doing business in a wide variety of product and geographic markets where the existence of minority firms would generally be expected to produce such transactions. A firm rated "F" would be one that actively maintained market barriers by refusing to entertain bids from minority firms or by failing to supply them information enabling them to bid. This kind of information could be provided and verified by minority business chambers of commerce. Firms too new to have a record would be unrated. They would either have to wait until they became "seasoned" enough for a rating or present proposals so attractive that they would win contract awards despite the lack of a rating.⁷⁴

A rating system would also permit distinctions among the types of transactions with minority firms. A contract with a minority computer services firm could be given a greater rating weight than one for janitorial services. This would prevent at-

⁷³ The discussion here is limited to simplified illustrative examples, because in actual operation the sophistication and development of the ratings would be highly dependent upon the initial resources devoted to establishing the rating agency. Key cities such as Chicago, New York, Washington, D.C. or Atlanta could have a substantial impact on the success of this approach by their presence or absence as subscribers. Moreover, certain commercial credit data that would be useful, though not critical, are either proprietary and owned by firms such as Dun & Bradstreet, or are controlled by the Census Bureau, whose cooperation should not be assumed.

⁷⁴ If a consumer borrower has an attractive financial profile, banks will lend despite the absence of a credit history.

tempts by some firms to relegate minority firms to stereotypical or undesirable market roles. Ratings would not, at least initially, attempt to make fine distinctions. The key distinctions would be between firms that are hostile to minority firms, those that are truly helpful, and those that are somewhere in the middle. Competitive pressure would encourage the large group of firms in the middle to outdo their competitors. The improvements in the attitudes and efforts of these firms would continually upgrade the criteria for being rated "truly helpful," so that firms with initially high ratings could not rest on their laurels.

Rated firms could challenge their ratings in an internal agency review procedure by providing either new information, a persuasive explanation for poor past performance, or perhaps information that might lower a competitor's rating and the overall average.⁷⁵ To improve its rating, a firm would first have to improve its historical record over some time period of reasonable duration. Thus a firm that consistently worked to increase access by minorities would receive a competitive advantage which would persist until other firms duplicated its efforts and incurred the same costs.⁷⁶

The volume of information required to set up this system would not be overwhelming because the minority business community is small.⁷⁷ Of the more than 800,000 minority-owned firms that existed in 1982, only about fourteen percent had any paid employees.⁷⁸ The vast bulk were part-time endeavors of

⁷⁵ Firms disappointed with their ratings could conceivably establish their own rating agency, but subscribers would have no reason to accept ratings from such a "captive" agency. One purpose for establishing the rating entity independent of a particular political jurisdiction would be to assure the integrity of its ratings. *See infra* note 80 and accompanying text. Since it would rely on subscriptions for its revenues, the entity would have to provide subscribers with an acceptable product. As long as the influential subscribers are jurisdictions with a genuine commitment to minority business development, they would insist on ratings with integrity.

⁷⁶ For a discussion of some of these costs, see *infra* notes 82-83 and accompanying text.

⁷⁷ Significant expense would be necessary to generate the necessary information, but set-aside programs also entail significant administrative costs and these costs would be saved. Any post-*Croson* set-aside must also generate expensive information in order to have a chance to survive strict scrutiny when challenged. A rating agency approach avoids the risk that after incurring such expenses, the plan might still be invalidated on equal protection grounds. *See infra* text at note 81.

⁷⁸ U.S. Bureau of the Census, *1977 Survey of Minority-Owned Business Enterprises*, MB77-1, MB77-2, MB77-3 (1979); U.S. Bureau of the Census, *1982 Survey of Minority-Owned Business Enterprises*, MB82-1, MB82-2, MB82-3 (1985-1987).

individuals employed full-time elsewhere. Fewer than 4000 had more than \$1 million in annual receipts, and fewer than 250 had 100 or more employees. Interpolating from this national data, the volume of information in any specific geographic area is likely to be manageable. Many medium-sized or smaller localities could keep track of these firms, their ownership and industry profile with comparatively minor effort. Moreover, unmanageability over time may prove a useful measure of diminished barriers. In larger communities, minority firms and minority business chambers of commerce could be expected to cooperate in providing information about their contracts. Comparing their information with that of bidders could help police the accuracy of the information on file. Places with too few minority firms for local firms to have any experience with them are also likely to be so lacking in minority population that no political pressure will be exerted on behalf of minority firms to adopt this approach. But even these places could utilize ratings when contracting with firms that do business in markets where minority firms can be found.⁷⁹

C. The Rating Agency: Financial and Operational Independence

Given the varying political climate in Washington, D.C. and various state capitals, a rating agency should be private and independent of government control.⁸⁰ It must be isolated from partisan politics and political pressures. To assure its financial independence, it should be financed by subscriptions paid by member governments using its services, possibly including the federal government, and by bid application fees.⁸¹ The cost of

⁷⁹ Jurisdictions too small to have development programs or with too few minorities could pay for rating services based only upon their actual use.

To the extent that ratings become significant to the investment community, they could be used to direct socially conscious investments, especially for those companies that are publicly held. A number of investment funds have been created in recent years that limit their investments to companies that adopt certain policies with respect to the environment, South Africa, and other public interests.

Consumers also make buying choices based on the social consciousness of consumer products firms. See S. Lydenberg, *Rating America's Corporate Conscience* (1986).

⁸⁰ For those opposed to the growth of government, this is an added advantage.

⁸¹ Only fees paid by successful bidders would be passed on to the government customer.

subscription might well be less than these governments currently spend on the administrative overhead needed to manage the minority business development programs under attack. As an alternative to set-aside programs in the post-*Croson* environment, the rating agency approach has the added advantage of being much less vulnerable to constitutional challenge. To conform to the requirements of *Croson*, a minority business set-aside must be the most narrowly tailored means necessary to remedy identified discrimination within the enacting government's jurisdiction. Satisfying this requirement will entail considerable research expenditures with no assurance that the program can survive strict scrutiny. If it cannot, these expenditures would be wasted.

III. Policy Advantages

A. *The Role of Market Competition*

Besides not requiring the use of racial classifications, the rating approach has another critical advantage over a set-aside program. As a business development policy, it permits gradations of compliance with the nondiscrimination obligation to be rewarded with incremental incentives. Incremental ratings, instead of the pass/fail dichotomy of the set-aside, would foster competition between competitors to comply with the nondiscrimination objective. Before a contract could be awarded, a contractor's anticipated performance of its nondiscrimination obligation would be compared with those of other bidders. In this respect it would be treated just like other contract terms, including price, quality and timeliness of performance. Since the best relative rating would confer an advantage, bidders would be forced to compete with respect to both the amount and quality of their transactions with MBEs.

Harnessing market competition in this fashion unleashes a powerful force to erode racial barriers to minority participation in both public and private procurement. Competitive ratings would serve a function analogous to price competition in our market economy. Price competition serves to lower prices, improve quality and spur innovation. Incremental ratings would enlist the same competitive forces endemic to the market system

in the service of the nondiscrimination obligation. Ratings create incentives for firms to use initiative and innovation continually to improve their rating. Because ratings would be relative and comparative, ideally a firm would have to improve each year even to maintain the same rating. Just as firms must be price competitive to succeed, a rating system would force firms to achieve high ratings to succeed in public procurement. To achieve high ratings would require them to honor both the letter and the spirit of the nondiscrimination obligation in all their transactions, public and private.

At present, firms that voluntarily seek to eliminate barriers to MBE participation incur short-term costs⁸² for engaging in socially desirable behavior without a commensurate competitive advantage. These costs can include the administrative costs of seeking out and identifying less visible minority firms, the productivity costs that might be associated with working with less experienced firms, and the financing costs of engaging firms with inadequate capital and bonding capacity. Firms that take no steps to eliminate present exclusionary practices or the effects of past ones do not incur such costs. Rewarding socially useful behavior with a competitive edge creates incentives more consistent with an equitable society and benefits society generally through greater productivity and more efficient use of human resources. There would be no guarantee of a minimum level of MBE participation in the contract to be awarded, since govern-

⁸² In the intermediate term, over a period of several years, an effort to seek out new suppliers may reduce costs. As part of its overall affirmative action plan the Consolidated Rail Corporation (Conrail) paid premium rates to develop minority- and female-owned firms as suppliers. In 1982 it incurred \$700,000 in costs over lower bids submitted by nonminority firms to make awards to minority- and female-headed firms. By the first nine months of 1985 these costs had decreased to less than \$6,000. Over the same period Conrail saved substantial sums (\$1,127,000 in 1982 and \$1,002,000 for the first nine months of 1985) when minority- and female-headed suppliers underbid nonminority firms. The data does not reveal whether the savings resulted from bids submitted by firms that had previously received premiums, from firms identified through the effort to find minority suppliers, or from minority firms that would have been suppliers anyway. Consolidated Rail Corporation's Ethics Committee, Affirmative Action Program, Fourth Quarter Report (1985); Consolidated Rail Corporation's Ethics Committee, Affirmative Action Program, Third Quarter Report (1985); Consolidated Rail Corporation's Ethics Committee, Affirmative Action Program, Fourth Quarter Report (1984); Consolidated Rail Corporation's Ethics Committee, Affirmative Action Program, Third Quarter Report (1984); Consolidated Rail Corporation's Ethics Committee, Affirmative Action Program, Third Quarter Report (1983).

ment could not demand participation if it is to avoid the equal protection problem. However, the long-run competitive advantage given to firms with a genuine commitment to equal opportunity would yield greater benefits to MBEs in the long term.

B. Access to the Private Sector

As a business development policy, one of the primary drawbacks of a set-aside program is that it is limited to government procurement. Governments tend to buy only certain goods and services and they buy in large quantities relative to the scale of new business ventures. They also impose bonding and burdensome paperwork requirements not found in the private sector. Moreover, they pay their bills very slowly,⁸³ a practice whose consequences fall most heavily on poorly capitalized firms, which MBEs tend to be.

In predicting which potential suppliers are least likely to discriminate in their subcontracting, there is no reason to restrict a review of past performance to government contracting. In fact, information showing that firms use MBE suppliers in their private sector subcontracting would be more telling than compliance with government nondiscrimination covenants. Since nongovernment customers ordinarily neither encourage MBE participation nor impose contractual obligations not to discriminate, MBE inclusion in private sector contracting would be more persuasive than equivalent inclusion where government customers emphasize such inclusion.

Giving a bidder "credit" for all MBE participation, not just participation in public procurement, provides a wider scope of opportunities and more accessible opportunities for MBE development.⁸⁴ If a government utility contracts for a powerhouse turbine, for example, no minority firms may be able to supply the goods or services required from subcontractors. But the prime contractor may use MBEs to maintain its computers,

⁸³ See generally Prompt Pay Act, 31 U.S.C. §§ 3901–3906 (1982 & Supp. V 1987), for a response to this problem.

⁸⁴ Ratings would be reported for firms on a consolidated basis, perhaps using the same criteria for consolidation as for financial reporting. If reported on a consolidated basis, a firm would not be at a disadvantage if, for tax or other reasons, it chose to conduct all of its public sector business through a wholly-owned subsidiary.

provide health insurance for its employees or landscape the grounds of its headquarters. If the goal is to eliminate barriers and encourage the formation and growth of MBEs, governments should expand their business development programs beyond the narrow confines of their own procurement. Minority entrepreneurs make business formation decisions based on the supply and demand status in the available markets, just as other entrepreneurs do. If their decision is skewed by the presence of large government contracts, they may be swayed to enter industries whose prospects are less favorable than other available opportunities. By giving the kind of "credit" proposed, the prime contractor has an incentive to include MBEs as suppliers in all its procurement, not just the portion involving government contracts. This creates broader economic opportunities for MBE development across the entire economy.

C. Equity Advantages

Minority business development policies primarily benefit the most advantaged individual minorities and minority groups. Generally, minority individuals and minority groups whose human and financial capital has been the most seriously impaired or stunted by discrimination are the least likely to create new firms that can operate in the relatively sophisticated business environment of public procurement.⁸⁵ The demands of such an environment require that the minorities who can succeed in it, when compared to most whites (although not when compared to white business owners), will seem relatively advantaged.

Set-aside programs provide their benefits to all minorities or minority groups that meet their eligibility criteria. Often general eligibility criteria advantage some specific entrepreneurs whose participation in the program may not be warranted. Al-

⁸⁵ One year prior to the initial formulation of the Small Business Association's § 8(a) program, Congress enacted the 1967 Amendment to the Economic Opportunity Act, Pub. L. No. 90-222, 81 Stat. 672 (1967) (repealed 1974), which directed the SBA "to assist in the establishment, preservation, and strengthening of small business concerns . . . with special attention to small business concerns (1) located in urban or rural areas with high proportions of unemployed or low-income individuals, or (2) owned by low-income individuals." Pub. L. No. 90-222, § 106(a) at 81 Stat. 710. This population contained few entrepreneurs capable of functioning as suppliers to the federal government.

though they meet the general criteria, whether market barriers exist that disadvantage these specific entrepreneurs is questionable. Any set-aside program that can sort out whether they belong in a particular program would find the administrative overhead too expensive. For instance, minority entertainment and sports celebrities like Bill Cosby and Julius Erving have benefited from incentives that encourage the sale of broadcast franchises to minorities.⁸⁶ Whether such high-status individuals encounter discrimination in the rarified world of corporate finance, where capital is raised for acquisition of such franchises, would be difficult to establish. The rating approach, rather than the "all or nothing" approach of set-asides, works on a continuum. A series of contracts with a group of minority celebrities need not, under suspicious circumstances,⁸⁷ count as much as a pattern of contracting with less recognized minority personalities.

The gradations to which the rating approach lends itself also allow other forms of intragroup equity. A few years ago wealthy Mexicans were sending enormous sums of capital out of Mexico's weak economy, mainly to the United States.⁸⁸ The Mexican Central Bank acknowledged at least \$33 billion in capital flight between 1977 and 1984, and other economists estimated a total closer to \$60 billion with another \$5 billion in 1985 alone.⁸⁹ The immigrants to the United States who were linked to this capital flight initially invested in financial assets but turned increasingly to business investments.⁹⁰ Since some set-asides are open to resident aliens,⁹¹ the businesses controlled by these wealthy foreign Hispanics could displace from set-aside programs Hispanic firms that lack capital and experience because they are owned by Hispanic Americans who have endured several generations of second-class status. The rating approach

⁸⁶ Rudnitsky, *How the Rich Get Richer*, *Forbes*, May 15, 1989, at 38.

⁸⁷ An example of such a circumstance would be a series of product endorsements pitched to the minority consumer market. Such contracts might be viewed as tending to support segregated markets.

⁸⁸ *Wall St. J.*, Oct. 11, 1985, § 1, at 1, col. 6.

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *See, e.g.*, U.S. Dep't of Transportation, 49 C.F.R. § 23.5 (1988) ("'Minority' means a person who is a citizen or lawful permanent resident of the United States and who is: . . . (b) Hispanic . . .").

provides a means to discount, without totally ignoring, transactions with what may be the United States subsidiaries of the Mexican Fortune 500.

The ability to rate transactions on a continuum leads to another form of intragroup equity. Race and ethnicity are social definitions rather than scientific ones. Transactions with "Hispanic" firms owned by Argentines whose parents immigrated from Germany in 1950 need not "count" for as much credit as transactions with "Hispanic" firms owned by Mexican Americans whose roots have been indigenous for many generations.⁹² Such fine distinctions would not be drawn in every instance; to do so might generate unworkable complexity. But if patterns of only nominal compliance by certain contractors emerge, ratings scaled on a continuum permit such compliance effectively to be discounted.

Lastly, as minority business development programs succeed, they will succeed with some groups before others. Incentives for transactions with the most successful groups will need to be phased out as the market barriers they encounter recede.⁹³ A rating approach accommodates this need.

D. Summary

A rating approach to minority business development has numerous policy advantages over traditional set-asides, and may be established with few new resources. The data base requirements may seem demanding at first, but the financial and credit industry's data collection and analysis of similar and much more voluminous information suggests that any problems would be manageable.

For the proposed approach to work, localities must be committed to creating opportunities for MBEs, but presumably ju-

⁹² Set-aside eligibility is typically provided for "Hispanic Americans," 13 C.F.R. § 124.105(b) (1989) [the Small Business Administration's § 8(a) set-aside program], or a "Hispanic (a person of Mexican, Puerto Rican, Cuban, Central or South American, or other Spanish culture or origin, regardless of race)," 49 C.F.R. § 23.5 (1988) [the Surface Transportation Assistance Act set-aside program]. But there is no consensus on whether "Hispanic" means ancestry, language, culture, national origin or some mixture of these elements,

⁹³ Some Asian groups already have higher educational and income levels than any white ancestry group. *See supra* note 33.

risdictions that have enacted set-asides have the necessary commitment. The commitment entails a willingness to assign a high priority to performance of the contractual obligation not to discriminate, perhaps a priority approaching that given to price.

The rating system approach avoids distributing public contracts by racial classifications and instead creates positive incentives for nonminority firms to abandon practices and attitudes which have created barriers for minority firms. It reserves for another day and for other issues the scarce moral capital consumed by preferential programs as sensitive and contentious as set-asides.

IV. Constitutionality

A. *The Racial Neutrality of the Rating Approach*

The rating approach has the significant advantage of not awarding public contracts according to racial classifications. Thus it largely avoids the constitutional infirmities of the plan declared unconstitutional in *Croson*. Unlike set-asides, which allocate government contracts by race, this approach does not require that any particular subcontract, nor even that any contract at all, be awarded to a minority firm. Instead, the ability of both nonminority and minority bidders to perform the non-discrimination covenant would be evaluated based upon their prior record of dealings with both nonminority and minority firms. Those firms with good records would be entitled to a favorable presumption. Those firms with poor records might find themselves at a relative disadvantage if their areas of operations (geographic and industry type) encompass areas with a significant potential for dealings with minority and nonminority firms.

A locality would remain free to choose a firm with a poorer record of performance or a new firm without a prior record because their prices or other factors were sufficiently favorable. Yet it could also reject such a firm's bid because that firm has failed to provide adequate assurance of fulfilling the important contractual term of nondiscrimination.

The rating approach limits race consciousness to use of a contractual term which imposes on suppliers a nondiscrimina-

tion obligation, and to evaluating their prior dealings to assess likely compliance with this obligation. Since a local government has a constitutional duty not to discriminate, neither the use of this contractual provision nor the evaluative assessment should violate the *Croson* principles or the Constitution. Since this nondiscrimination obligation would apply equally to minority prime contractors and would also protect nonminority subcontractors, the rating approach should be viewed as racially neutral and not as a suspect use of racial classifications.⁹⁴

B. Equal Protection Complications

Despite strong arguments demonstrating the racial neutrality of the rating approach, it nevertheless involves explicit recognition of race. “[T]he Equal Protection Clause requires the consideration whether the classifications drawn by any statute constitute an arbitrary and invidious discrimination.”⁹⁵ Equal application of the approach to minority and nonminority contractors, and the protection it provides to both minority and nonminority subcontractors, does not exempt it from the fourteenth amendment.⁹⁶ The Supreme Court has “reject[ed] the notion that the mere ‘equal application’ of a statute containing racial classifications is enough to remove the classifications from the [f]ourteenth [a]mendment’s proscription of all invidious discriminations”⁹⁷

Since equal application alone does not negate invidious discrimination, the question is whether the rating approach discriminates. “Discrimination is ‘an act based on prejudice’”⁹⁸ Discrimination draws “[d]istinctions between citizens solely because of their ancestry”⁹⁹ If the rating approach applied only to nonminority prime contractors and protected only minority subcontractors, it could be argued that it falls

⁹⁴ See *Croson*, 109 S. Ct. at 738–39 (Scalia, J., concurring) (programs which disproportionately benefit members of one race are constitutional if beneficiaries are not identified on the basis of their race).

⁹⁵ *Loving v. Virginia*, 388 U.S. 1, 10 (1967).

⁹⁶ *Id.* at 8.

⁹⁷ *Id.*

⁹⁸ L. Tribe, *American Constitutional Law* 1515 (2d ed. 1988).

⁹⁹ *Loving*, 388 U.S. at 11 (quoting *Hirabayashi v. United States*, 320 U.S. 81, 100 (1943)).

within the latter definition because it draws distinctions between citizens solely because of their ancestry.¹⁰⁰

Applied in this limited way, the rating approach to the nondiscrimination obligation becomes a set-aside, albeit one step removed. Rather than mandating that the prime contractor award subcontracts to minorities in order to receive the contract under bid as in a conventional set-aside, it could be argued that the rating approach pushes back in time the mandate to award subcontracts to minorities. One would argue that for a prime contractor to be considered for a bid award, it must have actually awarded contracts in the past to minorities. Under this interpretation, the rating approach would require discrimination against nonminority subcontractors. Only through previous discrimination against nonminority subcontractors could a prime contractor be qualified to perform the nondiscrimination obligation for purposes of future awards.

This argument assumes that awarding contracts to minority subcontractors requires discrimination against nonminority subcontractors because minority subcontractors do not deserve contract awards on the merits.¹⁰¹ Moreover, it ignores those aspects of formulating the rating that take into account the availability of minority firms as potential suppliers in the prime contractors' geographic and product markets. If minority firms are few and far between, then a failure to have significant dealings with them would not provide a basis for a negative rating. If minority firms abound and other bidders have significant dealings with them, then the burden would shift to the firm to explain the absence of such dealings. After all, if a firm lacks experience and its competitors do not, it must meet the customer's concern about its inexperience.

This argument, by insisting that the rating approach would equate nondiscrimination only with the actual award of con-

¹⁰⁰ Whether it could be conceived to be an act of prejudice would be another question. In *Loving* the Court looked to the longstanding adherence of the Virginia government to the doctrine of white supremacy. "The fact that Virginia prohibits only interracial marriages involving white persons demonstrates that the racial classifications must stand on their own justification, as measures designed to maintain White Supremacy." 388 U.S. at 11.

¹⁰¹ This assumption, based upon certain negative stereotypes, suggests the attitudes that inhibit the formation and growth of minority firms. These attitudes necessitate the kind of approach advocated by this Article.

tracts to minority firms, treats the discretion involved in formulating the ratings as merely camouflage for a discriminatory purpose. But evaluations involving the exercise of discretion occur with respect to many contractual obligations. The financial resources, experience and technical capabilities of bidders are evaluated with respect to their possible future performance of the contract. These evaluations involve a large measure of discretion because they involve an element of subjectivity. Yet when this subjectivity is exercised to deny contracts to minority firms that are otherwise the low bidders, a discriminatory purpose is not found.¹⁰² Why discretion should presumptively hide discriminatory purpose in one instance and not in the other cannot be related to the probability of its actual occurrence.¹⁰³ Instead it must be related to the relative practical importance of the contractual term involved. The Constitution does not require that only experienced, financially capable firms win contract awards, but “[i]t 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.”¹⁰⁴ To permit discretion only with respect to terms not concerned with non-discrimination is to reverse the priorities established by constitutional doctrine.

A last factor that the argument ignores is that ratings are a relative score, derived in part from a comparison with what other bidders have done. Over any extended period of time most bidders cannot win every contract, and private sector markets far exceed the size and scope of public sector ones. Thus it would be a risky gamble for bidders to build up their ratings by discriminating against nonminority firms¹⁰⁵ and absorbing increased costs for doing so, in the hopes that their increased share of public procurement in the future would make up the difference. This strategy would only pay off if one bidder counted on winning every public contract on which it bid. In

¹⁰² See *infra* notes 140–143 and accompanying text.

¹⁰³ No data exists for the latter, and the former, of course, has not yet been tried.

¹⁰⁴ *Croson*, 109 S. Ct. at 720.

¹⁰⁵ Since the rating agency would be assessing the nondiscrimination obligation with respect to discrimination against nonminority firms as well, this argument assumes that such discrimination would go undetected.

order, however, to recoup its increased costs from public procurement, this bidder would submit higher bids than its competitors. Its success would depend on its public customers rejecting lower bids in every instance because competing bidders could not show their ability to perform the nondiscrimination obligation. But if a single competing bidder could make a comparable showing without wholesale discrimination against non-minority subcontractors, it would be able to submit a lower bid and win the contract. A strategy that seeks high ratings by discriminating against nonminority firms cannot succeed economically.

C. Challenge as a Covert Set-Aside

A local government might adopt the rating approach after considering and rejecting a set-aside program or after the lapse or invalidation of a previously enacted set-aside program. Can bidders then challenge the program as a covert attempt to achieve an objective which would be forbidden if sought overtly?¹⁰⁶ To evaluate the merits of such a potential challenge requires consideration of two questions. First, does the rating agency approach have the same goal as a minority business set-aside? Second, does the means of achieving that goal lend itself to the abuses or suspect policies that require strict scrutiny?

Set-asides and the rating agency approach both attempt to remove the barriers to minority participation in the economy. But the means used by the rating agency approach to achieve that goal differs in a constitutionally significant way from the means used in a minority business set-aside. A set-aside requires a specified degree of minority business participation in a particular government procurement contract through the use of racial classifications. A rating agency program seeks to create a competitive advantage for firms that reject policies, practices and attitudes that exclude minority firms from business transactions. Only the means chosen has constitutional significance, and the

¹⁰⁶ See Brest, *Palmer v. Thompson: An Approach to the Problem of Unconstitutional Legislative Motive*, 1971 Sup. Ct. Rev. 95.

goal is constitutionally desirable so long as no suspect means are used to achieve it.¹⁰⁷

Nevertheless, if a city administers a rating program in a manner that seems to impose the same requirements as a set-aside, it remains vulnerable to the charge that it is operating a set-aside masquerading as something more innocent.¹⁰⁸ If, for example, an administrator ignored the assigned ratings and awarded contracts only to prime contractors that on previous contracts had met the minimum minority participation required by the superseded set-aside, a court might find the program suspect.

One reason the rating agency would be established as a financially independent entity, employing nongovernmental personnel to collect and analyze data and assign ratings to individual firms, would be to limit the ability of jurisdictions to pervert its intended means to unconstitutional ones. It would be structurally insulated both from blatant political pressure to reward campaign contributors with desirable ratings and from the inertia of administrators tempted to stick with companies favored under previous set-aside programs. Operated in this manner, the fear of racial politics expressed by the *Croson* Court should be allayed.¹⁰⁹

An independent rating agency would draw on a much broader information base than that available to a single city.¹¹⁰ The breadth would prevent ratings from being unduly influenced by a single transaction. By basing ratings on both public and private transactions, they would reflect a greater number of transactions. With a large number of transactions upon which to base a firm's rating, no particular transaction would weigh heavily.

Instead the overall pattern would be the important factor. The immediate past transactions with the city using the rating,

¹⁰⁷ See *supra* text accompanying note 94; *Croson*, 109 S. Ct. at 720 (Court finds a compelling interest in assuring that public dollars do not finance private prejudice).

¹⁰⁸ See *supra* notes 95-102 and accompanying text.

¹⁰⁹ *Croson*, 109 S. Ct. at 721.

¹¹⁰ The files on regional and national firms would include the information they had previously submitted with bids to jurisdictions all over the region or country. Even local firms would have data reported to the rating agency by the several layers of local government with which they might do business.

or even the cumulative total of all previous contracts with that particular jurisdiction, might have little impact on the final rating. With a greatly expanded data base any similarity between a firm's rating and its past performance in a set-aside program would be either coincidental or merely reflective of the lack of racial barriers in its dealings with minority firms. A firm whose only dealings with minority firms came through compliance with set-aside programs would probably have a low rating. A firm with many transactions with minority firms outside of compliance with set-aside programs would probably have a high rating. Its high rating, however, would not reflect merely performance in a previous set-aside, but also the lack of racial barriers in its private sector dealings with minority firms. The data base, expanded far beyond set-aside performance, should so differentiate ratings from set-aside performance that the suspect status of a set-aside should not carry over to the rating agency merely because it might incorporate previous set-aside transactions in its rating data base.¹¹¹

The share of a prime contractor's business going to MBEs would rarely, if ever, reflect prior requirements under set-aside programs. A firm of any size simply could not allocate the share of its overall subcontracting or purchasing to minority firms in the same proportions as the ten to thirty-five percent typically required by set-asides.¹¹² Minority firms are too small and too few to absorb this proportion of the total private and public procurement markets. Nationally, minority firms account for only about 0.6% of total business revenues.¹¹³ Since ratings would be based upon a much broader business base than just a single jurisdiction's procurement, there are too few minority businesses to require that a firm use MBEs as suppliers to the

¹¹¹ Since the private entity could not be held responsible for the previous set-aside program, including set-aside transactions in the ratings data base should not result in the rating agency being infected with the suspect standing of the set-aside.

¹¹² Ten percent was the goal established in the federal set-aside upheld in *Fullilove v. Klutznick*, 448 U.S. 448 (1980), 30% was the goal invalidated in *Croson*, 109 S. Ct. 706 (1989), and 35% was the size of the municipal set-aside struck down by the state supreme court in *American Subcontractors Ass'n v. Atlanta*, 259 Ga. 14, 376 S.E.2d 662 (1989).

¹¹³ U.S. Bureau of the Census, *1982 Survey of Minority-Owned Business Enterprises*, MB82-1, MB82-2, MB82-3 (1985 & 1986). In 1982, only 0.6% of all business receipts came from minority firms. R. Suggs, *Minorities and Privatization: Economic Mobility At Risk* 53 (1989).

extent mandated by set-asides. With the rating approach the overall participation of MBEs in a particular jurisdiction's procurement would almost certainly decrease as compared to under a set-aside. But if this alternative were employed, the incentives created for participation in the much larger and more diverse private sector would afford many more and better opportunities for minority business growth and development. With a program designed and implemented in this way, firms that previously complied with set-asides would not necessarily achieve a high rating, nor would the share of MBE participation in the jurisdiction's procurement approximate that prevailing under an earlier set-aside. These two pivotal facts substantially undermine an equal protection challenge against a rating agency program grounded on a claim that it merely achieves by covert means a constitutionally prohibited result.

D. Challenge Based Upon Discriminatory Purpose

For such an equal protection challenge to succeed a discriminatory purpose must be shown. In *Washington v. Davis*,¹¹⁴ the Court reconsidered its position on the significance of improper motivation¹¹⁵ and ruled that the lower courts had erred in applying the disparate impact standard developed under Title VII in *Griggs v. Duke Power Co.*¹¹⁶ to a constitutional claim. A

¹¹⁴ 426 U.S. 229 (1976).

¹¹⁵ Even if the legislative motive of a city council establishing a rating agency could be impugned, the use of the agency might still withstand an equal protection challenge. In *Palmer v. Thompson*, 403 U.S. 217 (1971), a decision that has subsequently been severely criticized by commentators, the Court first directly considered the role of motivation in equal protection doctrine. The Court refused to examine the motive of the city of Jackson, Mississippi, when it closed its swimming pools rather than integrate them. The city claimed that it acted not because it found the prospect of integration unbearable, but rather because of the attendant physical and economic hazards that integration created. Without offering any evidence, the city claimed that the pools could not be operated economically nor could law and order be maintained if the pools were operated on an integrated basis. *Id.* at 253. The Court perceived great difficulty in ascertaining the individual motives of a group of legislators. It therefore decided not even to inquire into their real motives, because invalidating the action for improper motivation could be corrected by reenactment based upon a proper motive. *See Ortiz, The Myth of Intent in Equal Protection*, 41 *Stan. L. Rev.* 1105 (1989). Since the legislative decision to close all pools burdened blacks and whites equally, the Court ruled that the Constitution did not prohibit the pool closing. *See also Brest, supra* note 106.

¹¹⁶ 401 U.S. 424 (1971).

showing of discriminatory purpose became necessary to establish a constitutional claim, and by itself disparate impact could not show such a purpose.¹¹⁷ The meaning of discriminatory purpose was developed in *Village of Arlington Heights v. Metropolitan Housing Development Corp.*¹¹⁸ The Court held that if a plaintiff showed that race at least partly motivated the decision, a discriminatory purpose had been shown.¹¹⁹ To show a discriminatory purpose, claimants could rely on disparate impact, events leading up to the challenged decision, departures from normal procedural sequence and usual substantive policies, and the legislative and administrative history of the action.¹²⁰ Then in *Personnel Administrator v. Feeney*,¹²¹ the Court rejected the formulation that a person intends the natural and foreseeable consequences of voluntary actions. Instead it adopted a more limited meaning for "discriminatory purpose." Such a purpose meant not an awareness of consequences, but "that the decisionmaker . . . selected . . . a particular course of action at least in part 'because of,' not merely 'in spite of,' its adverse effects upon an identifiable group."¹²²

These cases suggest that a challenge might be mounted on the grounds that the prior history of a set-aside plus disparate impact on nonminority firms showed the requisite discriminatory purpose with respect to nonminority firms and the lack of any compelling governmental interest as a justification. As discussed earlier,¹²³ the rating approach is facially neutral. This challenge would be to the program as applied.

How could a rating agency program produce an adverse impact when it affects both minority and nonminority firms equally? One line of argument would focus upon the ease with which a minority firm could satisfy the requirement that it not

¹¹⁷ In *Washington v. Davis*, the Court interpreted a number of its recent decisions as establishing "the basic equal protection principle that the invidious quality of a law claimed to be racially discriminatory must ultimately be traced to a racially discriminatory purpose." 426 U.S. at 240. See also L. Tribe, *supra* note 98, at 1497.

¹¹⁸ 429 U.S. 252 (1977).

¹¹⁹ *Id.* at 265-66.

¹²⁰ See *Ortiz*, *supra* note 115, at 1112; see also *Arlington Heights*, 429 U.S. at 266-68.

¹²¹ 442 U.S. 256 (1979).

¹²² *Id.* at 279 (citation omitted).

¹²³ See *supra* text accompanying note 94.

discriminate against nonminority firms. A minority firm could hardly do business at all without meeting this requirement given the predominance of nonminority firms in the economy. But a nonminority firm would not automatically find minority firms to deal with.

This argument mistakes the nature of the nondiscrimination obligation. There is no requirement that transactions with minority firms actually occur. If MBEs do not exist in significant numbers in the relevant product and geographic markets then no adverse inference is drawn from an absence of transactions with them. Because the availability of MBEs would be factored into the rating, there would be no adverse impact on nonminority firms by the operation of the program.

But the rating agency approach would be race neutral in its impact in an even more fundamental way. Minority firms can discriminate against other minority firms.¹²⁴ A minority prime contractor would be evaluated for its dealings with minority subcontractors just as would a nonminority prime contractor. It would be in the same competitive position as a nonminority prime contractor. Since all firms, regardless of their ethnic ownership would have an equal ability to meet the rating criteria for favorable ratings, there could be no adverse impact on any group.

E. The Role of Discretion: Nondiscrimination versus Intentional Discrimination

The argument that the rating agency approach is equivalent to a set-aside one step removed¹²⁵ is related to the argument that the only constitutionally permissible type of nondiscrimination obligation would be one that simply prohibits intentional discrimination.

A poorly rated firm could challenge a rating program on the basis that its low rating did not result from a showing of inten-

¹²⁴ Not only can discrimination occur between different minority groups, but legally cognizable discrimination can occur even within a single minority group. *See Walker v. Secretary of Treasury*, 713 F. Supp. 403 (N.D. Ga. 1989), recognizing a Title VII claim based upon discrimination by a dark-skinned black against a light-skinned black.

¹²⁵ *See supra* notes 100-102 and accompanying text.

tional discrimination. It would argue that the low rating, assigned without proof of intentional discrimination, showed a discriminatory purpose by the jurisdiction relying upon the rating.¹²⁶ A rating agency has sufficient discretion¹²⁷ in computing ratings to work to the disadvantage of nonminorities.¹²⁸ In challenging a jurisdiction that had previously enacted a set-aside, a plaintiff could argue that race had played an operative role in the decision to adopt the rating program which allowed for discretion in evaluating factors intended to distinguish between intentional discrimination and other causes that could lead to a lack of commercial relationships with minority firms.¹²⁹ A low rating might, because of the discretionary element, penalize behavior which violates neither statute nor constitution. The government decision to use this approach, it would be claimed, reflects covert antagonism towards nonminority firms, stigmatizing them because they have few or no commercial relationships with minority firms.

One response to this argument rests on the facts. The rating process already reflects objective and innocent reasons for lack of transactions with minority firms, like an absence of such firms in the relevant geographic and product markets for suppliers.¹³⁰ The rating procedure also provides an opportunity to the rated firm to challenge the rating assigned with additional or exculpatory information. While this process could not invariably distinguish between intentional discrimination of constitutional significance,¹³¹ and discrimination produced by racially selective

¹²⁶ The same objection could theoretically be made by a minority firm that avoided dealings with nonminority firms, but in the present economy such dealings would be unavoidable, so such a minority claimant is unlikely to exist.

¹²⁷ The *Croson* majority emphasized the significance of Richmond's status as a predominantly minority jurisdiction. 109 S. Ct. 706, 722 (1989). The Court might be suspicious of such discretion when the rating agency's clients are similarly composed jurisdictions.

¹²⁸ The delegation by the jurisdiction to a private rating agency of its discretionary power to compute ratings which influence its decisions may affect the constitutional challenge. The city could argue that its prior objectionable set-aside could not be attributed to the agency. *But see id.* at 720 (quoting *Norwood v. Harrison*, 413 U.S. 455, 465 (1973)) ("Racial discrimination in state-operated schools is barred by the Constitution and [i]t is also axiomatic that a state may not induce, encourage or promote private persons to accomplish what it is constitutionally forbidden to accomplish.").

¹²⁹ See Brest, *supra* note 106.

¹³⁰ See *supra* notes 72-73 and accompanying text.

¹³¹ "Discriminatory purpose' . . . implies more than intent as volition or intent as

sympathy, indifference,¹³² or unconscious racism,¹³³ to require a showing of intentional discrimination would necessitate proof of a contractor's state of mind—usually an impossible showing.¹³⁴

On a practical level, since minds cannot be read, jurisdictions cannot purge discrimination from their procurement if they can exclude or disfavor only firms shown to discriminate intentionally. Do governments have the discretion to pursue this objective through a rating agency in the manner outlined? Government can enact legislation against discrimination not shown to be intentional in the constitutional sense. Title VII¹³⁵ reaches employment practices which have discriminatory effects even without invidious intent.¹³⁶ Whether local governments have as much power as Congress to remedy discrimination by using racial classifications has provoked controversy.¹³⁷ But this controversy involves the outer limits of such power, when governments resort to explicit racial classifications for remedial purposes. When subordinate governments exercise power through racially neutral means for the constitutionally valued purpose of nondiscrimination, they act well within their powers.¹³⁸ In other areas of law all levels of government can sanction conduct

awareness of consequences. It implies that the decisionmaker, in this case a state legislature, selected or reaffirmed a particular course of action at least in part 'because of,' not merely 'in spite of,' its adverse effects upon an identifiable group." *Personnel Administrator v. Feeney*, 442 U.S. 256, 279 (1979) (citation omitted).

¹³² Brest, *supra* note 106 at 7-8; Welch, *supra* note 48, at 743-46.

¹³³ See Lawrence, *supra* note 48.

¹³⁴ A prime contractor in its award of public subcontracts and in its private sector procurement does not have to publicly announce bidding opportunities or specifications. It also does not have to accept the low bid. Intentional discrimination cannot be objectively shown because favoritism, for example, is a permissible basis upon which to select a supplier.

¹³⁵ 42 U.S.C. § 2000e-2(a) to 2000e-7 (1982).

¹³⁶ *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971). The recent decision in *Wards Cove Packing Co. v. Atonio*, 109 S. Ct. 2115 (1989), has eviscerated the ability of plaintiffs to bring disparate impact claims, but since it involved the interpretation of Title VII, it had no effect on Congress' power to bar practices that have discriminatory effects even without invidious intent.

¹³⁷ *Crosby* 109 S. Ct. at 719, 726-27, 755-57 (Marshall, J., dissenting).

¹³⁸ "Where 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. Under such circumstances, the city could act to dismantle the closed business system" *Id.* at 729 (citations omitted); see also *supra* note 31.

not shown to be intentional, from providing compensation for negligent torts to imposing strict liability for health and safety violations. So long as racially neutral means are used, there is no sound reason to apply special rules to limit government action against discrimination not shown to be intentional.

Contractual provisions concerning financial capability, timely performance and quality of workmanship routinely appear in procurement contracts. Governments often make discretionary and subjective evaluations of the ability of bidders to perform these provisions and will reject a low bid received from a firm considered unlikely to complete the work as planned. If subordinate governments lack the discretion to evaluate factors other than proof of intentional discrimination to disfavor firms in their procurement, then a perverse result follows. Governments must then give a lower priority of importance to nondiscrimination in their procurement than to factors without constitutional significance, like financial capability, timely performance or quality of workmanship. Governments have the discretion to exclude minority firms from their procurement to attain these other objectives, even without affirmative proof that these firms cannot perform, and even if these firms suffer from the continuing effects of prior discrimination.¹³⁹ If only firms shown to intentionally discriminate can be disfavored, then the goal of nondiscrimination must have a priority below that of objectives without constitutional significance.

A Second Circuit decision in *Jones v. Niagara Frontier Transportation Authority*¹⁴⁰ illustrates both this discretion with respect to routine objectives and how this discretion is used to disadvantage minority firms. In *Jones* an MBE bid unsuccessfully on a number of large prime contracts. It sought to enjoin award of the contracts to a competing nonminority firm, claiming discrimination. The MBE had the lowest bid at \$8,725,292, about \$900,000 below the Niagara Frontier Transportation Authority (the Authority) engineer's estimate, while the successful nonminority firm bid the second lowest at \$11,196,328. The MBE submitted the lowest bid on five of seventeen contracts,

¹³⁹ *Jones v. Niagara Frontier Transp. Auth.*, 836 F.2d 731 (2d Cir. 1987).

¹⁴⁰ *Id.*

but received none. On a related contract of nearly the same size the winning bid from a nonminority firm fell nearly \$650,000 below the engineer's estimate.

The Authority based its refusal to award the contract to the MBE on its failure to submit the required ten percent bid bond and because it was not a "responsible and responsive" bidder. This latter conclusion was based upon plaintiff's lack of financial resources (\$974 in cash), lack of necessary equipment (less than \$50,000 worth), and lack of major contracting experience (no project larger than \$136,000 in the previous five years). Plaintiff also conceded it was "broke" at oral argument. But the federal statute which funded the work involved obligated the Authority to "[provide] assistance to MBEs in overcoming barriers such as the inability to obtain bonding, financing, or technical assistance."¹⁴¹ Yet the authority never provided any assistance.

In denying the request for a preliminary injunction, the court found "it ironic that plaintiff's lack of bonding is a major reason asserted by the [Authority] for its refusal to award plaintiff a contract when the [Authority] had refused to help plaintiff obtain bonding in apparent derogation of its duty under federal regulations."¹⁴²

In *Jones*, a procurement officer with an affirmative mandate to include minority firms had discretion to rely upon purportedly race neutral factors, which correlate strongly as proxies for race, to exclude MBEs. Similarly then, a procurement officer with an affirmative obligation to purge procurement of discrimination,¹⁴³ must have discretion to weigh whether bidders can perform the nondiscrimination obligation, especially when this obligation is imposed through means which are formally and substantively race neutral.

The procurement official evaluating the bids would use the rating as a gauge of anticipated performance, just as the same

¹⁴¹ *Jones*, 524 F. Supp. 233, 239 (W.D.N.Y. 1981), *aff'd*, 836 F.2d 731 (2d Cir. 1987) (quoting 49 C.F.R. § 23.45(c)(2)).

¹⁴² *Jones*, 524 F. Supp. at 239.

¹⁴³ "It would seem equally clear, however, that a state or local subdivision (if delegated the authority from the State) has the authority to eradicate the effects of private discrimination within its own legislative jurisdiction." *Croson*, 109 S. Ct. at 720.

"It is beyond dispute that any public entity . . . has a compelling interest in assuring that public dollars . . . do not serve to finance the evils of private prejudice." *Id.*

official would use credit ratings and financial statements to predict the contractor's future solvency. Ratings would assess the individual record of each bidder for evidence of nondiscrimination—just the kind of individualized assessment whose absence was condemned as evil in *Regents of the University of California v. Bakke*.¹⁴⁴ The rating approach would award no particular contract based on the racial identity of a company. Each bidder could compete for every contract based upon demonstrated ability to perform the terms of the contract.¹⁴⁵ Competition would remain among all bidders for every contract. It was the elimination of this type of competition that Justice Powell in *Bakke* viewed as fundamentally unfair.¹⁴⁶ Whatever burden a rating agency approach imposes, it falls equally on minorities and nonminorities, and those affected have not yet been selected or identified, which diminishes the burden's significance.¹⁴⁷ Surely a procurement official can assign at least the same degree of importance to a nondiscrimination covenant as to a covenant specifying a completion date or imposing bonding requirements. A public entity has a constitutional duty to remedy its own intentional discrimination¹⁴⁸ and has power to rectify the effects of identified discrimination within its jurisdiction.¹⁴⁹ It would be curious indeed for a court to hold that a city has no power to prevent such discrimination from occurring through race neutral means.

The federal government prohibits employment discrimination by firms performing under federal contracts. Such contractors must file compliance reports containing their employment

¹⁴⁴ "The denial to respondent of this right to individualized consideration without regard to race is the principal evil of petitioner's special admissions program." 438 U.S. 265, 318 n.52 (1978) (Powell, J.).

¹⁴⁵ In *Bakke*, Justice Powell condemned the foreclosure of a nonminority candidate from all consideration for admissions slots set aside for minority applicants simply "because he was not the right color or had the wrong surname." *Id.* at 318.

¹⁴⁶ *Id.* at 319 n.53. For an argument that the record before the Court was seriously defective, see Smith, *Reflection on a Landmark: Some Preliminary Observations on the Development and Significance of Regents of the University of California v. Allan Bakke*, 21 *How. L.J.* 72, 77-84 (1978).

¹⁴⁷ See *Wygant v. Jackson Bd. of Educ.*, 476 U.S. 267, 282 (1986) ("the burden to be borne by innocent individuals is diffused to a considerable extent among society generally").

¹⁴⁸ *Croson*, 109 S. Ct. at 734 (Kennedy, J., concurring).

¹⁴⁹ *Id.* at 729.

policies and statistics.¹⁵⁰ The government may require prospective contractors to disclose participation in any previous contract and submit those compliance reports as part of their initial bid.¹⁵¹ Reports from earlier contracts could identify firms failing to satisfy the nondiscrimination in employment covenant.¹⁵² Collecting data on whether a contractor has complied with earlier nondiscrimination obligations has not been, and should not be, considered a "racial classification" of the kind giving rise to strict scrutiny.¹⁵³ Otherwise a nondiscrimination obligation can be no more than hortatory.

Conclusion

During the struggle to obtain civil rights for minorities, advocates focused on barriers preventing access to housing, schools, jobs, and most importantly, the vote. Despite twenty-five years of progress and change, the aggregate economic position of blacks and other minorities has not improved significantly.¹⁵⁴ The paucity of business ownership among minorities might account for some of this economic stagnation.¹⁵⁵ Such a dearth may in part reflect the fact that none of the civil rights statutes explicitly bars discrimination in private commercial business transactions.¹⁵⁶

Minority business set-asides represent an attempt to overcome the barriers which prevent minority firms from participating in public procurement. These barriers include both continuing discrimination by prime contractors as well as the disabling historic effects of prior discrimination. The Supreme Court de-

¹⁵⁰ Exec. Order No. 11246, § 203(a), 3 C.F.R. 339, 341 (1964-1965).

¹⁵¹ Exec. Order No. 11246, § 203(b), 3 C.F.R. 339, 341 (1964-1965).

¹⁵² In 1985 a company was debarred for only the second time during the Reagan administration. The debarment was for failure to file any report at all. Disqualification of federal contractors for compliance failures is exceedingly rare. From 1965 to 1985 only 27 firms were sanctioned for violations. *Firm Penalized Under Anti-Bias Rules*, Wash. Post, Sept. 7, 1985, p. A10.

¹⁵³ In one respect a rating agency approach goes beyond this precedent because it would collect data from private commercial transactions not covered by express nondiscrimination obligations. Section 1981, it can be argued, would impose this nondiscrimination obligation even on these private transactions. 42 U.S.C. § 1981 (1982).

¹⁵⁴ See *supra* text accompanying notes 32-35.

¹⁵⁵ See *supra* text accompanying notes 36-40.

¹⁵⁶ See *supra* text accompanying notes 4-12.

cision in *Croson* makes it difficult, if not impossible, for local governments to promote minority business development through set-asides. But even if some set-asides survive the strict scrutiny required by *Croson*, they fail to reach barriers in private commercial procurement.

The minority business development strategy proposed in this Article seeks to erode barriers in both public and private transactions by harnessing the market force of competition. By limiting access to public contracts to firms which demonstrably do not discriminate in the public or private sectors, it creates positive incentives to do business with minority firms. This approach has several advantages over set-asides. It lowers barriers in the private sector that set-asides leave untouched. It also avoids the use of racial classifications to allocate public benefits and thus escapes serious constitutional challenge. Politically, it avoids the use of scarce moral capital to justify minority preferences in an environment hostile to minorities generally. The rating agency approach also affords fewer opportunities for the reward of political supporters than the typical set-aside structure. With set-asides on hold nationally, the role of business in the creation of wealth looms too large to allow election politics to subvert larger objectives. Now is the time to get on with the business of minority business.

