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Department of Defense Procurement Practices after Adarand: What Lies Ahead for the Largest Purchaser of Goods and Services and Its Base of Small Disadvantaged Business Contractors

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Department of Defense Procurement Practices After *Adarand*: What Lies Ahead for the Largest Purchaser of Goods and Services and Its Base of Small Disadvantaged Business Contractors

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I. INTRODUCTION

Three decades have passed since the inception of experimental special programs collectively known as affirmative action.¹ The term embraces an array of initiatives, including special recruiting and hiring goals, designed to help racial minorities and women become full participants in this nation's economic structure.²

In 1961, federal affirmative action programs were initiated by President John F. Kennedy.³ With regard to public procurement con-

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1. Holly Idelson, *A Thirty Year Experiment*, 53 CONG. Q. 1579 (1995).
2. *Id.*
3. *Id.*

tracting, President Kennedy ordered federal contractors to make special efforts to ensure that workers be hired and treated without regard to race or ethnicity.⁴ President Lyndon B. Johnson significantly expanded affirmative action programs by requiring contractors who conducted business with the federal government to adopt affirmative action plans for all their operations, including goals and timetables for increased minority hires.⁵

The most important advancement, however, was made by President Nixon in 1969 when he implemented the "Philadelphia Plan," which required minimum levels of minority participation on federal construction projects in Philadelphia and three other cities.⁶ These efforts culminated in virtually all federal contractors adopting affirmative action plans during the following year.⁷ The agency initially charged with the responsibility for implementing and enforcing the affirmative action plans mandated by the Executive Branch was the Office of Federal Contract Compliance Programs ("OFCCP").⁸

Because of the efforts of the Kennedy, Johnson, and Nixon administrations, federal agencies such as the Department of Defense ("DoD") began to seriously establish affirmative action plans in the context of government procurement. DoD's establishment of these programs was critical because federal government construction is believed to represent almost five percent of all new construction, with military construction having a substantial impact on the entire construction industry.⁹ In addition, DoD executes roughly two-thirds of all federal prime contracts, spending approximately \$175 billion a year on goods and services.¹⁰ Of these contract dollars spent by DoD, small disadvantaged businesses ("SDBs") received \$13 billion in fed-

4. *Id.*

5. *Id.*

6. *Id.*

7. *Id.*

8. White House Office of Communications, Affirmative Action Review: Report to the President, at 29 (July 19, 1995) (available through White House Office of Communications, Washington, D.C., or through White House home page on the Internet Worldwide Web at <http://www.whitehouse.gov/WH/EOP/OP/html/aa/aa-index.html>). On March 7, 1995, President William J. Clinton directed that a review be conducted of the federal government's affirmative action programs describing and explaining the design and effects of the programs and initiatives in place. *Id.* at 1.

9. G. BROCKWEL HEYLIN, *THE COMPETITIVE BIDDING PROCESS—AN ENDANGERED SPECIES?* 7 (1981).

10. Sharon O. Richardson, *Planning, Programming, and Budgeting System 6* (Nov. 1, 1995) (unpublished manuscript prepared for Judge Advocate General's Fiscal Law Course, citing DoD News Release on the President's FY 1996 Budget) (on file with author).

eral contract dollars with only one-sixth of that amount spent on subcontracting with other non-minority small and large businesses.¹¹

Despite close to 95% of prime contract dollars being awarded to non-minority businesses, majority contractors believe that affirmative action in the form of federal procurement minority set-asides is “discrimination for its own sake.”¹² Seemingly adopting this belief, the Supreme Court in *Adarand Constructors, Inc. v. Pena*,¹³ struck a blow to the minority contracting community by raising the standard of review in cases challenging the constitutionality of federal affirmative action programs to the highest level of review—strict scrutiny.¹⁴

As a result of the Supreme Court’s decision in *Adarand*, DoD has been compelled to quickly review its own affirmative action programs and determine the best course of action in light of the Supreme Court’s pronouncement that federal race-conscious affirmative action programs be reviewed under strict scrutiny. Part II of this essay begins with a brief analysis of the Supreme Court’s decision in *Adarand* and the legislative history of DoD’s most successful affirmative action procurement program, which is often referred to as the “1207 program.”¹⁵ Part III reviews the post-*Adarand* effect on the program, highlighting legal challenges to DoD’s race-based set-asides. Part IV proposes the type of evidence that may be used by DoD to support the constitutionality of its affirmative action programs and suggests alternative programs which will ensure that small disadvantaged businesses receive meaningful opportunities to compete for defense contract dollars.

II. AN ANALYSIS OF ADARAND

Adarand Constructors, Inc. (“Adarand”) is a “Colorado based highway construction company specializing in guardrail work.”¹⁶ In 1989, the Mountain Gravel and Construction Company (“Mountain Gravel”) was awarded the prime contract for a highway construction

11. White House Office of Communications, *supra* note 8, at 66.

12. MICHAEL A. CARVIN ET AL., RACIAL PREFERENCES IN GOVERNMENT CONTRACTING 111 (Robert Clegg ed., 1993) (citing *Regents of Univ. of Cal. v. Bakke*, 438 U.S. 265, 307 (1978)).

13. *Adarand Constructors, Inc. v. Pena*, 115 S. Ct. 2097 (1995).

14. *Id.* at 2118.

15. In 1987, Congress passed that year’s Defense Authorization Act, which included § 1207, entitled “Contract Goal for Minorities,” later codified at 10 U.S.C. § 2323 and renamed “Contract Goal for Small Disadvantaged Businesses and Certain Institutions of Higher Education.” 10 U.S.C. § 2323 (1988).

16. *Adarand*, 115 S. Ct. at 2102.

project in Colorado by the Central Federal Lands Highway Division (“CFLHD”) of the United States Department of Transportation (“DoT”).¹⁷ Mountain Gravel solicited bids from subcontractors for the guardrail portion of the project, and Adarand submitted the lowest bid.¹⁸ Gonzales Construction Company (“Gonzales”) also submitted a bid in response to Mountain Gravel’s solicitation.¹⁹ Although Adarand had submitted the lowest bid in response to Mountain Gravel’s solicitation, Adarand was not certified as a small business controlled by “socially and economically disadvantaged individuals.”²⁰ The prime contract’s terms gave additional compensation to Mountain Gravel for hiring subcontractors certified as SDBs, and Gonzales, who was a certified SDB, was awarded the subcontract from Mountain Gravel.²¹

Adarand’s claim before the Supreme Court did not center on Mountain Gravel’s award of the subcontract to Gonzales; rather, it revolved around the presumption created by a section of the Small Business Act in favor of minorities.²² The Small Business Act mandates the inclusion of a clause which gives general contractors in government projects additional financial compensation for hiring SDBs.²³ Furthermore, the Small Business Act states that “contractor[s] shall presume that socially and economically disadvantaged individuals include Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and other minorities, or any other individual found to be disadvantaged by the [Small Business] Administration pursuant to section 8(a) of the Small Business Act.”²⁴

DoT established a subcontracting compensation clause (“SCC”) program to implement the Small Business Act. Under the SCC program, prime contractors whose number of SDB subcontracts exceeded certain percentages received incentive payments.²⁵ An SCC clause was included in the contract awarded to Mountain Gravel.²⁶ Adarand

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*; see 15 U.S.C. § 637(d)(3)(C)(ii) (1988).

23. 15 U.S.C. § 637(d)(2) (1988).

24. 15 U.S.C. § 637(d)(3)(C)(ii) (1988).

25. *Adarand*, 115 S. Ct. at 2103.

26. The clause in the contract awarded to Mountain Gravel reads as follows:

Subcontracting. This subsection is supplemented to include a Disadvantaged Business Enterprise (DBE) Development and Subcontracting Provision as follows:

asserted that the presumption of social and economic disadvantage created by the statute and the federal government's use of race-conscious presumptions in identifying individuals, discriminates on the basis of race in violation of the Fifth Amendment's guarantee of equal protection.²⁷

Adarand's claim was rejected by the Tenth Circuit when the court applied the "heightened scrutiny" standard.²⁸ The court found that the CFLHD had acted within its discretion by adhering to the congressional mandate expressed in the Small Business Act.²⁹ In vacating the judgment of the Tenth Circuit, the Supreme Court held that "all racial classifications, imposed by whatever federal, state, or local governmental actor, must be analyzed by a reviewing court under strict scrutiny."³⁰ Without invalidating the specific classification in the Small Business Act, the Supreme Court held that the Tenth Circuit used the incorrect standard in evaluating Adarand's challenge.³¹ The Court remanded the case to determine whether DoT's SCC program is "narrowly tailored" to achieve a "compelling" government interest.³²

On the contrary, the Supreme Court appeared to recognize that there was a continued need for the classifications found in the Small Business Act.³³ The Court even stated that a racial classification might withstand constitutional muster where it is found to be narrowly

Monetary compensation is offered for awarding subcontracts to small business concerns owned and controlled by socially and economically disadvantaged individuals. . . . A small business concern will be considered a DBE after it has been certified as such by the U.S. Small Business Administration or any State Highway Agency. Certification by other Government agencies, counties, or cities may be acceptable on an individual basis provided the Contracting Officer has determined the certifying agency has an acceptable and viable DBE certification program. If the Contractor requests payment under this provision, the Contractor shall furnish the engineer with acceptable evidence of the subcontractor(s) DBE certification and shall furnish one certified copy of the executed subcontract(s).

The Contractor will be paid an amount computed as follows:

1. If a subcontract is awarded to one DBE, 10 percent of the final amount of the approved DBE subcontract, not to exceed 1.5 percent of the original contract amount.
2. If subcontracts are awarded to two or more DBEs, 10 percent of the final amount of the approved DBE subcontracts, not to exceed 2 percent of the original contract amount.

Id. at 2103-04.

27. *Id.* at 2102.

28. *Adarand Constructors, Inc. v. Pena*, 16 F.3d 1537, 1543-44 (10th Cir. 1994).

29. *Id.* at 1545-46.

30. *Adarand Constructors, Inc. v. Pena*, 115 S. Ct. 2097, 2113 (1995).

31. *Id.* at 2118.

32. *Id.*

33. "The unhappy persistence of both the practice and the lingering effects of racial discrimination against minority groups in this country is an unfortunate reality, and the government is not disqualified from acting in response to it." *Id.* at 2117.

tailored to further a compelling interest on the part of the government.³⁴ Nevertheless, the ruling in *Adarand* has had the effect of foreclosing any opportunity to draw racial classifications that could comply with the Constitution. By requiring courts to review all racial classifications under the strict scrutiny standard, the Court has set the stage for the end of governmental racial classifications.³⁵

Notably, only two of the Justices in the majority favored a blanket prohibition on racial classifications. Justice Scalia remarked that “government can never have a ‘compelling interest’ in discriminating on the basis of race in order to ‘make up’ for past racial discrimination in the opposite direction.”³⁶ Likewise, Justice Thomas, in accord with Justice Scalia, stated “that under our Constitution, the government may not make distinctions on the basis of race.”³⁷ Justices Scalia and Thomas, however, fail to address the differences in the people of our country, which in many circumstances, are magnified by disparate treatment based on race and economic status.

The difficulty lies in the majority’s use of a single standard applied to all race-based programs that fails to take into account the Court’s jurisprudence regarding the difference between “invidious” and “benign” discrimination.³⁸ The dissenters in *Adarand* point not only to the differences among the American people themselves, but also to the differences among the institutions that govern the American people. Specifically, Justice Stevens found fault with the majority’s analysis because it did not recognize that the federal and the state governments have inherently different powers.³⁹ Justice Stevens ob-

34. “When race-based action is necessary to further a compelling interest, such action is within constitutional constraints if it satisfies the ‘narrow-tailoring’ test this Court has set out in previous cases.” *Id.*

35. As Justice Stevens observed:

I think that it is unfortunate that the majority insists on applying the label ‘strict scrutiny’ to benign race-based programs. That label has usually been understood to spell the death of any governmental action to which a court may apply it. The Court suggests today that ‘strict scrutiny’ means something different—something less strict—when applied to benign racial classifications. Although I agree that benign programs deserve different treatment than invidious programs, there is a danger that the fatal language of ‘strict scrutiny’ will skew the analysis and place well-crafted benign programs at unnecessary risk.

Id. at 2121 n.1 (Stevens, J., dissenting).

36. *Id.* at 2118 (Scalia, J., concurring in part and concurring in judgment) (citing *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 520 (1989) (Scalia, J., concurring in judgment)).

37. *Id.* at 2119 (Thomas, J., concurring in part and concurring in judgment).

38. *Id.* at 2121 (Stevens, J., dissenting); see *Washington v. Davis*, 426 U.S. 229 (1976).

39. *Id.* at 2123 (Stevens, J., dissenting).

served that “an interest in ‘consistency’ does not justify treating differences as though they were similarities.”⁴⁰

The use of a single standard to evaluate all race-conscious programs also fails to consider the fundamental concept of “congruence.”⁴¹ To equate the review of a federally created affirmative action program with that of a state-created affirmative action program fails to recognize the difference between federal and state governments. In essence, the majority does not afford Congress the appropriate level of deference. As recognized in *Fullilove v. Klutznick*,⁴² the Court must approach its task of review with “appropriate deference” to Congress as a co-equal branch of government.⁴³

Justice Souter’s dissent concentrates on the principle of *stare decisis*, which compels the application of judicial precedent.⁴⁴ According to Justice Souter, *Fullilove* controls the standard of review because the statute at issue in *Adarand* is “substantially better tailored” to the harm being remedied than was the statute at issue in *Fullilove*.⁴⁵ Justice Souter pointed out that the majority missed a critical issue when it failed to recognize the constitutional authority to remedy past discrimination by eliminating its present effects.⁴⁶ Justice Souter also observed that discrimination in the construction industry may be addressed by congressional authority, and if Congress should choose to address the discrimination by providing preferential treatment, such treatment would fall within the power of the Congress under section five of the Fourteenth Amendment.⁴⁷

The dissenting opinion of Justice Ginsburg, joined by Justice Breyer, underscores the issues addressed by both Justices Stevens and Souter and highlights the common ground that exists among all of the dissenting opinions.⁴⁸ This common ground is the acknowledgment that racial inequality exists in America and that, as Justice Ginsburg reiterates, Congress has the authority to actively end discrimination and counteract any of its lingering effects.⁴⁹ Nevertheless, acknowledging the existence of racial inequality is only the beginning. As Jus-

40. *Id.* at 2121 (Stevens, J., dissenting).

41. *Id.* at 2123 (Stevens, J., dissenting).

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

43. *Adarand*, 115 S. Ct. at 2124 (Stevens, J., dissenting) (citing *Fullilove*, 448 U.S. at 472).

44. *Id.* at 2132 (Souter, J., dissenting).

45. *Id.* (citing Stevens, J., dissenting).

46. *Id.* at 2132 (Souter, J., dissenting).

47. *Id.*

48. *Id.* at 2134-36 (Ginsburg, J., dissenting).

49. *Id.* at 2134 (Ginsburg, J., dissenting).

tice Ginsburg noted: “[b]ias, both conscious and unconscious, reflecting traditional and unexamined habits of thought, keeps up barriers that must come down if equal opportunity and nondiscrimination are ever genuinely to become this country’s law and practice.”⁵⁰

Despite these poignant protests by the dissenters, the strict scrutiny standard of review is the law of the land as to the constitutionality of race-conscious affirmative action programs.⁵¹ Therefore, it is the task of the federal government and all parties adversely affected by *Adarand* to determine a course of action that allows socially and economically disadvantaged small businesses to retain a meaningful position in the defense procurement system.

A. The Legislative History of DoD’s 1207 Program

In 1986, Congress passed a law⁵² requiring DoD to set an objective that would achieve the goal of awarding at least five percent of DoD’s total amount obligated for contracts and subcontracts⁵³ to socially and economically disadvantaged⁵⁴ small businesses and individuals.⁵⁵ By establishing the 1207 program, Congress intended to provide increased opportunities for minority involvement in government contracting.

In response to this Congressional mandate, DoD introduced and implemented its own goals and procedures.⁵⁶ In order to meet the

50. *Id.* at 2135 (Ginsburg, J., dissenting) (citations omitted).

51. *Id.* at 2118.

52. Defense Authorization Act, 10 U.S.C. § 2323(a) (1988).

53. The DoD’s goal included amounts authorized and appropriated for any fiscal year for contracts entered into with DoD for procurement, research, development, testing, and evaluation (“RDT&E” or “R&D”), military construction, and operation and maintenance (“O&M”). See 10 U.S.C. § 2323(b).

54. SDB is defined by § 8(d) of the Small Business Act as a concern that is at least 51% owned by one or more socially and economically disadvantaged individuals; and whose management and daily business operations are controlled by one or more of such individuals. 15 U.S.C. § 637(a)(4). The Small Business Act describes socially disadvantaged individuals as “those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as members of a group without regard to their individual qualities.” 15 U.S.C. § 637(a)(5). Economically disadvantaged individuals are defined as “those socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same business area who are not socially disadvantaged.” 15 U.S.C. § 637(a)(6)(A).

55. DoD’s five percent goal also applies to historically black colleges and universities (“HBCUs”), including any nonprofit research institution that was an integral part of such a college or university before November 14, 1986, and minority institutions. Department of Defense Federal Acquisition Regulation Supplement (“DFARS”) § 219.000(1) (1991) (codified at 48 C.F.R. § 219.000(1)).

56. In addition to goal setting and § 8(a) of the Small Business Act, DoD has implemented the § 1207 program, or “rule of two” set-aside, and the ten percent bid preference. Although the

five percent goal established by Congress, DoD has used small disadvantaged business set-asides and evaluation preferences, advance payments, outreach, and technical assistance.⁵⁷ Of all these programs, DoD has relied heavily upon its set-aside and preference programs to successfully attain the five percent goal. DoD's SDB set-aside provision is commonly known as the "rule of two." According to the rule of two, a contracting officer must set-aside an acquisition exclusively for small disadvantaged business participation when a reasonable expectation exists that there will be offers received from at least two responsible SDBs who will offer the goods or services requested at a price that does not exceed ten percent of the fair market price.⁵⁸ A solicitation exclusively set aside for small disadvantaged business participation could not be withdrawn by the contracting agency unless the set-aside was inappropriate or the low, responsive, and responsible offeror submitted a price which exceeded the fair market price plus a ten percent ceiling.⁵⁹

With regard to evaluation preferences, DoD provided that in procurements conducted under full and open competition, offers from small disadvantaged businesses were to be given an evaluation preference.⁶⁰ DoD's preference provision requires contracting officers to place a ten percent premium on all bids submitted by contractors that did not qualify as SDBs.⁶¹

An understanding of the purpose of the SDB contract goal legislation and DoD's regulations is needed in order to appreciate the effect of the Supreme Court's decision in *Adarand* on DoD's SDB procurement program. Unfortunately, the legislative history of the

statute merely makes these tools available to DoD as a means of achieving its contract goals, DoD's procurement regulations, prior to October 23, 1995, mandated their use. See DFARS Part 219.5 (1991) (listing SDB contracting procedures and business concerns). "Over 60 percent of DoD's contracting with SDBs occurs through either the "rule of two" set-aside or through the § 8(a) program." White House Office of Communications, *supra* note 8, at 61.

57. DFARS § 219.201(a) (1991).

58. DFARS § 219.502-2.70(a) (1991).

59. DFARS § 219.506(a) (1991). Several other restrictions on SDB set-asides exist. For instance, a contracting officer may not set aside an acquisition for exclusive SDB participation if the goods or services have been successfully acquired by small business set-aside or the acquisition is for construction with an estimated cost under \$2 million, or dredging with an estimated cost under \$1 million. DFARS § 219.502-2.70(b) (1991). See DFARS Subpart 219.5 (1991) (providing a full set of rules and regulations for DoD's set-aside program).

60. DFARS § 219.7000 (1991).

61. DFARS § 219.7002 (1991). Preferences are optional when other than price related factors are evaluated. See DFARS § 219.7001 (1991). Evaluation preferences are not provided when, among other things, small purchase procedures are used or a solicitation is issued on a small business or SDB set-aside basis. See DFARS § 219.70 (1991) (detailing an exhaustive list of restrictions on the use of evaluation preferences for SDBs).

1207 program is limited. In DoD's 1985 appropriations bill, the House Committee on Appropriations raised concerns about "the level of socially and economically disadvantaged business participation in defense procurements."⁶² The Committee reported that only 1.9% of DoD's procurements were awarded to SDBs.⁶³ The Committee opined that this did not appropriately reflect the Department's "best efforts toward expanding opportunities for such businesses."⁶⁴ This low level of participation created a concern which led to the DoD's study assessing the feasibility of increasing procurement opportunities for SDBs to a level of ten percent.⁶⁵

Although DoD reported that it could not achieve a ten percent goal while continuing to maintain its standards of contract responsibility, it found that only one percent of each fiscal year's procurement expenditures from 1969 to 1973 had gone to SDBs.⁶⁶ Thus, it was apparent to the Committee that these expenditures were paltry when compared to the total amount of DoD procurement spending and that more could be done to assist SDBs in gaining a more equitable share of defense contract dollars.⁶⁷ The Committee opined that the absence of SDBs in competitive contracting was the result of their exclusion from "participation in the 'early' development of major Defense systems."⁶⁸

During the debates over the 1207 program, several notable observations were made by certain members of Congress. For instance, Representative Savage recognized:

[O]nly 2.2 percent of FY84 procurement dollars and less than 1 percent of RDT&E dollars went to SDBs under prime contracts. . . . This is outrageously unfair in light of general population proportions and even more egregious if you look at statistics of those who are defending our country. . . . Black Americans constitute only 12 percent of our total population, but comprise 19.6 percent of our Armed Forces. Hispanics 3.6 percent and other minorities 4 percent. . . . Minorities account for 26.7 percent of the Armed Forces

62. See Memorandum from Gurden E. Drake, DoD Office of the Deputy General Counsel (Acquisition and Logistics) to the *Adarand* Working Group 20 (Aug. 30, 1995) (citing H.R. REP. No. 1086, 98th Cong., 2d Sess. 100 (1984)) (on file with author) [hereinafter *Drake Memorandum*].

63. *Id.*

64. *Id.* at 20 (citing H.R. REP. NO. 1086, 98th Cong., 2d Sess. 100 (1984)).

65. *Id.*

66. *Id.* at 21.

67. *Id.*

68. *Id.* at 22 (citing H.R. REP. NO. 332, 99th Cong., 1st Sess. 140 (1985)).

. . . [and they] should participate at least 10 percent . . . in preparation for war.⁶⁹

In addition to Representative Savage, Representative Collins expressed anecdotal evidence of discrimination by the Department when she stated:

What has happened heretofore is that you have had one or two minorities to come into the system; they are given some little, small contracts by DoD; the Department then finds, for no reason whatsoever, problems with the contract, the way it has been executed, and the way the services are being done; it takes everybody in Congress to try to straighten that matter out; and then, in spite of our efforts, DoD takes the contract away.

Minorities do not get a fair shake when it comes down to procurement in the Federal Government. This amendment will assure that minorities who are readily accessible and available to participate in DoD contracting and who are qualified to provide needed services, become part of the procurement system.⁷⁰

Despite the failure of the ten percent SDB participation amendment (the 1207 program) to make it through Conference, the program was reintroduced in 1986.⁷¹ Representative Bustamante expressed support for the 1207 program when he stated: “[t]he Committee included this section to encourage the Department to pursue higher levels of minority business participation. . . . It promotes the opportunity of all to compete in our economy. And it reaffirms our commitment to full economic parity for all American businesses.”⁷² The end result of the reports, debates, and hearings was the passage of the 1207 program into law.⁷³ The program required DoD to achieve a five percent goal in awarding total contract and subcontract dollars to SDBs.⁷⁴

III. ADARAND'S EFFECT ON DOD'S 1207 PROGRAM

As is evident from this sampling of legislative history, Congress enacted the 1207 program to provide SDBs with an opportunity to compete in the DoD procurement system, to gain experience in procurement, and to provide a mechanism to ensure an equitable distri-

69. *Id.* at 24 (citing 131 CONG. REC. H4943 (1985)).

70. *Id.* at 25-26 (citing 131 CONG. REC. H4943 (1985)).

71. *Id.* at 26 (citing 132 CONG. REC. H5264 (1986)).

72. *Id.* (citing 132 CONG. REC. H5400 (1986)).

73. *Id.* at 27-28 (citing 132 CONG. REC. H10,118 (1986)).

74. *Id.*

bution of DoD contract dollars to those SDBs capable of performing work in accordance with DoD standards. These purposes were addressed by The Honorable William T. Coleman III, General Counsel of the Army, during his speech at the U.S. Army Corps of Engineers, Legal Services Worldwide Conference, where he informed conference participants that, while *Adarand* requires federal affirmative action programs to be reviewed under strict scrutiny, the decision "did not offer guidance in determining whether a government interest is compelling and the nature of the record that would be needed to justify a program."⁷⁵ The Army General Counsel explained that "as these issues have not yet been resolved, there is no need to change the way [the Army does] business," especially its contracting programs.⁷⁶ The General Counsel noted that if the Army's program was subject to constitutional challenge, such a case was "likely [to] have government-wide implications."⁷⁷

Not surprisingly, the Army General Counsel's predictions came true. The U.S. Army Corps of Engineers received its first challenge to its set-aside program.⁷⁸ The challenge came from a non-SDB contractor, a California corporation, registered in Hawaii with its principal place of business in Hawaii.⁷⁹ The corporation has filed suit in the United States District Court for the District of Hawaii asserting that an award of a construction contract to an SDB was invalid since the basis for the award, the SDB set-aside, was unconstitutional in light of the Supreme Court's decision in *Adarand*.⁸⁰

Specifically, the plaintiff corporation alleges that although it submitted the lowest bid for the project, its bid was rejected because it lacked certification as a SDB.⁸¹ Moreover, the plaintiff contends the following: (1) no legislative evidence has been proffered which supports a finding that DoD's SDB set-aside program is narrowly tailored

75. U.S. ARMY CORPS OF ENGINEERS, SIXTH WORLDWIDE USACE LEGAL SERVICES CONFERENCE REPORT 31 (1995) [hereinafter USACE REPORT].

76. *Id.* By passage of the Federal Acquisition Streamlining Act ("FASA") in 1994, Congress and the Executive Branch expressed their support of minority business opportunities in federal procurement. See Pub. L. No. 103-355 (1994). FASA made DoD's small disadvantaged business award goal government-wide. All federal agencies now have a five percent goal for award of total contract and subcontract dollars to SDBs. See Devron E. Hewitt, *Adarand: Misplaced Politics in the Courts*, PROCUREMENT LAW, Spring 1995, at 1.

77. USACE REPORT, *supra* note 75, at 31.

78. Gusalino Bros. Constr., Inc. v. Dept. of Defense, No. 95-00854 ACK (D. Haw. filed Oct. 17, 1995) (first amended verified complaint for declaratory judgment and permanent injunction).

79. *Id.* ¶ 1.

80. *Id.* ¶ 26.

81. *Id.* ¶¶ 11-12.

to correct a known and documented history of prior racial discriminatory practices in the awarding of federally financed construction contracts in Hawaii; (2) DoD has improperly imposed the five percent goal on the state of Hawaii since a large portion of the Hawaiian construction trade consists of minority contractors; and (3) DoD has violated plaintiff's constitutional rights of due process and equal protection by excluding the plaintiff from the bidding process, which is otherwise based on full and open competition.⁸² Although the dollar amount of the contract awarded to the SDB was relatively small, the award had great implications to the Army, the DoD, and the federal government due to the government-wide application of DoD's 1207 set-aside program.

In a memorandum dated October 23, 1995, the Under Secretary of Defense informed all major commands that, effective immediately, DoD had suspended all of its SDB set-aside regulations.⁸³ Whereas the Army General Counsel may have been ready to confront constitutional challenges to the Army's set-aside program after the *Adarand* decision, a politically protracted analysis led DoD officials to conclude that the 1207 program may be indefensible against the Supreme Court's standard of strict scrutiny imposed in *Adarand*.⁸⁴ It is currently unknown whether DoD's suspension of its SDB set-aside and the plaintiff corporation's challenge to that program will affect the contract awarded to the SDB in Hawaii. While the plaintiff's challenge is most likely in response to *Adarand*, the challenge highlights a legitimate concern about the current set-aside program—namely, the imposition of set-asides in a geographical area that has large participation by minority contractors in that area's construction trade.

The immediate effects of *Adarand* and DoD's recent decision to suspend its SDB set-aside regulations are difficult to gauge. Nonetheless, SDBs and contracting officers are gravely concerned that the suspension will result in a loss of prime contract and subcontract opportunities for a segment of society which has been historically excluded from DoD's procurement system. In addition, the majority of federal contracting officers may display concern because their performance is partially measured by their ability to promote greater

82. *Id.* ¶¶ 15-16, 21-32.

83. Memorandum from Paul G. Kaminski to Secretaries of the Military Departments, Service Acquisition Executives (Oct. 23, 1995) (on file with the author) [hereinafter *Kaminski Memorandum*]; see Defense Federal Acquisition Regulation Supplement; Small Disadvantaged Business Utilization Program, 60 Fed. Reg. 54,954 (1995).

84. *Kaminski Memorandum*, *supra* note 83.

SDB participation in the government contracting process. Finally, the *Adarand* decision attacks the presumption of discrimination inherent in the Small Business Act's definition of socially and economically disadvantaged individuals.⁸⁵

One immediate effect of *Adarand*, however, has been the numerous challenges to DoD's set-aside program in the form of complaints and protests initiated prior to DoD's suspension of its regulations. For example, two cases challenging DoD's SDB set-aside program have been filed with the U.S. Army Corps of Engineers after the Supreme Court's ruling in *Adarand*.⁸⁶ First, a solicitation was issued by the U.S. Army Engineering District, Baltimore, seeking bids for the repair and renovation of two buildings at Ft. Belvoir.⁸⁷ The District issued a synopsis which indicated that the acquisition was being considered for exclusive small disadvantaged business participation, but all bidders were encouraged to request bid information.⁸⁸ Subsequently, the contracting officer concluded that more than two SDBs would submit bids at fair market prices and as a result, the contracting officer issued an amendment to inform bidders that the acquisition would be set-aside.⁸⁹ In response, an agency bid protest was filed challenging the validity of the set-aside based upon the Supreme Court's decision in *Adarand*.⁹⁰

Similarly, the second bid protest filed with the U.S. Army Engineer District, Mobile, challenged the validity of a solicitation issued as a set-aside for the construction of an aircraft parking apron in Florida with an estimated cost of \$7.5 million.⁹¹ In both of these pre-set-aside suspension cases, the Corps' Divisions concluded that each respective contracting officer reasonably followed the rule of two.⁹²

The above decisions ultimately concluded that *Adarand* was not clear judicial precedent with respect to the unconstitutionality of the

85. *Adarand Constructors, Inc. v. Peña*, 115 S. Ct. 2097, 2102-05 (1995). Members of certain minority groups are presumed to be disadvantaged, but that presumption is rebuttable if the disadvantage does not in fact exist. See 15 U.S.C. § 637(6)(C) (1988).

86. Memorandum from Danielle Conway-Jones to Donald Remy, Assistant General Counsel of the Army (June 26, 1995) (on file with author).

87. *Elrich Contracting, Inc.*, U.S. Army Engineer Division, North Atlantic ("NAD") Docket No. 95-007-P, ¶ 1 (Aug. 25, 1995) (unpublished pre-award agency protest).

88. *Id.* ¶ 2.

89. *Id.* ¶ 3.

90. *Id.* ¶ 6.

91. *Greenhut Constr. Co., Inc. et al.*, U.S. Army Engineer Division, South Atlantic ("SAD") Docket No. 95-7-P, ¶ 1 (Aug. 1, 1995) (unpublished agency protest).

92. *Id.* ¶ 15; *Elrich Contracting Inc.*, NAD Docket No. 95-007-P, ¶ 17.

DoD's SDB set-aside program.⁹³ In light of the Comptroller General's decision in *McCrossan Construction*,⁹⁴ contractors who would otherwise seek relief from the General Accounting Office ("GAO") upon perceiving an apparent agency violation of procurement statutes or regulations, are no longer filing bid protests with this forum. The *McCrossan* decision informs contractors that the GAO will not decide whether an agency's actions are unconstitutional because such constitutional issues are matters for the court to decide.⁹⁵ Thus, until a court of competent jurisdiction determines that race-based federal affirmative action programs are unconstitutional, the GAO will not hear such challenges.

Unfortunately, DoD has been placed in the precarious situation of defending its set-aside programs in cases initiated prior to its decision to suspend its set-aside regulations. Furthermore, now that DoD has suspended its regulations without providing for public comment in accordance with federal agency notice procedures,⁹⁶ the Department has opened the door for administrative challenges from SDBs that have been directly affected by the suspension.

One commentator has stated that *Adarand* "is almost certain to have a chilling effect, [b]ut in the long run, the results will be 'a mixed bag,' with some wins and some losses, depending on the particular facts of each case and the particular viewpoint of the individual judges who hear the cases."⁹⁷ DoD's response to *Adarand* demonstrates that it does not intend to share in the "mixed bag" of wins and losses, rather, by announcing the suspension of its SDB set-aside regulations, DoD chose not to take that battle to federal court. DoD has deemed it more prudent to provide its contracting officers with general policy guidelines.⁹⁸ For instance, the Deputy Secretary of Defense has requested that contracting officials "make participation of SDBs in [] contracting and subcontracting programs a number one priority and redouble efforts to achieve and exceed past levels of SDB participation."⁹⁹

93. *Id.*

94. *C.S. McCrosson Constr., Inc.*, B-259225, Mar. 16, 1995, 95-1 CPD ¶ 146.

95. *Id.* at 4.

96. See *Kaminski Memorandum*, *supra* note 83 (waiving the notice requirements of the Office of Federal Procurement Policy Act because action to take account of the *Adarand* decision was "urgent and compelling").

97. Kenneth Jost, *After Adarand*, 81 A.B.A. J. 70 (1995).

98. See *Kaminski Memorandum*, *supra* note 83.

99. See Memorandum from Deputy Secretary of Defense to Secretaries of the Military Departments, Directors of the Defense Agencies (Oct. 23, 1995) (on file with author).

As is evidenced by DoD's suspension of its set-aside program, the Supreme Court's decision in *Adarand* has significantly and unalterably affected a major vehicle used by SDBs to gain equitable access to DoD's procurement system. Despite this blow, Congress, DoD, and other agencies must now either look to other means of justifying present remedial affirmative action programs or must begin placing greater emphasis on other DoD and government programs that are not race-based. An optimal alternative is the use of race-neutral measures which concentrate on increasing the national defense industrial base by cultivating small businesses crippled by economic disadvantage.

IV. USE OF DISPARITY STUDIES TO SUPPORT THE 1207 PROGRAM

Unfortunately, as demonstrated above, Congress did not anticipate the need to prepare specific studies to support the determination that race and gender discrimination permeated the defense procurement system and the private defense industry. Given the immediate need to seek and obtain remedies for past discrimination in defense procurement, Congress relied upon only a few studies and anecdotal evidence of discrimination when enacting the 1207 program.¹⁰⁰ Therefore, had Congress envisioned the aftermath caused by *Adarand*, presumably it would have taken steps to fully document the past discrimination and the necessity of race-conscious federal affirmative action programs.

Presently, DoD, like Congress and other federal agencies, must decide the importance of its SDB set-aside program. If DoD should decide to resurrect its SDB set-aside regulations or some modified version of the program, it will have to demonstrate that these programs are narrowly tailored to achieve a compelling government interest—namely, accounting for the current passive discrimination in the defense procurement industry, in order to justify setting aside acquisitions for exclusive small disadvantaged business participation and to pass constitutional muster under the strict scrutiny standard of review.

The method suggested to satisfy the compelling government interest prong of the strict scrutiny standard is the compilation of dispar-

100. See *Drake Memorandum*, *supra* note 62, at 19-28.

ity studies or factual predicate studies.¹⁰¹ These studies attempt to demonstrate that discrimination in a market area has resulted in the underutilization of minority-owned firms, thereby necessitating the use of a race-conscious affirmative action program to remedy that discrimination.¹⁰² The methodology of a disparity study may follow the guidelines established in *City of Richmond v. J.A. Croson Co.*¹⁰³ In *Croson*, the Supreme Court held that an inference of discrimination in an entity's market area may be drawn from a significant statistical disparity between the percentage of minority businesses utilized as prime contractors, and the percentage of available and responsible minority firms in the market area that are capable and willing to perform the required work.¹⁰⁴ Statistical findings are often accompanied by anecdotal evidence,¹⁰⁵ which, in narrative form, helps to explain routine practices of both passive and active discrimination that result in the exclusion of minority-owned businesses from contracting opportunities.¹⁰⁶

Although the task of compiling the necessary statistics to measure the disparity between the percentage of SDB utilization and SDB availability in defense contracting may seem herculean, present technology provides the government and private industry with innovative tools to assist them in the collection of this data. In addition, the short-lived existence of DoD's rule of two regulations and policies also provides a basis upon which to measure the utilization of SDBs in government contracting. For instance, DoD's eight years of experience with the rule of two program should yield sufficient data regarding the effectiveness of this program in contributing to the attainment of the statutorily prescribed five percent goal of minority participation in government contracting. The statistics gathered over the eight-year life of DoD's rule-of-two program can also be used to detect those industries in a particular market area where minority firms have been

101. See *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989).

102. Disparity Study Final Report from Mason Tillman Assoc., Ltd. to Alameda County Transportation Authority (June 1994) (on file with Alameda County Transportation Authority) [hereinafter *Disparity Study*].

103. *Croson*, 488 U.S. at 469-504.

104. *Id.* at 501.

105. Anecdotal evidence includes the following: SDB's inability to obtain contracts for private sector work; existence of an "old boy's network;" SDB denied award of contract, despite status as low, responsive, and responsible bidder; disqualification of SDB as nonresponsible, but later determined to be responsible; and SDBs being discouraged from participating in competition. See *Disparity Study*, *supra* note 102, at 3-4, 5-6.

106. *Id.* at 3.

unable to make inroads. DoD could then determine which industries are prone to greater levels of disparity between SDB utilization and SDB availability. Finally, based upon the information received from disparity studies, DoD could establish time parameters for the application of the rule-of-two program in those industries where minority firm underutilization has been demonstrated.

A. Alternatives to Race-Based Set-Asides

DoD has determined that in taking account of the Supreme Court's decision in *Adarand*, its SDB set-aside regulations are not likely to withstand review under the strict scrutiny standard.¹⁰⁷ Therefore, it is incumbent upon DoD to determine other options that will prevent the demise of SDB contractors in the defense industrial base. DoD has the option of reviving its labor surplus area ("LSA") set-aside program or tailoring their existing programs such that they provide special treatment to businesses located in economically distressed areas.

The purpose of the LSA set-aside program is to increase the involvement of contractors in the federal procurement process who have typically suffered economically in the American business environment as a result of their physical location.¹⁰⁸ Because eligibility requirements for this program are based solely on economics, the existence of potentially unconstitutional racial preferences is not implicated. The Federal Acquisition Regulation ("FAR") defines a "labor surplus area" as a geographical area identified by the Department of Labor that has "concentrated unemployment or underemployment or an area of labor surplus."¹⁰⁹ Furthermore, the FAR defines a "labor surplus area concern" as one that "together with its first tier subcontractors will perform substantially in labor surplus areas."¹¹⁰ Performance is "substantially in labor surplus areas if the costs incurred under the contract on account of manufacturing, production, or performance of appropriate services in labor surplus areas exceed fifty percent of the contract price."¹¹¹

If properly reconstructed, the LSA set-aside program could realistically be instrumental in retaining SDBs in the defense industrial

107. See *Kaminski Memorandum*, *supra* note 83.

108. 48 C.F.R. §§ 20.000-20.102 (1995).

109. 48 C.F.R. § 20.101 (1995).

110. *Id.*

111. *Id.*

base that are otherwise too large for SBA's section 8(a) program but too small to compete effectively against small businesses in their set-asides or against large businesses under full and open competition. While the LSA set-aside program would not retain all SDBs, it could, for the immediate future, provide an objective rather than a discretionary means of involving those businesses located in economically distressed areas in the defense industrial base. Although there are no concrete numbers to define the makeup of the businesses located in labor surplus areas, DoD can be confident that through implementing the LSA set-asides, small disadvantaged businesses will have an opportunity to receive an increased number of government contracts.

In addition, DoD has the opportunity to place greater emphasis on its mentor-protége, advance payments, outreach, and technical assistance programs. These programs, with the exception of the mentor-protége program,¹¹² are race-neutral measures that can be employed to assist SDBs in retaining a foothold in DoD's procurement system. Likewise, Congress can enact race-neutral legislation to provide non-traditional firms with access to capital and bonding assistance. These race-neutral incentive measures can be used to attract minorities, women, and economically disadvantaged entrepreneurs who are otherwise qualified to participate in DoD construction and procurement.

V. CONCLUSION

Aside from the budget debates, the question pervading the political arena has been whether race-based affirmative action programs have outlived their usefulness. As demonstrated above, affirmative action programs extend further than equal opportunity in employment and equal access to education. Affirmative action programs in federal government contracting have provided contract opportunities to small disadvantaged businesses who otherwise would not have been included in the federal government's industrial base. Specifically, the

112. See *Defense Contracting: Implementation of the Pilot Mentor-Protége Program*, General Accounting Office Report No. NSIAD-94-101 (Feb. 1994). The mentor-protége program provides incentives for prime contractors to increase SDB participation in DoD subcontracting and authorizes a number of other forms of developmental assistance to the protégé by its mentor. *Id.* at 1-2. Incentives can be cash, but more often, incentives take the form of credit towards SDB subcontracting goals. *Id.* at 2. The primary goal of the program is to foster business development of any individual who can prove social or economic disadvantage or of individuals presumed to be disadvantaged. *Id.* at 1. The mentor-protége program increases the capabilities of protégé firms to participate as subcontractors and suppliers in DoD contracts, other government contracts, and commercial contracts. *Id.*

rule-of-two program has made competition and economic success a reality for the majority of the DoD's SDB contractors. The objective elements of the rule-of-two program provided contracting officials with clear, strict, and unambiguous guidelines for seeking and attaining competitive SDB involvement in the defense industrial base. Unfortunately, with the suspension of the rule-of-two program, DoD and SDB defense contractors will have to rely on myriad discretionary procedures to sustain SDB involvement in defense contracting.

This change from objective standards to discretionary procedures will likely result in stark variations in contract awards. To avoid the uncertainties caused by discretionary procedures used to encourage SDB participation, DoD must continue to study and implement new measures to assure contract award consistency throughout the defense procurement community. Ultimately, DoD must either decide whether it can successfully draft a version of the rule-of-two program which could withstand judicial review under the strict scrutiny standard, or determine that race-neutral affirmative action programs are the only legal and defensible tools to remedy the social and economic disadvantage that has plagued minority contractors in the past.