Court of Appeals Upholds Illinois Department of Transportation's DBE Program

By
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In a unanimous opinion, the Seventh Circuit Court of Appeals on February 7, 2007 affirmed the trial court's ruling that the Illinois Department of Transportation's (IDOT) Disadvantaged Business Enterprise (DBE) Plan is constitutional.[1] IDOT had a compelling interest in remedying discrimination in the marketplace for federally funded highway contracts, and its Federal Fiscal Year 2005 DBE Plan was narrowly tailored to that interest and in conformance with the DBE Program regulations.[2]

Facts and Procedural History

Northern Contracting, Inc. (NCI), a guardrail construction and landscaping firm, challenged IDOT's DBE Plan in 2000, alleging that the DBE Program regulations are facially unconstitutional and that IDOT's Plan was unconstitutional as applied under those regulations.[3] Following every court that has considered the question, the district court first granted summary judgment in favor of the U.S. Department of Transportation on the issue of whether the regulations met strict constitutional scrutiny on their face.[4] In adopting the revised DBE Program in 1998, Congress had ample statistical and anecdotal evidence of discrimination in the transportation industry nationwide.[5] Relevant evidence before Congress included:

- Disparities between the earnings of minority-owned firms and similarly situated white-owned firms;

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[1] *Northern Contracting, Inc. v. Illinois Department of Transportation*, 473 F.3d 715 (7th Cir. 2007).
[2] 49 C.F.R. Part 26.
[3] *See Adarand Constructors v. Pena*, 515 U.S. 200, 235, 115 S. Ct. 2097, 132 L. Ed. 2d 158 (1995). In order to survive strict scrutiny, a government program that uses racial classifications must be narrowly tailored to serve a compelling governmental interest.
[4] *Northern Contracting, Inc. v. Illinois Department of Transportation*, 2004 U.S. Dist. LEXIS, 3226 (N.D. Ill., Mar. 3, 2004); *see Western Sates Paving Co. v. Washington State Department of Transportation,* 407 F.3d 983 (9th Cir. 2005), *cert. denied*, 126 S. Ct. 1332, 164 L. Ed. 2d 49 (Feb. 21, 2006); *Sherbrooke Turf, Inc. v. Minnesota Department of Transportation*, 345 F.3d. 964 (8th Cir. 2003), *cert. denied*, 541 U.S. 1041, 124 S. Ct. 2158, 158 L. Ed. 2d 729 (2004).
[5] Transportation Equity Act for the 21st Century ("TEA-21"), Pub. L. No. 105-178, § 1101(b)(1), 112 Stat. 107, 113 (1998).

- Disparities in commercial loan denial rates between black business owners compared to similarly situated white business owners;

- The large and rapid decline in minorities' participation in the construction industry when affirmative action programs were struck down or abandoned; and

- Various types of overt and institutional discrimination by prime contractors, trade unions, business networks, suppliers and sureties against minority contractors.[6]

The regulations on their face also satisfied the narrow tailoring requirement. According to the Seventh Circuit, "Overall, TEA-21 and its implementing regulations possess all the features of a narrowly tailored remedial program."[7] Specifically,

- TEA-21 and 49 C.F.R. Part 26 require that the maximum feasible portion of the recipient's DBE goal be achieved through race-neutral means;

- The Program is flexible; there are no quotas and contractors' good faith efforts to meet DBE contract goals are recognized;

- The statute is subject to periodic review and reauthorization, and grantees must tailor their goals to their specific marketplaces;

- The burden on non-DBEs is permissible and minimal: even white males can qualify as DBEs if they can prove they suffer social disadvantage; and

- The personal net worth limit ensures that "wealthy" minorities do not receive a windfall.

However, the court held that there were genuine issues of material fact that precluded the grant of summary judgment to either party, and a trial was held in October 2005.[8,9] The judge concluded that IDOT's DBE program was narrowly tailored to the compelling interest identified by Congress. IDOT had commissioned a study to meet Part 26's requirements from Dr. Jon Wainwright of NERA Economic Consulting, Inc., an international firm of consulting economists. The IDOT Study included a detailed custom census of the availability of DBEs in IDOT's geographic and procurement marketplaces, weighted by the location of

[6] *See Western States*, 407 F.3d at 992-93.
[7] *Id*. at 995.
[8] The court reviewed IDOT's Federal Fiscal Year 2005 DBE Plan, rather than the 2000 Plan, because NCI sought only prospective relief, not monetary damages.
[9] The authors served as IDOT's testifying experts at trial.

IDOT's contractors and the types of goods and services IDOT procures. NERA estimated that DBEs comprised 22.77 percent of IDOT's available firms.[10] The IDOT Study next examined whether and to what extent there were large and statistically significant disparities between the rates at which DBEs form businesses relative to similarly situated white men, and the relative earnings of those businesses. Controlling for numerous variables such as the age and education level of the owner, the Study found that in a race- and gender-neutral marketplace the availability of DBEs would be approximately 20.8 percent higher, for an estimate of DBE availability "but for" discrimination of 27.51 percent.

In addition to the IDOT Study by NERA, the court also relied upon:

- A NERA Study conducted for Metra, the Chicago commuter rail agency;

- Expert reports relied upon by an earlier trial court in finding that the City of Chicago had a compelling interest in its minority and women business program for construction contracts;[11]

- Expert reports and anecdotal testimony presented to the Chicago City Council in support of the City's revised M/WBE Program ordinance in 2004;

- Anecdotal evidence gathered at IDOT's public hearings on the DBE program;

- Data on DBE involvement in construction projects in markets without DBE goals; and

- IDOT's "zero goal" experiment, where DBEs received approximately 1.5% of the total value of the contracts. This was designed to test the results of "race-neutral" contracting policies, that is, the utilization of DBEs on contracts without goals, which several courts have held to be highly relevant and probative of the continuing need for race-conscious remedies.

"Also of note, IDOT examined the system utilized by the Illinois State Toll Highway Authority, which does not receive federal funding; though the Tollway has a DBE goal of 15%, this goal is completely voluntary -- the average DBE usage rate in 2002 and 2003 was 1.6%. On the basis of all of this data, IDOT adopted 22.77% as its Fiscal Year 2005 DBE goal."[12]

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[10] This baseline figure of DBE availability is the "step 1" estimate recipients must make pursuant to 49 CFR §26.45(c).
[11] *Builders Association of Greater Chicago v. Chicago*, 298 F. Supp. 2d 725 (N.D. Ill. 2003).
[12] 473 F.3d at 719.

Likewise, the trial court held that IDOT had properly considered the effects of the ongoing DBE program and discrimination in narrowly tailoring its goal.[13] IDOT's broad array of race-neutral measures met the regulatory requirement that recipients use such measures to the maximum feasible extent in meeting their DBE goals.

Appellate Decision

On appeal, NCI challenged only IDOT's implementation of Part 26, not the holding that the regulations were facially constitutional. Nevertheless, the court thought

> it prudent to briefly address the compelling interest aspect of the strict scrutiny analysis and we agree with the district court that IDOT has satisfied its burden here. As a state entity implementing a congressionally mandated program, IDOT relies primarily on the federal government's compelling interest in remedying the effects of past discrimination in the national construction market… In the post-*Adarand* era, two other circuits have considered the question of whether a state may properly rely on the federal government's compelling interest in implementing a local DBE plan for highway construction contracting, and both have concluded that a state may properly do so.[14]… NCI has not articulated any reason for us to break ranks with our sister circuits. Indeed, prior to the Supreme Court's decision in *Adarand*, we considered the question of whether the federal government's interest in remedying discrimination in highway construction contracting provided sufficient justification for the state to engage in a federally mandated DBE program, and we concluded that it did.[15]

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[13] This is the “step 2” determination of whether to adjust the “step 1” estimate recipients must make pursuant to 49 C.F.R. §26.45(d).

[14] *See Western States,* 407 F.3d at 997 ("When Congress enacted TEA-21, it identified a compelling nationwide interest in remedying discrimination in the transportation contracting industry. Even if such discrimination does not exist in Washington, the State's implementation of TEA-21 nevertheless rests upon the compelling interest identified by Congress."); *Sherbrooke,* 345 F.3d at 970 ("When the program is federal, the inquiry is (at least usually) national in scope. If Congress or the federal agency acted for a proper purpose and with a strong basis in the evidence, the program has the requisite compelling government interest nationwide, even if the evidence did not come from or apply to every State or locale in the Nation.").

[15] *See Milwaukee County Pavers Ass'n v. Fiedler*, 922 F.2d 419, 423 (7th Cir. 1991) ("Insofar as the state is merely complying with federal law it is acting as the agent of the federal government and is no more subject to being enjoined on equal protection grounds than the federal civil servants who drafted the regulations.... If the state does exactly what the statute expects it to do, and the statute is conceded for purposes of the litigation to be constitutional, we do not see how the state can be thought to have violated the Constitution."); *see also Tennessee Asphalt Co. v. Farris,* 942 F.2d 969, 975 (6th Cir. 1991).

Turning to the narrow tailoring requirement of strict scrutiny, the court affirmed that IDOT had not exceeded its grant of federal authority under Part 26. None of NCI's attacks on IDOT's implementation of the regulatory requirements was persuasive.

First, NCI's argument that the federal DBE program should be subject to the identical analysis the Seventh Circuit had applied to a local affirmative action contracting program[16] amounted to an attempt to collaterally attack the judgment in favor of USDOT that it chose not to appeal.

> IDOT here is acting as an instrument of federal policy and NCI cannot collaterally attack the federal regulations through a challenge to IDOT's program. The gravamen of NCI's first noncompliance argument is that IDOT miscalculated the number of DBEs that were "ready, willing, and able" by utilizing the NERA custom census instead of a simple count of the number of registered and prequalified DBEs under Illinois Law. But as the district court correctly observed, NCI has pointed to nothing in the federal regulations indicating that a recipient must so narrowly define the scope of ready, willing, and available firms. The NERA custom census reflects an attempt by IDOT to arrive at more accurate numbers than would be possible through use of just the list. Indeed, the method used here by NERA is the very methodology that was used by the Minnesota Department of Transportation in the unsuccessful challenge to its program in *Sherbrooke*…. Moreover, it seems illogical that the regulations would refer to five different methods of calculating the relative availability of DBEs if any method other than strict reference to the list of registered and prequalified DBEs would be considered inappropriate.[17]

NCI's second objection, that IDOT did not properly adjust its goal based on local market conditions, also failed.

> 49 C.F.R. § 26.45(d) does not require any adjustments to the base figure after the initial calculation, but simply provides recipients with

[16] *Builders Association of Greater Chi. v. County of Cook*, 256 F. 3d 642 (7th Cir.2000).
[17] *Id*. at 722-23. The method that NCI argued for was essentially the "bidders list" method that the regulations list as one possible method of calculating relative availability. *See* 49 C.F.R. § 26.45(c)(2).

> authority to make such adjustments if necessary. NCI's argument is that IDOT essentially abused its discretion under this regulation by failing to separate prime contractor availability from subcontractor availability. However, NCI has not identified any aspect of the regulations that requires such separation. Indeed, as the district court observed, the regulations require the local goal to be focused on overall DBE participation in the recipient's DOT-assisted contracts. *See* 49 C.F.R. § 26.45(a)(1). It would make little sense to separate prime contractor and subcontractor availability as suggested by NCI when DBEs will also compete for prime contracts and any success will be reflected in the recipient's calculation of success in meeting the overall goal.[18]

Finally, NCI's argument that IDOT failed to meet the maximum feasible portion of its overall goal through race-neutral measures was "meritless."[19] NCI argued that IDOT should have considered past levels of DBE participation when DBEs were awarded subcontracts by prime contractors on goals projects where the prime contractor "did not consider DBE status."[20] First, the regulations do not require a grantee to search for such information to calculate past race-neutral attainment. IDOT had no such evidence and NCI produced none proving that IDOT's past participation figure was invalid. While IDOT was required to use strictly race-neutral means (*i.e.*, no contract goals) if it projected that it could achieve its goal that way, IDOT's projection yielded no such conclusion. "In any case, the record makes clear that IDOT uses nearly all of the methods described in § 26.51(b) to maximize the portion of the goal that will be achieved through race-neutral means."[21]

Implications

This opinion continues the unbroken line of cases finding that the legislation authorizing the DBE program and the implementing regulations meet strict constitutional scrutiny. In view of the unanimous rejection of the argument that the DBE program *per se* fails strict scrutiny, it is likely that the focus of anti-affirmative action litigation will shift to grantees' (too often *pro forma*) adoption of annual goals. Thus, recipients must carefully consider their goal setting methodologies to ensure that the approach adopted is based on sound science. While the exact types of evidence necessary to survive judicial review may not be conclusively established, what is certain is that simply filling in the USDOT Sample DBE Plan will not be sufficient.

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[18] 473 F.3d at 723.
[19] *Id*.
[20] 49 CFR §26.51(a).
[21] *Id*. at 724.

Both the *NCI* and *Western States* opinions make this clear. *Western States* suggests that evidence of discrimination in the local jurisdiction is required for narrow tailoring, and *NCI* focused on how IDOT met Part 26's directive that it consider such evidence.[22] While it could perhaps be argued that these opinions are in conflict,[23] Part 26 explicitly adopts the constitutional standard as the regulatory mandate. A recipient's compliance with the narrowly tailored regulations is compliance with strict scrutiny. Thus, the difference in language between the courts is a distinction without effect. As a practical matter, IDOT presented comprehensive statistical and anecdotal evidence that discrimination continues to effect all presumptively socially disadvantaged groups in its market for federally-assisted contracts, and that without the use of narrowly tailored contract goals, the Department would be unable to achieve a level playing field for all firms. This is precisely the goal setting methodology that has been upheld by the Seventh and Eighth Circuits and cited with approval by the Ninth Circuit.

[22] 49 CFR §26.45(d);

[23] The Seventh Circuit rejected the *Sherbrooke* and Western *States'* majority's interpretation of a Seventh Circuit decision that held that a recipient is insulated from an "as applied" challenge that amounts to a collateral attack on the federal legislation. Although the prior DBE authorizing statute had set a mandatory ten percent setaside and TEA-21 makes the national goal merely aspirational, the Seventh Circuit was "not convinced" that this difference amounted to a change in the analytic framework.