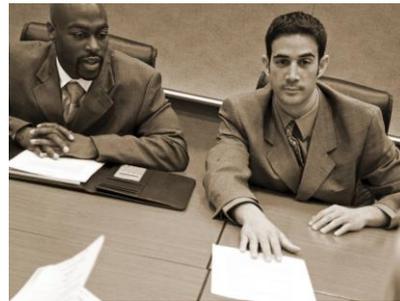




# Public Contracting in the Proposition 209 Era:

## Options for Preventing Discrimination and Supporting Minority- and Women-Owned Businesses

January 2012



## BACKGROUND

**The Insight Center for Community Economic Development** is a national research, consulting, and legal organization dedicated to building economic health and opportunity in vulnerable communities. The Insight Center works in collaboration with foundations, nonprofits, educational institutions, and businesses to develop, strengthen, and promote programs and public policy that:

- Lead to good jobs—jobs that pay enough to support a family and offer benefits and the opportunity to advance;
- Strengthen early care and education (ECE) systems so that children can thrive and parents can work or go to school; and
- Enable people and communities to build assets and reduce bad debt.

The Insight Center's Inclusive Business Initiative promotes policies and programs that strengthen minority and women business enterprises and microenterprises.

For more information on the Insight Center, visit our website at [www.insightcced.org](http://www.insightcced.org).

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# TABLE OF CONTENTS

Introduction .....	1
Legal Overview .....	2
Legal Analysis of Program Elements.....	7
Category 1: Permitted under Proposition 209.....	7
Category 2: Possibly Permitted by Proposition 209.....	19
Category 3: Generally Prohibited by Proposition 209.....	20
Conclusion .....	22
Appendix A: Examples of public entities operating different types of programs .....	23

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## Introduction

Proposition 209, which prohibits preferential treatment in public employment, education, or contracting on the basis of race, gender, or national origin, was adopted by California voters in November 1996. Since then, government entities in California have eliminated or modified their contracting affirmative action programs, in response to real or perceived limitations imposed by the new law. However, there have been surprisingly few legal decisions regarding the parameters of Proposition 209, leaving some uncertainty about the range of measures available to government entities to ensure diversity, promote competitiveness, and avoid discrimination in public contracting.

With support from the California Dream Fund, the Insight Center has prepared this briefing paper in order to provide practical advice to government entities in California, with regard to their ability to undertake affirmative action efforts and related initiatives in public contracting. This brief will provide an overview of relevant law, indicating areas of certainty and uncertainty; and will describe and evaluate the wide range of options available to government entities in this area.<sup>1</sup> Case law interpreting Proposition 209, and well-established principles of federal and state antidiscrimination law, establish that public entities in California retain a range of viable options to prevent current and future discrimination in public contracting, ameliorate the effects of past discrimination, and provide crucial support and opportunities to minority- and woman-owned businesses.<sup>2</sup>

A cautionary note: While this brief sets forth a great number of possible measures that comply with Proposition 209, the only method actually proven to advance the ends described above is a program of enforceable Minority and Women Business Enterprise (MWBE) contracting goals – precisely the approach that is generally prohibited by Proposition 209, according to the California Supreme Court. The permissible approaches described in this brief are promising, and with aggressive and creative implementation many prove helpful in assuring fairness in public contracting and addressing the barriers faced by MWBEs – but they should not be taken as a substitute for the more direct affirmative action measures that Proposition 209 generally prohibits. The authors of this brief and the Advisory Committee members strongly support repeal of Proposition 209, in order to allow a full range of antidiscrimination and affirmative action efforts in this area. In the meantime, however, this brief presents a range of legal options that are worth considering by California jurisdictions subject to Proposition 209.

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<sup>1</sup> This brief represents the views of the Insight Center and the authors; Advisory Committee members reviewed the brief, provided comments and feedback, and support the overall perspective of the brief, but may diverge on particular points and legal interpretations. This brief should not be taken as representing the opinion of each advisory committee member on each point expressed within.

<sup>2</sup> For information on the continuing need for efforts to assist MWBEs, see *Free to Compete? Measuring the Impact of Proposition 209 on Minority Business Enterprise*, Discrimination Research Center, 2006; *A Vision Fulfilled? The Impact of Proposition 209 on Equal Opportunity for Women Business Enterprises*, Thelton E. Henderson Center for Social Justice, 2007; *The Path to Equal Opportunity: An Investigation of Best Practices in Employment and Contracting*, Thelton E. Henderson Center for Social Justice. See also recent judicial opinions discussing disparity studies, e.g., *H.B. Rowe, Inc. v. Tippett*, 615 F.3d 233 (4<sup>th</sup> Cir. 2010); and numerous recent disparity studies, available from various sources. In addition, in 2009, the U.S. House of Representatives' Committee on Transportation and Infrastructure received extensive evidence on continuing patterns of discrimination and underutilization of MWBEs. See committee report, "The Department of Transportation's Disadvantaged Business Enterprise Program," 111-18, U.S. House of Representatives' Transportation and Infrastructure Committee, Committee (2009).

## Legal Overview

Proposition 209 was adopted by California voters in November, 1996 through the initiative process, adding a new Section 31 to Article 1 of the California Constitution. The section's central provision states that "The state shall not discriminate against, or grant preferential treatment to, any individual or group on the basis of race, sex, color, ethnicity, or national origin in the operation of public employment, public education, or public contracting."<sup>3</sup> Proposition 209 limits the flexibility of public entities to take affirmative action measures to prevent current race and gender discrimination, and to address residual effects of past discrimination. As discussed below, however, these limits are not absolute: in many circumstances, including where federal funding is involved, public entities may be permitted or perhaps even required to take affirmative action, despite Proposition 209.

### Legal Backdrop Prior to Proposition 209

Prior to the passage of Proposition 209, the primary limitation on California state and local governments' use of affirmative action in public contracting was the equal protection clause of the U.S. Constitution, as interpreted in *City of Richmond v. J.A. Croson Company*.<sup>4</sup> *Croson* diverged from prior Supreme Court case law in holding that affirmative action measures, like traditional race- and gender discrimination, should be subject to "strict scrutiny," the most demanding standard under equal protection jurisprudence. This approach, at a basic level equating remedial affirmative action programs with invidious race- and gender discrimination against minorities and women, has come under substantial criticism, but it remains the law.

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<sup>3</sup> Full text of the article is as follows:

*SEC. 31. (a) The state shall not discriminate against, or grant preferential treatment to, any individual or group on the basis of race, sex, color, ethnicity, or national origin in the operation of public employment, public education, or public contracting.*

*(b) This section shall apply only to action taken after the section's effective date.*

*(c) Nothing in this section shall be interpreted as prohibiting bona fide qualifications based on sex which are reasonably necessary to the normal operation of public employment, public education, or public contracting.*

*(d) Nothing in this section shall be interpreted as invalidating any court order or consent decree which is in force as of the effective date of this section.*

*(e) Nothing in this section shall be interpreted as prohibiting action which must be taken to establish or maintain eligibility for any federal program, where ineligibility would result in a loss of federal funds to the state.*

*(f) For the purposes of this section, "state" shall include, but not necessarily be limited to, the state itself, any city, county, city and county, public university system, including the University of California, community college district, school district, special district, or any other political subdivision or governmental instrumentality of or within the state.*

*(g) The remedies available for violations of this section shall be the same, regardless of the injured party's race, sex, color, ethnicity, or national origin, as are otherwise available for violations of then-existing California antidiscrimination law.*

*(h) This section shall be self-executing. If any part or parts of this section are found to be in conflict with federal law or the United States Constitution, the section shall be implemented to the maximum extent that federal law and the United States Constitution permit. Any provision held invalid shall be severable from the remaining portions of this section.*

<sup>4</sup> 488 U.S. 469, 109 S. Ct. 706,102 (1989).

*Croson* and its progeny require state and local government entities that wish to use race-based affirmative action measures to demonstrate that the proposed measures serve a compelling governmental interest, and are narrowly tailored to advance that interest, as with other governmental actions subject to strict scrutiny. Avoiding and remedying race discrimination by government actors, and avoiding public subsidization of private racial discrimination, are clearly established as compelling governmental interests, satisfying the first prong of the *Croson* analysis; and well-designed affirmative action programs, tailored to evidence of present or past discrimination, can satisfy the second prong as well. Thorough “disparity studies” of contract awards in a jurisdiction over time can demonstrate patterns of discrimination, providing the “strong basis in evidence”

needed to establish the need for, and defend the use of, affirmative action programs under the equal protection clause. Multiple judicial opinions have wrestled with the question of what types of data will establish the factual predicate for permissible affirmative action under *Croson*.<sup>5</sup>

*Croson*, therefore, left leeway for local governments to utilize affirmative action programs in public contracting, under certain circumstances.<sup>6</sup> While *Croson* requires substantial evidence of discrimination and careful program design, it does recognize the legitimacy and value of affirmative action as a tool to break down patterns of discrimination in public contracting.

In addition, several aspects of federal law actually *require* affirmative action in certain circumstances, as described below. Furthermore, affirmative action steps are a well-established remedy applied to public entities engaging in discrimination in violation of federal law, with such steps either taken voluntarily or imposed or negotiated in resolution of litigation. The implications of the continued existence of these legal duties in the Proposition 209 era are discussed below.

Before the passage of Proposition 209, state law went no further than federal law in imposing limitations on local government’s use of affirmative action as an antidiscrimination tool. Certain competitive bidding provisions have at times been interpreted as limiting the ability of local governments to impose affirmative action requirements, but the leading case in this area, *Domar Electric*, rejected this type of claim, based on

#### **Clarification of Terms**

Following are plain-language definitions of key certain key terms as they are used in this document.

**Affirmative Action:** explicitly race- or gender-based measures in a public contracting, employment, or education system.

**MWBE:** Shorthand for minority-owned and women-owned business enterprise. This brief uses this term to encompass related terms and categories often treated similarly in affirmative action programs, including ethnicity, national origin, and so forth.

**OBE:** Shorthand for “Other Business Enterprise,” meaning any business that is not an MWBE.

**SBE:** Shorthand for “Small Business Enterprise.”

**Outreach:** a procedural requirement in a public contracting system, related to what businesses *are notified* about contracting or subcontracting opportunities, but *not* directly affecting what businesses are awarded contracts or subcontracts. Outreach measures can be required either of government officials who are awarding prime contracts or service/supply contracts, or of prime contractors, during their subcontract award process.

<sup>5</sup> See, e.g., *H.B. Rowe, Inc. v. Tippett*, 615 F.3d 233 (4<sup>th</sup> Cir. 2010); *Concrete Works of Colorado Inc. v. City and County of Denver*, 321 F.3d 350 (10<sup>th</sup> Cir. 2003); *Coral Constr. Co. v. King County*, 941 F.2d 910, 914 (9<sup>th</sup> Cir. 1991).

<sup>6</sup> For an overview of the case law interpreting and applying *Croson*, see Appendix C to National Cooperative Highway Research Program Report 644, Guidelines for Conducting a Disparity and Availability Study for the Federal DBE Program (available online at [http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp\\_rpt\\_644.pdf](http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp_rpt_644.pdf)).

the competitive bidding clause of the Los Angeles City Charter.<sup>7</sup> California state law prior to Proposition 209 granted state and local entities at least as much leeway in utilizing affirmative action programs as did *Croscon*, leaving the federal equal protection clause as the primary limitation on local governments in this area.

## Passage and Court Interpretation of Proposition 209

Soon after Proposition 209's passage by California voters in November 1996, the U.S. District Court of Northern California enjoined state officials from enforcing the initiative for a period of several months. The injunction was eventually lifted and the district court's opinion overturned by the Ninth Circuit Court of Appeals.<sup>8</sup>

Surprisingly, in the fifteen years since the initiative's passage, there have been only two California Supreme Court cases interpreting the law. While the text of the law itself is simple, the range of policy approaches available to local officials operating contracting systems leads to myriad legal questions in application. This brief evaluates particular policy options below, and Appendix A describes many interesting approaches on the books inside and outside of California. Following is an overview of the issues and holdings in the two California Supreme Court cases interpreting Proposition 209, *Hi-Voltage Wire Works* and *Coral Construction*.

### Hi-Voltage Wire Works v. City of San Jose

In 2000, the California Court decided *Hi-Voltage Wire Works*, the leading decision interpreting Proposition 209.<sup>9</sup> The *Hi-Voltage* court struck down in its entirety the City of San Jose's subcontracting affirmative action program, on the basis of Proposition 209. The court was unanimous in striking down the program, but issued several opinions, including a majority opinion written by Justice Janice Rogers Brown.<sup>10</sup>

San Jose's ordinance at issue established a standard program aimed at avoiding discrimination in subcontracting on large City contracts, requiring prime contractors to demonstrate either utilization of MWBE subcontractors at specified percentages, or good faith efforts to do so. The court evaluated these two options (the "Documentation of Participation" and "Documentation of Outreach" options), and found that they each constituted grants of "preferential treatment" in violation of the new law.<sup>11</sup>

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<sup>7</sup> See *Domar Electric, Inc. v. City of Los Angeles*, 9 Cal. 4th 161 (1995).

<sup>8</sup> Plaintiffs in that litigation raised an equal protection claim against Proposition 209, arguing that the proposition would disadvantage minorities in the state's political process, under the U.S. Supreme Court decisions in *Hunter v. Erickson* (1969) 393 U.S. 385 and *Washington v. Seattle School Dist. No. 1* (1982) 458 U.S. 457 (Seattle). U.S. District Court Judge Thelton Henderson issued a preliminary ruling that the proposition was likely unconstitutional on this basis (*Coalition for Economic Equity v. Wilson*, 946 F.Supp 1480 (N.D. Cal 1996)), but a three-judge panel of the Ninth Circuit overruled this decision, rejecting the *Hunter/Seattle* challenge (*Coalition for Economic Equity v. Wilson*, 110 F.3d 1431 (9<sup>th</sup> Cir. 1997)). The Ninth Circuit denied rehearing *en banc*, and the U.S. Supreme Court denied certiorari. As of this writing, the *Hunter-Seattle* argument is being considered by two federal circuit courts. In July 2011, the Sixth Circuit ruled that Michigan's version of Proposition 209 is unconstitutional under the *Hunter-Seattle* doctrine.

See *Coalition to Defend Affirmative Action v. Regents of the Univ. of Mich.*, 652 F.3d 607 (6th Cir. Mich. 2011). The full Sixth Circuit recently vacated that decision and agreed to rehear the case *en banc*. (*Coalition v. Regents of the Univ. of Mich.*, 2011 U.S. App. LEXIS 18875 (6th Cir., Sept. 9, 2011).) In addition, in a case before the Ninth Circuit, an organizational plaintiff concerned about student body diversity at the University of California has argued that, as applied to the U.C. admissions process, Proposition 209 is unconstitutional under the *Hunter-Seattle* doctrine. See *Coalition to Defend Affirmative Action v. Schwarzenegger*, 2010 U.S. Dist. LEXIS 129736 (N.D. Cal. Dec. 8, 2010), currently on appeal.)

<sup>9</sup> *Hi-Voltage Wire Works, Inc. v. City of San Jose*, 24 Cal. 4th 537 (2000),

<sup>10</sup> Chief Justice George issued a thoughtful opinion concurring in the court's ruling, but sharply criticizing Justice Brown's opinion as excessively inflammatory and political, and unfairly critical of the motives of proponents of affirmative action.

<sup>11</sup> See *Hi-Voltage* at 562.

Of these two options, the outreach option presented a closer question under Proposition 209. The *Hi-Voltage* court ultimately struck down the outreach program, holding that, as structured, the program provided a clear preference to MWBE subcontractors, in violation of Proposition 209.<sup>12</sup> Despite this holding, however, other types of outreach programs almost certainly are permissible under Proposition 209. There are strong arguments that outreach requirements promote competition, bring down public costs, and help avoid discrimination, while allowing a level playing field between subcontractors who are actually bidding on a job. Many types of outreach programs can be sufficiently divorced from the contract award process itself, or sufficiently inclusive, that they may not constitute “preferential treatment” in violation of Proposition 209, as we discuss below. The *Hi-Voltage* decision noted that “Although we find the City’s outreach option unconstitutional under section 31, we acknowledge that outreach may assume many forms, not all of which would be unlawful.”<sup>13</sup>

### **Coral Construction Co. v. City and County of San Francisco**

In 2010, the California Supreme Court decided *Coral Construction, Inc. v. City and County of San Francisco*, the court’s first interpretation of Proposition 209 in the decade since *Hi-Voltage*.<sup>14</sup> The court considered several legal issues related to San Francisco’s “Minority/Women/Local Business Utilization Ordinance,” enacted in 1984 and repeatedly amended and bolstered with updated legislative findings. The version of the ordinance at issue was readopted in 2003, with legislative findings including extensive evidentiary evidence, both statistical and anecdotal, regarding discrimination against MWBEs by both the City and by prime contractors awarded City contracts. The ordinance contains a bid discount program, awarding discounts of 5-10% to MWBE contractors applying for contracts with the City. The ordinance also requires prime contractors on certain City contracts to either achieve specified percentages of MWBE utilization in subcontracting, or to demonstrate good faith efforts to do so. These programs exemplify typical prime contracting and subcontracting affirmative action programs from the pre-209 era, with San Francisco presenting unusually strong legal arguments due the extensive factual record of discrimination that it had compiled.<sup>15</sup>

The court considered and rejected the City’s argument that Proposition 209 on its face violates the federal equal protection clause, under the “political structure doctrine” of the U.S. Supreme Court’s *Hunter/Seattle* line of cases; the court followed the Ninth Circuit’s decision rejecting this theory in *Coalition for Economic Equity v. Wilson*. The court also rejected the City’s argument that its program was required by various federal regulations that impose conditions on recipients of federal funding. The court held that unless the federal regulations at issue specifically required race-based affirmative action – rather than merely permitting or authorizing such action among a range of antidiscrimination measures – the California funding recipient’s affirmative action efforts remained voluntary, and thus prohibited by Proposition 209.<sup>16</sup>

However, the court validated and endorsed San Francisco’s argument that in certain cases the federal equal protection clause actually *requires* public entities to undertake affirmative action measures.<sup>17</sup> The court remanded the case to Superior Court for a hearing on whether the factual evidence of discrimination that San

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<sup>12</sup> *Hi-Voltage* at 562.

<sup>13</sup> *Hi-Voltage* at 565.

<sup>14</sup> *Coral Construction, Inc. v. City and County of San Francisco*, 50 Cal.4th 315 (2010).

<sup>15</sup> The City’s review of its contracting practices found a range of practices and statistical patterns indicating active race and gender discrimination by both City actors and prime contractors. The City identified a range of practices that either constituted active discrimination or unnecessarily impacted MWBEs – “old-boy” networks, unnecessary contracting requirements like delays in payments and excessive bonding standards, and so forth.

<sup>16</sup> *Coral Construction* at 335.

<sup>17</sup> *Id.* at 335-338.

Francisco had put forth was sufficient to justify the City's program as essentially a required measure to avoid violation federal law, and thereby insulate it from challenge based on Proposition 209. As of this writing, the case is still on remand.

The court's holding contains two crucial implications: *First, federal law can at times require a preferential, race-based bid-discounting and subcontractor utilization program; and, second, evidence put forward by San Francisco is of the type that might establish such a requirement.* While the court did not itself review the sufficiency of San Francisco's evidence for this purpose, it did provide some guidance to lower courts in evaluating evidence of discrimination in this context, as discussed below.<sup>18</sup> While standards for establishment and defense of an affirmative action program under this theory are strict, it is a viable approach where the facts warrant it.

### Lower-Court Interpretations

Together, the *Hi-Voltage* and *Coral Construction* opinions constitute the entirety of the California Supreme Court's jurisprudence with regard to Proposition 209. Several lower court decisions illuminate additional issues and apply the early *Hi-Voltage* case, but most of these cases are outside the public contracting context; many explore particularly challenging issues in applying Proposition 209 in the educational context.

Although generally arising outside the public contracting context, these lower-court cases establish one important principle: *Proposition 209 does not prohibit all governmental action that takes race and gender into account; i.e., not all such action constitutes preferential treatment.*

In particular, California courts have established that the following types of governmental action do not constitute preferential treatment under Proposition 209:

- Emphasizing the value of diversity and avoidance of discrimination;<sup>19</sup>
- Collection and reporting of data regarding utilization of MWBEs in an entity's public contracting program;<sup>20</sup>
- Revision of contracting programs and policies to avoid an adverse impact on MWBEs; this is certainly permitted, and in some instances may be a requirement of federal law, as discussed below;<sup>21</sup>
- Requirements of outreach to both MWBEs and Other Business Enterprises (OBEs).<sup>22</sup>

These principles are reflected and discussed further in the legal analysis of different program elements set forth below.<sup>23</sup>

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<sup>18</sup> The court's discussion of this point is set forth in full in the section below on programs permitted as requirements of federal law.

<sup>19</sup> See *L.A. County Prof'l Peace Officers Ass'n v. County of Los Angeles (PPOA)*, 2002 WL 1354411, at \*5 (Cal. Ct. App. June 20, 2002) (unpublished) (Proposition 209 permits state agencies to establish policies that "generally emphasize ... the value of 'diversity' in the workplace.").

<sup>20</sup> See *Connerly*, 92 Cal. App. 4th at 53 (tracking and reporting data regarding participation of women and minorities does not violate Proposition 209).

<sup>21</sup> *Connerly* at 56.

<sup>22</sup> See the *Hi-Voltage* court's citation with approval of Los Angeles' inclusive outreach program discussed in *Domar Electric (Hi-Voltage)*, 24 Cal. 4th at 562-64 (majority opinion), see also *id.* at 597-98 (George, C.J., concurring in part and dissenting in part).

<sup>23</sup> Thanks to Munger, Tolles and Olson's excellent legal memo for useful illumination of this aspect of post-Proposition 209 jurisprudence. Please see MTO memo, available from the authors, for a detailed account of all cases interpreting Proposition 209 through early 2010.

## Legal Analysis of Program Elements

This section describes a wide range of program elements that public entities might consider in attempting to ensure fair participation of MWBEs in public contracting systems, and avoid either engaging in or subsidizing race or gender discrimination. We have divided our discussion and these program elements into three categories: permitted under Proposition 209; possibly permitted under Proposition 209; and prohibited under Proposition 209.

Contract award processes aimed at preventing discrimination and increasing diversity, including many examples cited in the text and in Appendix A, combine several of these elements, wisely aiming at a comprehensive approach. Because such elements may fall into different categories of permissibility – and because courts will likely assess program elements independently – we have chosen to separately evaluate and discuss individual program elements. Ordinances or policies containing multiple elements should contain a severability clause – i.e., a clear legislative statement that courts should uphold or reject program elements independent of each other – to increase the likelihood that some program elements can continue even if one or more elements are found to violate the law.

The following sections discuss the legality of program elements only under Proposition 209. Evaluation of these programs under other legal requirements, like competitive bidding laws and individual city charters, is beyond the scope of this brief. However, it is safe to say that any program element that is permissible under Proposition 209 is almost certainly permitted under federal antidiscrimination laws such as the equal protection clause, Titles VI and VII, and so forth.

### Category 1: Permitted under Proposition 209

The following requirements and procedures, while providing a wide range of tools to work with in ensuring equity and efficiency in public contracting, do not violate Proposition 209. We encourage public entities to consider these strategies, to combine them in workable ways, and to be creative in developing new approaches along these lines.

Most, but not all, of the approaches below do not explicitly utilize race or gender criteria. Put simply, *any program element that does not explicitly involve race or gender is permitted under Proposition 209*. This leaves a great range of options, including small business targeting, geographic targeting, and – perhaps most importantly – a wide range of aggressive efforts to root out and prevent traditional race- and gender-discrimination. In addition, certain efforts that include specific consideration of race and gender are permitted by Proposition 209 – including crucial data-gathering and inclusive-outreach efforts.

#### A. Race-Neutral Contracting Preferences.

- **Small- and micro-business preferences: bid preferences, bid discounts, set-asides, outreach efforts, etc.** A great number of jurisdictions and public entities in California operate a variety of small-business programs. These programs are justified on multiple public policy grounds, including targeting a market segment with a higher proportion of MWBEs, as well as assisting small contractors generally. As long as such programs are not race- or gender-based, they do not implicate Proposition 209 – even where they provide preferences, discounts, or even set-asides. Such programs, particularly in combination with other MWBE support efforts described in this brief, can help drive work to many MWBEs, while also assisting other emerging businesses in a sector of the contracting economy that can be extremely challenging. Note that

an “inclusive outreach” program, requiring outreach to MWBEs and OBEs as described below, is a natural fit with a small business program, since it will naturally target the full range of small, local businesses.

A crucial determinant of whether a small-business program will benefit MWBEs is the dollar value of the threshold. A great number of MWBEs have low levels of assets and revenue as compared with many contractors working for public entities; Small Business Enterprise (SBE) programs have thresholds set high enough that, while excluding very-large businesses, still do not target business at the level of many or most MWBEs. If SBE programs are going to be effective at helping small MWBEs grow and become able to bid on larger contracts, programs need to carefully target emerging businesses through the program’s dollar threshold and application. The City and County of San Francisco’s small business ordinance targets both “small” and “micro” level businesses, with the business receipts threshold for a micro business being half that for a small business.<sup>24</sup> In the construction sector, programs targeting SBE subcontractors are likely to be more effective than those targeting award of prime contracts. Award of supply, service, and trucking contracts are other sectors in which SBE programs with careful thresholds are likely to help MWBEs.

- **Local-business preferences: bid preferences, bid discounts, set-asides, outreach efforts, etc.** Local-business preferences are on the books in many cities; efforts to keep public contracting dollars in the community or jurisdiction surrounding the funding entity have obvious political and policy appeal. Local-business preferences can be combined with small business programs as well as non-preferential efforts to support MWBEs outside the contracting process, to create a promising program. As with small-business programs, such programs do not violate Proposition 209 if they are race-and gender-neutral (although they may raise concerns under other state or federal laws).

Geographic preferences do not need to be strictly “local” or to target the entire jurisdiction operating the program. Public entities can create a program based on business location or operation in areas of below-average household incomes, or high unemployment rates. Such tailoring can achieve important, well-established policy goals of fighting poverty and revitalizing disadvantaged neighborhoods – while also improving the targeting of MWBEs, without use of race- and gender-based elements. While such

**HUD “Section 3” Program.** Projects receiving assistance from the U.S. Department of Housing and Urban Development are subject to HUD’s “Section 3” program, which requires directing business opportunities to targeted contractors “to the greatest extent feasible.” In general, targeted contractors include those owned by or employing substantial numbers of low-income residents of surrounding communities. (For full detail, see federal regulations implementing Section 3, at 24 CFR § 135.1.) Section 3 also requires all contractors on covered projects to target job opportunities to low-income local residents, a separate requirement that may itself assist local businesses, who are more likely to employ or have access to such workers.

programs are always permissible under Proposition 209, they are in fact required for projects that receive assistance from the U.S. Department of Housing and Urban Development: see box on HUD “Section 3” Program.

<sup>24</sup> See Local Business Enterprise and Non-Discrimination in Contracting Ordinance, San Francisco Administrative Code, Chapter 14B.

- **Requirements that prime contractors subcontract with small and/or local businesses.** As with the above, such programs do not violate Proposition 209, and local elements can include careful targeting to disadvantaged neighborhoods. Remember that this type of race-neutral program can include firm subcontracting percentage requirements, without implicating either Proposition 209 or invoking strict scrutiny under the equal protection clause.
- **Local hiring policies: Preferences to businesses that employ local and/or low-income residents.** Geographical preferences can look not just at business location, but also at residence of a business' employees. In certain contexts, such preferences may prove to be very powerful tools to target MWBEs, which in many industries have very high percentages of low-income, minority employees. This type of program can specifically target businesses that employ workers residing in specified low-income neighborhoods, like redevelopment areas. These programs can therefore advance goals of fighting unemployment and revitalizing distressed neighborhoods without implicating Proposition 209.<sup>25</sup>

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<sup>25</sup> Note, however, that the U.S. Department of Transportation (USDOT) currently interprets its competitive bidding regulations as prohibiting local hiring and contracting policies on most USDOT-funded projects. As of this writing, this interpretation is being reviewed by the Obama administration, in light of recent experience with local hiring policies on many large, non-USDOT-funded projects. Even where USDOT's prohibition applies, targeted hiring based on income and other factors aside from residence may be permissible, depending on the funding agency within USDOT.

**Legal Concerns Regarding Local Employment Policies.** There is much misinformation about legal issues related to geographic preferences. The Privileges and Immunities clause of the U.S. Constitution, while relevant, does not preclude local employment requirements placed on public contracts – it merely states a legal claim that requires justification of them. The leading case regarding the Privileges and Immunities clause and local geographic preferences in *United Building and Construction Trades Council v. City of Camden*, 465 U.S. 208 (1984). *Camden* is often wrongly cited as having prohibited geographic preferences, when in fact it simply remanded the case for consideration of whether the local-preference ordinance at issue could be justified. (The case settled on remand.) The *Camden* court noted that in the public contracting context, public entities have particularly broad power to set terms, and that fighting unemployment is a legitimate policy goal that in certain circumstances can support a local employment policy. (“The fact that Camden is expending its own funds or funds it administers in accordance with the terms of a grant is certainly a factor -- perhaps the crucial factor -- to be considered in evaluating whether the statute's discrimination violates the Privileges and Immunities Clause.” *Camden* at 261.)

Under *Camden*, jurisdictions that advance a policy goal *other than simple economic parochialism* have strong arguments to defend local employment preferences in public contracting. Fighting poverty and unemployment, and directing economic opportunities to low-income neighborhoods, are well-established governmental policy goals.

In addition, some local employment policies in California have limited the application of the preference to jobs filled by residents of California, thus ensuring that no resident of another state is disadvantaged by the policy. (See City of San Francisco’s Local Hiring Policy for Construction, San Francisco Administrative Code Section 6.22(G) *et seq*; Los Angeles Community Redevelopment Agency’s Construction Careers and Project Stabilization Policy.) Since claims under the Privileges and Immunities clause can be raised only by residents of other states, this approach completely eliminates any risk due to this legal claim – and in most industries will have a negligible impact on the effectiveness of the policy.

In sum, legal risks of local employment policies are often exaggerated, and can be minimized or eliminated through careful policy development and legal drafting. Many of the policy goals of MWBE policies, and other laudable policy goals as well, can be advanced through local employment policies.

## B. Other Aspects of the Contracting Process.

- **Data collection.** Tracking and reporting amount of procurement, including prime contracts and subcontracts, going to MWBEs, is an essential, basic aspect of understanding the operation of a public contracting system on these issues. The simple act of requiring reporting may make contracting officers and prime contractors more likely to be thoughtful and careful to avoid discrimination. In addition, data collection and analysis is the underpinning of antidiscrimination efforts for public entities, as discussed below. This kind of data tracking has been held to be legal under Proposition 209,<sup>26</sup> and is essential to identifying and rooting out race and gender discrimination, as discussed below.
- **“Inclusive Outreach” Programs: Requirements that public entities awarding contracts undertake outreach efforts to MBEs, WBEs, and OBEs.** While it might seem odd to establish a policy requiring outreach to OBEs, including OBEs in an outreach policy – along with MBEs and WBEs, of course – increases overall competition and should protect the policy from challenge under Proposition 209.<sup>27</sup> While such a policy takes race and gender into account, we believe that

<sup>26</sup> *Connerly* at 53.

<sup>27</sup> As noted above, majority and concurring opinions in *Hi-Voltage* expressed approval of this type of program.

it does not constitute “preferential treatment,” since all contractors get the benefit of the outreach. Many MWBEs assert that without outreach requirements, prime contractors do not even notify them of subcontracting opportunities and give them a chance to bid, so this type of policy can be of real value to them, even with the inclusion of OBEs. Explicitly requiring contracting officers to perform outreach to “MBEs, WBEs, and OBEs,” rather than just requiring outreach to “small businesses,” avoids the possibility of a public entity performing outreach only to majority-owned small businesses.

- **“Inclusive Outreach” Requirement in Subcontracting: Requirements that prime contractors undertake outreach efforts to MBEs, WBEs, and OBEs in selection of subcontractors.** For the reasons described above, this type of policy can be valuable and is likely safe from challenge under Proposition 209. Decades of experience have demonstrated a persistent problem, which this type of program can address: unless required to change their normal practices, many prime contractors simply do not notify businesses of subcontracting opportunities other than subcontractors with whom the prime has worked before – and who are usually white-owned businesses. Because of the importance of the subcontracting market to MWBEs, this type of program may be of greater benefit than one applying to bidding opportunities for prime contracts. Explicitly requiring prime contractors to perform outreach to “MBEs, WBEs, and OBEs,” rather than just requiring outreach to “small businesses,” avoids the possibility of a prime performing outreach only to majority-owned small subcontractors.
- **Other changes to selection processes or bidding or performance requirements, aimed at ensuring a broad pool of bidders.** Public entities should always be looking at a range of efforts to widen the pool of bidders for public contracts. Such efforts can include:
  - broadening outreach efforts as described above, both for contracting officers and prime contractors;
  - improving the completeness, clarity, and timeliness of information describing bidding opportunities, through the internet and otherwise;
  - requiring re-bidding if the number of respondents is small,
  - working proactively with prospective respondents to answer questions and work through challenges respondents face;
  - closely scrutinizing all bidding requirements – including insurance and bonding levels, experience, and so forth – to ensure they are actually necessary at the specified levels;
  - basing performance reviews for contracting officers on the number of bidders for contracts they award;
  - breaking large contracts into separate, smaller contracts in order to allow a wider range of businesses to compete.

Each of these initiatives, if race- and gender-neutral, is legal under Proposition 209 and antidiscrimination law. These type of steps take additional effort from public entities, but should lead to lower contracting costs through a wider range of bidders – MWBEs and others as well.

In fact, taking these kinds of steps to reform contracting processes may in some cases be an affirmative requirement of federal law. In the employment context, the California Supreme Court has established that “before utilizing a selection procedure that has an adverse impact on

minorities, [a public employer] has an *obligation* to explore alternative procedures and to implement them if they have less adverse impact and are substantially equally valid.”<sup>28</sup> This principle is equally applicable in the public contracting context.

- **Public credit for contracting officers and prime contractors who increase MWBE utilization on a voluntary basis.** Public entities can encourage purchasing agents and contracting officers to utilize MWBEs through legal mechanisms such as broad outreach and the other steps described above. Prime contractors bidding on large contracts can be similarly encouraged to utilize MWBE subcontractors or suppliers. Results of the initiative for different departments, and even for different contracting officers and bidders, can be made public, with credit given by public officials for good performance. As long as the system is voluntary on the part of participants, and the program’s “carrots” and “sticks” do not relate to contract awards or performance reviews, this type of program should be safe from challenge under Proposition 209.
- **Helping MWBEs create or connect with a trade association for the purpose of purchasing insurance or other goods and services at a lower cost.** An MWBE-focused trade association may be of great assistance to participating businesses. As a private entity, a trade association is not subject to Proposition 209 and many other antidiscrimination laws. A public entity’s encouragement and assistance to such a trade association would not implicate Proposition 209. Referring MWBEs to various entities and programs that can assist them is likewise permissible.
- **Certifying firms as MWBEs.** Even if a public entity is completely race- and gender-neutral in its public contracting, it can still assist MWBEs by certifying them as such. Prime contractors working on public or private contracts unconnected with the public entity may wish to utilize MWBEs, either as a project requirement or as a simple matter of values. Smaller public entities or project owners may wish to require MWBE utilization but lack the expertise or capacity to certify businesses. Many large private companies have well-established supplier or contractor diversity programs, some of which rely on public entities for certification. Certifying MWBEs as such, and making the information public, does not violate Proposition 209. Agencies can also encourage MWBEs to apply for certification with other public entities, and can share data with those entities, to minimize administrative costs of the certification process.
- **Creating bond, bond guarantee, loan, loan guarantee, or insurance programs.** Bonding, loan, and insurance assistance programs can be a tremendous support to MWBEs, helping them overcome some of the most frequently-cited barriers to participation in public contracting. Well-designed business assistance programs can go a long way toward leveling the playing field between emerging MWBEs and businesses with a longer track record with this type of contract. These programs can assist MWBEs that are interested in prime contracts or service-supply contracts, as well as those interested in subcontracting on large construction projects. Due to traditional antidiscrimination laws, participation in such programs should not be limited exclusively to MWBE. But programs can and should be tailored to typical needs of MWBEs, and recruitment for participation is focused on the MWBE community, trade associations, and so forth.

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<sup>28</sup> *S.F. Fire Fighters Local 798 v. City of San Francisco*, 38 Cal. 4th 653, 676 (2006) (quoting *Brunet v. City of Columbus*, 1 F.3d 390, 412 (6<sup>th</sup> Cir. 1993) (alterations omitted)).

### C. Affirmative Action Required by Federal Law.

In certain circumstances, federal law may require public entities to undertake affirmative action efforts in public contracting programs. The Supremacy Clause of the U.S. Constitution establishes that, in case of a conflict between the dictates of federal law and a state constitutional provision like Proposition 209, federal law governs.

1. **Affirmative action required by the equal protection clause or federal statutes.** The equal protection clause of the U.S. Constitution requires government entities to ensure that they are not engaging in discrimination, and that they are not knowingly distributing public funds in a manner that subsidizes discrimination by private actors.<sup>29</sup>

Either situation may leave the public entity vulnerable to discrimination claims under the equal protection clause and various state and federal statutes. The U.S. and California supreme courts have established that at times, fulfilling this duty to avoid discrimination may require race-conscious action, as discussed below. This duty includes both the responsibility to avoid discriminating in the future, and the responsibility to rectify the effects of past unconstitutional discrimination.

In both the *Hi-Voltage* and *Coral Construction* decisions, the California Supreme Court endorsed these principles, derived from various U.S. Supreme Court cases.<sup>30</sup> The *Coral Construction* majority approvingly quotes *Hi-Voltage*'s statement that "Where the state or a political subdivision has intentionally discriminated, use of a race-conscious or race-specific remedy necessarily follows as the only, or at least the most likely, means of rectifying the resulting injury."<sup>31</sup> In *Coral Construction*, the City of San Francisco argued that its evidence of past and current discrimination by the City and by prime contractors established just such a situation – mandating use of affirmative action in order to comply with federal law, and thus insulating its affirmative action program from Proposition 209. The California Supreme Court accepted the viability of this theory, and remanded for a "largely factual" hearing regarding the basis of evidence established by the City.

The court stated that San Francisco would need a "strong basis in evidence" in order to justify its program, and set forth detailed guidance on this point. Because of the importance of this issue, it is worth quoting the court's guidance in full:

We offer the following comments to assist the superior court in resolving the federal compulsion issue on remand: While the parties have not brought to our attention any decision ordering a governmental entity to adopt race-conscious public contracting policies under the compulsion of the federal equal protection clause, the relevant decisions hold open the possibility that race-conscious measures might be required

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<sup>29</sup> *Croson* at 492-493 ("[I]f the city could show that it had essentially become a 'passive participant' in a system of racial exclusion practiced by elements of the local construction industry, we think it clear that the city could take affirmative steps to dismantle such a system. It 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.")

<sup>30</sup> See *Wygant v. Jackson Bd. of Educ.*, 476 U.S. 267, 280-81 (plurality opinion); at 291 (O'Connor, J., concurring) (state has a "constitutional duty to take affirmative steps to eliminate the continuing effects of past unconstitutional discrimination."); see also *City of Richmond v. J.A. Croson Co.*, 488 U.S. 469, 509 (1989); *Croson*, 488 U.S. at 518 (Kennedy, J., concurring).

<sup>31</sup> *Coral Construction* at 320, quoting *Hi-Voltage* at 568.

as a remedy for purposeful discrimination in public contracting. (*Hi-Voltage, supra*, 24 Cal.4th 537, 568 [“Where the state or a political subdivision has intentionally discriminated, use of a race-conscious or race-specific remedy necessarily follows as the only, or at least the most likely, means of rectifying the resulting injury.”]; see also *Croson, supra*, 488 U.S. 469, 509 (plur. opn. of O’Connor, J.) [“In the extreme case, some form of narrowly tailored racial preferences might be necessary to break down patterns of deliberate exclusion.”].)

All racial classifications, even those contained in ostensibly remedial laws, must survive strict scrutiny. (*Parents Involved, supra*, 551 U.S. 701, 720; *Adarand, supra*, 515 U.S. 200, 226-227.) This is because “ ‘ ‘racial classifications are simply too pernicious to permit any but the most exact connection between justification and classification.’ ’ ” (*Parents Involved*, at p. 720, quoting *Gratz v. Bollinger* (2003) 539 U.S. 244, 270.) Under the strict scrutiny test, “such classifications are constitutional only if they are narrowly tailored measures that further compelling governmental interests.” (*Adarand*, at p. 227.) The only possibly compelling governmental interest implicated by the facts of this case is the interest in providing a remedy for purposeful discrimination. (See *Croson, supra*, 488 U.S. 469, 500; see also *id.*, at p. 509 (plur. opn. of O’Connor, J.); *Hi-Voltage, supra*, 24 Cal.4th 537, 568.)<sup>[19]</sup> In any event, proof of discriminatory purpose or intent is always required to show a violation of the federal equal protection clause (*Arlington Heights v. Metropolitan Housing Corp.* (1977) 429 U.S. 252, 265), and remedial action must actually be necessary (*Croson*, at p. 500).

Accordingly, to defeat plaintiffs’ motion for summary judgment, the City must show that triable issues of fact exist on each of the factual predicates for its federal compulsion claim, namely: (1) that the City has purposefully or intentionally discriminated against MBE’s and WBE’s; (2) that the purpose of the City’s 2003 ordinance is to provide a remedy for such discrimination; (3) that the ordinance is narrowly tailored to achieve that purpose; and (4) that a race- and gender-conscious remedy is necessary as the only, or at least the most likely, means of rectifying the resulting injury. If any of these points can be resolved as a matter of law in plaintiffs’ favor, it follows that the City cannot establish federal compulsion and that plaintiffs are entitled to summary judgment.

As of this writing, the *Coral Construction* case is on remand.

- 2. Affirmative action required as a condition of receipt of federal funds.** Proposition 209 by its own terms exempts from its scope actions that are required as a condition of receipt of federal funds.<sup>32</sup> In evaluating San Francisco’s claim that its affirmative action programs fell under this exemption, the *Coral Construction* court evaluated the Title VI implementing regulations issued by the U.S. Environmental Protection Agency and Department of Transportation – both of which state that fund recipients are required to take “affirmative action” in specified circumstances. The court held that these clauses do not by themselves establish a directive implicating the exemption. The court reasoned that these regulations do not clearly establish a requirement to

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<sup>32</sup> “Nothing in this section shall be interpreted as prohibiting action which must be taken to establish or maintain eligibility for any federal program, where ineligibility would result in a loss of federal funds to the State.” (§ 31, subd. (e).)

use race-based measures, since the term “affirmative action,” in context, was amenable to multiple interpretations.<sup>33</sup>

On this point, therefore, *Coral Construction* indicates that the federal-funding exemption to Proposition 209 is triggered only when the recipient public entity is clearly instructed by the federal government that race-based affirmative action is a requirement of receipt of funds. Encouragement, authorization, or imprecise statements in this vein are not sufficient.

Note, however, that some federal regulations do in fact require race- and gender-based affirmative action in particular cases. 49 C.F.R. part 26, requires most recipients of certain funds from the U.S. Department of Transportation (USDOT) to establish and operate a Disadvantaged Business Enterprise (DBE) Program, with specific utilization goals for DBEs, and to have that program approved by USDOT; in certain cases, race- and gender-conscious action may be required in order to achieve these goals.<sup>34</sup> In addition to the plain language of federal regulations, in particular circumstances federal agencies may require race- and/or gender-conscious affirmative action measures on a case-by-case basis. This could be due to particular impacts of a project, such as racially-disparate environmental justice impacts requiring mitigation, or in response to evidence the local funding recipient puts forward regarding the facts of the local contracting industry and how contracting dollars will flow in the absence of affirmative action. Federal agencies are granted broad power to interpret their own regulations, and may choose to interpret broad regulations like those described in *Coral Construction* as requiring race- and/or gender-conscious measures in particular cases. As long as a federal official with proper authority informs the local recipient that race- or gender-conscious affirmative action is required as a condition of receipt of funds, the exemption is implicated and Proposition 209 permits the required action.

#### **D. Antidiscrimination Efforts.**

An important step public entities can take on behalf of MWBEs is to prevent race and gender discrimination in their contracting systems, especially by prime contractors in their selection of subcontractors. Public entities have an affirmative responsibility under state and federal law to ensure that their contracting systems are free from invidious discrimination, both in their own decisions, and in the subcontracting decisions made by prime contractors that public entities retain. Preventing discrimination is an unimpeachable public policy goal, cannot possibly be said to violate Proposition 209, and is in fact legally mandated.

Unfortunately, preventing discrimination is not easy – it requires aggressive efforts to monitor contract and subcontract awards, evaluate race and gender patterns in discrete contracting industries, carefully reform contracting processes, and take adversarial enforcement action in many cases. This all takes dedicated staff and funding, and a sustained public commitment to this issue.

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<sup>33</sup> *Coral Construction* at 334-335.

<sup>34</sup> USDOT’s regulations require that local entities establishing DBE programs review certain evidence in order to establish their DBE utilization goals. See 49 C.F.R. section 26.45. In addition, Ninth Circuit jurisprudence may require California recipients of USDOT funds to develop additional evidence and narrowly tailor program details in implementing a DBE program to comply with USDOT’s requirements. See *Western States Paving Co., Inc. v. Washington Department of Transportation*, 407 F.3d 983 (9th Cir. 2005), *cert. denied*, 546 U.S. 1170 (2006). For an extremely thorough discussion of considerations in establishing such a program, and an analysis of the somewhat opaque *Western States* decision, see Highway Research Program Report 644, Guidelines for Conducting a Disparity and Availability Study for the Federal DBE Program (available online at [http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp\\_rpt\\_644.pdf](http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp_rpt_644.pdf)).

Following is a brief overview of some steps public entities can take to identify and address discrimination in contracting systems.

### 1. Preventing discrimination in subcontracting.

The *Croson* court noted:

[I]f the city could show that it had essentially become a "passive participant" in a system of racial exclusion practiced by elements of the local construction industry, we think it clear that the city could take affirmative steps to dismantle such a system. It 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.<sup>35</sup>

Preventing discrimination in subcontracting by prime contractors is one of the most challenging aspects of antidiscrimination efforts by public entities. But it is crucial: on large construction contracts, the prime contractor will typically perform only a small portion of the contracted work itself, meaning that the vast majority of the public dollars spent on a construction contract will flow down to subcontractors. In addition, emerging MWBEs are typically in much better position to bid on small, trade-specific subcontracts than on large public works prime contracts. Because prime contractors are very protective of their established relationships with subcontractors, enabling them to open up their subcontracting process and consider working with new businesses, particularly MWBEs, is difficult.

The essential first step in any antidiscrimination effort is gathering data. **Public entities should require bidders for prime contractors, as part of submission of a bid, to state the proportion of their subcontracts to be performed by MWBEs and by OBEs.** During performance of the contract, as a condition of progress and final payment, **prime contractors should be required to report the proportion of the project's subcontracted work that was performed by MWBEs and by OBEs.** Contractors may also be required to report on what steps they took in recruitment and selection of subcontractors. So long as it is clear that prime contractors are not required to satisfy particular goals or percentages, none of these requirements would violate Proposition 209.

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<sup>35</sup> *Croson* at 493.

**Prime contractors for which the data indicates persistent patterns of underutilization of MWBEs in their subcontracts can come under additional scrutiny by public entities.**

In order to justify and fairly undertake this type of evaluation and scrutiny, a public entity should have current data about availability of MWBE subcontractors in the relevant market and industry, with data and analysis rising to the level of a disparity study. With this data available, prime contractors can be asked to explain their system of providing notice of subcontracting opportunities, their method of selecting subcontractors, their rejection of lower bids from MWBE subcontractors, and so forth.

Many prime contractors will defend their choice of subcontractors on the grounds that they have used the listed subcontractors before, and are confident in their work. However, public entities are well within their legal rights to require that prime contractors look beyond their usual subcontractors and make opportunities available to a wider range of businesses. This step is well-justified both as a measure to guard against discrimination and as a cost-control measure, since a more open, competitive subcontracting process should lead to lower overall costs to the public entity.

As discussed above, requiring primes to consider a range of subcontractors – and even to perform outreach to or obtain bids from both MWBEs and OBEs – is not considered preferential treatment, and does not violate Proposition 209. Such a requirement, combined with an analysis of subcontracting decisions over time, should have a prophylactic effect in preventing discrimination, and should enable public entities to identify and take action against prime contractors who engage in discrimination against (or simply refuse to consider) MWBE subcontractors.

**Antidiscrimination Programs Required as a Condition of Federal Funding**

The Federal Railroad Administration (FRA) recently required California's High-Speed Rail Authority, as a condition of receipt of federal funding, to undertake an aggressive set of antidiscrimination measures, including many of those described herein. Although USDOT's primary DBE program did not apply to this project, the FRA required these measures as a means of ensuring that the Authority did not violate Title VI in its contract awards. The FRA required the Authority to:

- establish a DBE program and specify a single official responsible for it;
- conduct an availability and disparity study within one year;
- establish and publicize a directory of available SBEs and DBEs;
- establish an SBE/DBE business development program to assist SBEs and DBEs in growing;
- establish a "Business Advisory Council" to improve communications between the Authority and the S/DBE communities; and
- file a comprehensive plan addressing all aspects of the DBE program, including publication of contracting opportunities, setting utilization goals, review of contracting standards for disparate impact, etc.

This comprehensive program is likely to have a major impact on M/WBE utilization on the high-speed rail project. Almost all of these steps could be taken voluntarily by California's public entities, without violating Proposition 209, and even in the absence of federal funding.

## 2. Preventing discrimination in selection of prime contractors, suppliers, and services

**contractors.** While a great number of public entities take steps to prevent discrimination by prime contractors in award of subcontracts, proactive efforts by public entities to prevent discrimination in their own award of prime contracts are less common and less developed. However, every public entity is of course under a legal obligation to refrain from discriminating; avoiding discrimination will promote competition and hold down costs; and preventing discrimination in contract awards is perhaps the most important thing that public entities can do to ensure fair opportunities for MWBEs.

Experience has shown that it is not enough to simply instruct contracting officers not to discriminate. Even if individuals awarding contracts are free from intentional bias, unintentional bias can occur, and unnecessary contractual requirements can have an adverse impact on MWBEs. Proactive efforts to identify and prevent discrimination are necessary, due to the range of different agencies and departments within a single jurisdiction, contracts being awarded in multiple industries, and use of various contract award processes even by a single public entity.

The underpinning of any effective antidiscrimination program is **data collection and analysis.** Public entities should require bidders for contracts to self-certify MWBE or OBE status, and awarding officers and departments should report to a central repository their data regarding contract awards. Ideally, this data should be provided electronically, in a form that enables assessment based on various contract award processes, types of goods or services provided, awarding department or agency, and even individual awarding officers.

In order to draw meaningful conclusions from this data, public entities need to compare patterns of contract awards with availability of MWBEs in various industries. Many cities in California have retained analysts to conduct disparity studies, which necessarily include industry-specific determinations of availability; public entities should consider commissioning such studies in intensive and/or historically-problematic contracting industries, to provide data to help identify problem areas. In many instances, this type of comparison can reveal disparities not rising to the level of illegal discrimination, but simply indicating an area worthy of additional scrutiny – perhaps by considering reforming contracting award processes or bidding requirements, in order to ensure the broadest possible pool of bidders.

Contracting award systems and contractual requirements also need to be closely scrutinized. For award processes where subjective measures like interview scoring are involved, having a diverse panel of evaluators is important. In addition, as discussed above, contractual requirements like bonding, insurance, and prior experience need to be closely scrutinized to ensure that they are truly necessary at the specified levels, and that they are not having a disparate impact on MWBEs. In many cases, bonding and insurance levels are far higher than the contract in question actually requires, and past experience requirements can be broadened to include transferable experience from related types of projects. These kinds of changes can open up bidding opportunities to many MWBEs, while still protecting public needs and taxpayer dollars.

Note that while prevention of future discrimination in public contracting systems is an important step, it is not sufficient to overcome the barriers faced by MWBEs. Decades of past discrimination have left MWBEs in the aggregate facing challenges in bonding, insurance, cash flow, and other factors essential to business growth. Simple prevention of future discrimination will not itself overcome these factors. A range of additional steps such as those described elsewhere in this brief – such as bonding, insurance,

business assistance, and outreach, and SBE programs – will be necessary in order to break down the effects of historic patterns in these industries.

## Category 2: Possibly Permitted by Proposition 209

The following policies and requirements may be permissible under Proposition 209, but to our knowledge have not been tested in court.

- **MBE/WBE/OBE goals/good-faith-efforts programs.** Certain California jurisdictions have established contracting programs that require prime contractors to conduct outreach to MBEs, WBEs, and OBEs regarding subcontracting opportunities, with outreach requirements deemed automatically satisfied if specified percentages of each type of business are utilized. This type of program looks quite similar to the traditional goals/good-faith-efforts approach struck down in *Hi-Voltage* – but with the crucial addition of OBEs. This change means that all types of businesses are treated the same under the program, with assurances that they will receive outreach. We would argue that this approach should not be considered a preference in violation of Proposition 209, both because ensuring outreach is not a preference, and because it treats all groups equally. However, this approach has not been tested in court, to our knowledge.
- **MWBE bid requirements.** Akin to outreach requirements, requiring that contracting officers obtain at least one MWBE bid and one OBE bid for contracts over a certain size may violate Proposition 209. We would argue that this type of requirement does not constitute a preference, as it is a simple expansion of outreach efforts, encourages competition, lowers eventual contracting costs, does not exclude anyone, and is distinct from the actual contract award process. However, the *Hi-Voltage* court’s disapproval of the outreach requirements at issue in that case might lead a court to a similar conclusion in this context.
- **MWBE-only networking opportunities.** Because a lack of relationships is often cited as a barrier to MWBE business development, networking opportunities aimed at developing relationships between MWBEs and contracting officers may be effective. Networking events can connect MWBEs with both public entity purchasing agents and also with prime contractors in the construction field. As with bonding and insurance assistance described above, if such events are limited solely to MWBEs, some might argue that they violate Proposition 209 or traditional antidiscrimination laws. However, in that case there would be a strong argument that operating this kind of event for MWBEs is not a “grant of preferential treatment ... in the operation of ... public

**Comprehensive “Supplier Diversity” Programs.** Many public entities have formal, thorough “Supplier Diversity Programs” containing several elements described in this brief, including networking, data tracking, and publicity, both positive and negative. A comprehensive supplier diversity program aims at attaining a desired level of MWBE procurement by creating an integrated and monitored program that encourages inclusion at each step in the procurement system. The key steps include efforts to increase the number of MWBEs in the vendor pool and increasing the likelihood, without mandated goals, that the prime vendors/contractors and the public purchasing agents utilize MWBE firms. This increase in likelihood is caused by creating a general environment of inclusion, by setting up face-time between prime vendors and purchasing agents and MWBE firms so that relationships are formed, by celebrating and recognizing those prime vendors and purchasing agents that are inclusive, and by negative publicity to those prime vendors who are not inclusive. Please see Appendix A for information regarding the State of Florida’s supplier diversity program. Legality of this type of program under Proposition 209 depends on program particulars.

contracting”; and the prospect of successful litigation under traditional antidiscrimination laws for a simple networking event seems remote. Whatever small degree of risk exists around this type of approach could be minimized or eliminated by allowing non-MWBEs to attend the event, while simply marketing it primarily to MWBE networks and organizations.

### Category 3: Generally Prohibited by Proposition 209

The following requirements or policies, if incorporated into a California public entity’s contracting process, almost certainly violate Proposition 209. Note, however, that even with the following types of programs, there are certain situations where they are nonetheless permissible despite Proposition 209, as discussed above. These include programs required as a condition of receipt of federal funding, and programs permitted or required in order to address established systemic discrimination, per *Coral Construction*, etc.

- **Bid preferences, discounts, or set-asides for MWBEs.** A contract award system under which MWBEs are given an explicit preference in the award process, directly affecting the award determination, plainly violates Proposition 209. This type of approach was common in the pre-209 era. Examples include:
  - in a scored contract award system, granting MWBEs additional points based on MWBE status, or awarding preference points or bid discounts to respondents based on utilization of MWBE subcontractors;
  - in a lowest-responsible-bidder award system, discounting an MWBE’s bid by a set percentage based on MWBE status.
  - Allowing set-aside contract awards, or limiting applicants for contract awards, to MWBEs based on MWBE status.
- **Requirements that prime contractors subcontract a certain percentage of work to MWBEs, or show good faith efforts to do so.** This approach was the most common type of affirmative action program in construction contracting in the pre-209 and pre-*Croson* era. This approach was struck down by the *Hi-Voltage* court, and the court did not seem to consider it to be a close question. Similarly prohibited would be award of preference points or bid discounts to respondents based on utilization of MWBE subcontractors.
- **Requirements that prime contractors perform outreach to MWBEs (without a requirement to perform outreach to non-MWBEs).** There are strong arguments that an outreach-only requirement – ensuring that MWBEs receive notice from prime contractors and an opportunity to bid on subcontracts – does not directly affect actual award of subcontracts, and therefore should not be considered “preferential treatment” in violation of Proposition 209. Close ties between prime contractors and the subcontractors they have used in the past is often cited as a barrier to MWBE business development, and an increase in the number of subcontractors bidding on a project should promote competition, bring costs down, and help level the playing field for businesses looking for a chance to prove themselves. However, the *Hi-Voltage* court struck down a subcontractor-outreach requirement that was part of San Jose’s program:

The outreach component requires contractors to treat MBE/WBE subcontractors more advantageously by providing them notice of bidding opportunities, soliciting

their participation, and negotiating for their services, none of which they must do for non MBE's/WBE's.<sup>36</sup>

Fortunately, public entities can ensure that primes provide broad outreach to potential subcontractors by requiring outreach to MWBEs and also to non-MWBEs, as discussed below.

- **Requirements that contracting officers perform outreach to MWBEs (without a requirement to perform outreach to non-MWBEs).** As with subcontractor-outreach requirements placed on prime contractors, requirements that public entities perform outreach solely to MWBEs almost certainly violates Proposition 209, under *Hi-Voltage*. Again, however, expanding this type of outreach requirement to include non-MWBEs as well should ensure a range of outreach efforts and should be permissible under Proposition 209.

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<sup>36</sup> *Hi-Voltage* at 562.

## Conclusion

We hope this brief has clarified that, while Proposition 209 imposes clear and unmistakable limitations on public entities' use of affirmative action, there is still a wide range of available initiatives in the public contracting sector to prevent discrimination, maximize competition, and support MWBEs in local communities. We encourage California's public entities to consider comprehensive programs combining various program elements discussed above, to develop new approaches, and to share information and creative thinking as we move forward in the post-209 era.

For more information on the legal arguments and conclusions of this brief, please contact Julian Gross ([julian@juliangross.net](mailto:julian@juliangross.net)). For copies of the programs and other materials referenced in this brief and Appendix A, please contact Tim Lohrentz ([tlohrentz@insightcced.org](mailto:tlohrentz@insightcced.org)).

# Appendix A

## Examples of public entities operating different types of programs

Following are examples of programs in effect in various jurisdictions, inside and outside California. This list is not meant to be comprehensive; rather, it lists policies and programs cited by MWBE advocates and public entity staff as thorough and well-developed, or that demonstrate create approaches. Since many of these programs contain multiple elements, only some of which might raise concern under Proposition 209, they are grouped by type of program, rather than by degree of legal risk in California.

1. Supplier diversity (Florida; Washington; City of Grand Rapids, Michigan; Contra Costa County, California)

Florida has an elaborate supplier diversity program.<sup>37</sup> The program is noteworthy because program elements would most likely each be permitted by Proposition 209 if undertaken by a California public entity. A look at some of the activities of the Florida program:

- Florida Office of Supplier Diversity sponsors workshops, trade shows, and conferences. They also have special match-maker events. The annual Matchmaker and Trade Fair has over 1000 participants, mostly MWBE firms but also state purchasing agents and prime vendors. (Approach permitted by Prop. 209.)
- They also create strategic alliances with the Supplier Diversity development council and member corporations to spotlight certified firms and create new contract opportunities.
- They bring together the purchasing agents of each state department and each month will spotlight one or more vendors in a targeted forum. They will also do vendor spotlights at cross-agency content meetings – such as IT firms at the IT state officer meeting.
- Each quarter, each agency, including state universities, receives a procurement report, including spending from certified and non-certified M/WBEs. The Governor's office reviews the report and if the proportion of M/WBE has dropped, the Governor will ask each agency why they dropped. There is commitment at the top. Each agency will receive a report card and each contractor will receive a report card on their supplier diversity. These are made public. In general, they have had a lot of cooperation. For at least some of the time the agency director's job performance review is impacted by the supplier diversity reports.

**California Public Utilities' Commission Supplier Diversity Program.** The California Public Utilities' Commission's Supplier Diversity Program requires utilities operating in California to establish an annual plan for increasing use of MWBEs through voluntary, non-preferential steps, consistent with Proposition 209. In addition, program regulations state that "the commission shall, by rule or order, adopt criteria for verifying and determining the eligibility of women and minority business enterprises for procurement contracts."

2. Blended SBE/MBE programs – Certain preference programs combine race-based and race-neutral elements, by targeting both MBEs from the whole jurisdiction and SBEs from geographically

<sup>37</sup> The Florida program, while thorough, varies in success rates as implemented by various administrations. See [http://www.dms.myflorida.com/other\\_programs/office\\_of\\_supplier\\_diversity\\_osd](http://www.dms.myflorida.com/other_programs/office_of_supplier_diversity_osd).

impoverished areas. In each case the jurisdiction then used a preference program, generally a sub-contracting program, to move procurement dollars to the geographic areas or to MWBEs. For example Ohio uses the federal HUB areas for the geographic designation of its program along with MBEs, mainly in the construction sector. (Iowa's Targeted Small Business enterprise program<sup>38</sup>, Minnesota's Economically Disadvantaged/Targeted Group business enterprise program<sup>39</sup>, and Ohio EDGE.<sup>40</sup> Ohio calls the EDGE race neutral.) In California, program elements that provide race-based preferences, including MWBE-specific outreach requirements, probably violate Proposition 209, as discussed above.

3. Other variations on SBE programs. (Virginia, Los Angeles, San Diego, Oregon). In these programs, diversity is advanced by race- and gender-neutral measures and by utilizing MWBEs, as any other firm, on below-threshold purchases. Virginia's program is called SWAM – Small, Women, and Minority business enterprise program.<sup>41</sup> The City of Los Angeles has the MWOBE program – Minority, Women and Other Business Enterprise program.<sup>42</sup> Los Angeles' program includes targeted outreach to MBEs and WBEs, but also to OBEs. Variations on the SBE program include the Local Small Business Enterprise program, where only small businesses within the jurisdiction or other area, are included (City of San Diego.<sup>43</sup>) Another variation is the Emerging Business Enterprise program which is essentially an SBE program where the size of eligible firms is smaller than the typical SBE program (Oregon<sup>44</sup>). Each of these program elements is permitted by Proposition 209.
4. Improved Outreach. Each of the following program elements can be implemented in California without violating Proposition 209, perhaps with minor tweaks from approaches taken in other states.
  - A. Vendor outreach and vendor notification: provide information about bid opportunities to MWBEs by telephone call conferences, video conferences, and webinars. (Michigan).
  - B. Keep up a list of potential projects for MWBE firms on website. (Indiana)
  - C. Outreach for the purpose of building relationships between agency purchasing agents and MWBEs and to encourage firms to become active public agency vendors – register or certify. Trade shows, expositions, trade fairs, other outreach/networking events or regular meetings (quarterly) to highlight MWBEs, with corporations, municipalities, local/state government purchasing agents. (Kansas, Maryland, Massachusetts, North Carolina, Tennessee). Setting up presentations by MWBE vendors to relevant state purchasing agents (Texas). Vendor outreach at the annual business meetings of the various business associations and ethnic chambers (Florida).
5. Improved Bid Process
  - A. Electronic procurement system sends special bid announcements to MWBE firms. (Delaware) (Permitted by Proposition 209 so long as bid announcements are widely broadcast.)

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<sup>38</sup> <http://www.iowalifechanging.com/business/tsb.aspx>.

<sup>39</sup> <http://www.mmd.admin.state.mn.us/mn02001.htm>.

<sup>40</sup> <http://das.ohio.gov/Divisions/EqualOpportunity/MBEEDGECertification/tabid/134/Default.aspx>.

<sup>41</sup> <http://www.dmbe.virginia.gov/index.html>.

<sup>42</sup> [http://bca.lacity.org/index.cfm?nxt=div1&nxt\\_body=div\\_occ.cfm](http://bca.lacity.org/index.cfm?nxt=div1&nxt_body=div_occ.cfm).

<sup>43</sup> <http://www.sandiego.gov/eoc/boc/sbe.shtml>.

<sup>44</sup> <http://www.oregon4biz.com/Grow-Your-Business/Business-services/Minority-Owned-Business-Certification/>.

- B. Requiring a MWBE bid. At least one of three quotes for bids under \$25K needs to be a MBE or WBE (Arizona). Later this was raised to bids of less than \$50K. Executive Order 2000-4. (Possibly permitted by Proposition 209 – see discussion in main document.)
  - C. Purchasing staff encouraging the Prime Contractor of larger projects to use an M/WBE sub-contractor on construction-related projects. It is voluntary and Prime Contractors need to inform purchasing staff which subs they use. In the case of Vermont, usage of M/WBEs is not tracked. (Vermont Dept. of Building and General Services, for any project >\$80,000.) (Permitted by Proposition 209.)
  - D. A public agency may waive bonding requirements for MWBEs or DBEs (Maryland DOT), or guarantee the bond, making the bond much easier to obtain. (Possibly permitted by Proposition 209, depending on program details and implementation.) Both Mississippi and Ohio offer a 90 percent bond guarantee to MBE firms.
6. Tracking/Publicity. Each of the following steps is permitted by Proposition 209.
- A. Tracking level of procurement with MWBEs of various agencies and posting on a website (many, including Florida, Georgia, Virginia). Florida tracks spending with both certified and non-certified MWBEs, while Georgia tracks only non-certified MWBEs (vendor self-registry).
  - B. Publishing every prime vendor/contractor's MWBE spend on the internet each month. (previously, Florida)
  - C. Giving each contractor an 'A' to 'F' grade for their MWBE sub-contracting participation and publishing these grades on the internet. A Title VI assessment is done on any firm receiving an 'F' for three consecutive years. (previously, Florida)
  - D. In order to give positive publicity to those who voluntarily participate well, conducting an annual Minority Business Awards event and giving out awards. (Florida<sup>45</sup> and Illinois DOT). In the case of Florida the awards included:
    - Minority business of the year
    - State agency of the year (for the highest percentage of M/WBE procurement)
    - State advocate of the year
    - Director's award for majority companies that help mentor or form strategic alliances with minority firms
    - Corporation of the year, for strategic partnerships with minority firms on state contracts
7. Business Environment.
- A. Commercial nondiscrimination law – Passing a law that it makes it possible for a business to bring a complaint against any other business, including financial institutions, if they believe they have been discriminated against, based on race, gender, etc. The complaints are investigated by

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<sup>45</sup> See, for example, the 2010 awards:  
[http://www.dms.myflorida.com/agency\\_administration/communications/dms\\_press\\_releases/2010\\_press\\_releases/11\\_19\\_10\\_florida\\_office\\_of\\_supplier\\_diversity\\_presents\\_2010\\_diversity\\_awards](http://www.dms.myflorida.com/agency_administration/communications/dms_press_releases/2010_press_releases/11_19_10_florida_office_of_supplier_diversity_presents_2010_diversity_awards).

- the Human Rights Commission and penalties can result. (Maryland<sup>46</sup>) (Permitted by Proposition 209.)
- B. Requiring a group of companies regulated by the government agency and with over a certain amount in annual revenue to carry out a (race and gender neutral) supplier diversity program. (California PUC for all utility companies with over \$25 million in annual revenue.)<sup>47</sup> (Permitted by Proposition 209.)
8. Networking. Each of the following approaches is permitted by Proposition 209.
- A. Helping MWBEs link to private corporations and companies through hosting networking events and by setting up one-on-one meetings.
- B. Producing a directory (online or hard copy) of MWBEs including their NAICS and geographic areas of service and distributing to other governments to use as well as to large vendors/contractors. (Arizona, Iowa, and South Dakota DOT). Arizona also shares the directory with all major cities and counties through its *Arizona Steps Up* program.<sup>48</sup> Iowa promotes the directory and online database to corporations and private companies. South Dakota DOT previously provided an in-color DBE (or MWBE) directory with the owners' photographs and business profile to contractors and on the internet.
9. Technical Assistance. Each of the technical assistance approaches described below can be implemented without violating Proposition 209, with careful attention to program details. Legal risk can be minimized or eliminated by ensuring that these programs are divorced from the contract award process itself, and by allowing participation by OBEs (even though program services and outreach are focused on MWBEs). These types of programs may be permissible even without those steps, however.
- A. Workshops and business development services for MWBEs (many states including Alabama DOT, Arkansas, Indiana, Massachusetts, Nebraska Economic Development, Washington DOT, and Wisconsin). For example Arkansas Department of Economic Development provides multiple services specifically to MBEs, including workshops and trainings, marketing projects, special consultant services, feasibility studies, manufacturing services, and assistance with large procurement or specialized entrepreneurial projects.<sup>49</sup> Additional workshop topics provided by other states include: how to get bonded and how to get certified. Wisconsin will help write a business plan for selected MBEs.
- B. Mentor-protégé program for MWBEs in order to strengthen their businesses and prepare them for doing business with the public agency and corporations. Many states and cities do this.
- C. Subsidized-cost high-end one-on-one business development services to MBEs. (Indiana, previously combined state funds with federal MBDA funds).

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<sup>46</sup> Text of law: [http://mlis.state.md.us/2006rs/fnotes/bil\\_0007/sb0897.pdf](http://mlis.state.md.us/2006rs/fnotes/bil_0007/sb0897.pdf).

<sup>47</sup> <http://www.cpuc.ca.gov/puc/supplierdiversity/>.

<sup>48</sup> <http://az.gov/app/azstepsup/home.xhtml>.

<sup>49</sup> <http://arkansasedc.com/small-and-minority-business/business-services.aspx>.

- D. Assisting one specific racial or ethnic group, with evidence of being excluded. The assistance may include how to how register (or certify) as vendors and information and assistance in obtaining public contracts. (North Dakota, Native American Business Center<sup>50</sup>.)
10. Education. Sponsoring or organizing youth-of-color entrepreneurial programs/classes/activities in order to expose the youth to business development. (Arkansas, Delaware) (Should be permitted under Proposition 209, with attention to program details.)
11. Financing. As with the technical assistance approaches described above, the financing approaches set forth below can be implemented without violating Proposition 209, with careful attention to program details. Legal risk can be minimized or eliminated by ensuring that these programs are divorced from the contract award process itself, and by allowing participation by OBEs (even though program services and outreach are focused on MWBEs). These types of programs may be permissible even without those steps, however.
- A. Bond guarantees: Guarantee 90% of necessary bonds for MWBEs. (Mississippi<sup>51</sup> and Ohio<sup>52</sup>)
- B. Loan program: Low-interest loans for MWBEs (Mississippi<sup>53</sup>, Ohio<sup>54</sup>, Rhode Island<sup>55</sup>, and Washington<sup>56</sup>). Variations include providing funding to nonprofit organizations to administer a MWBE loan fund (New York<sup>57</sup>) and a capital access fund (Ohio<sup>58</sup>).
- C. Previously Ohio operated the Venture Capital Tax Credit program, part of which was especially designed for investments in MBEs. A 30% tax credit for investments of up to \$150,000 in MBEs was provided as long as the MBEs were located in economically distressed counties.

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<sup>50</sup> <http://www.business.nd.gov/resource/american-indian-business/>.

<sup>51</sup> <http://www.mississippi.org/mda-library-resources/finance-tax-info/loan-programs/minority-surety-bond-guaranty-program.html>.

<sup>52</sup> <http://www.development.ohio.gov/Minority/MBBP.htm>.

<sup>53</sup> <http://www.mississippi.org/minority-business/news/accessing-capital.html>.

<sup>54</sup> <http://www.development.ohio.gov/Minority/MDLP.htm>.

<sup>55</sup> Rhode Island is a funder of this program: [http://www.communityinvestmentnetwork.org/nc/single-news-item-states/article/rhode-island-coalition-for-minority-investment/?tx\\_ttnews\[backPid\]=1593&cHash=5ce7c9219c](http://www.communityinvestmentnetwork.org/nc/single-news-item-states/article/rhode-island-coalition-for-minority-investment/?tx_ttnews[backPid]=1593&cHash=5ce7c9219c).

<sup>56</sup> <http://www.omwbe.wa.gov/financing/ldp/index.shtml>.

<sup>57</sup> <http://www.empire.state.ny.us/BusinessPrograms/MWBBERevolvingLoanTrustFund.html>.

<sup>58</sup> <http://www.development.ohio.gov/Minority/tip.htm> and see <http://www.development.ohio.gov/Minority/CAP/default.htm>.

