

SECTION I.

Introduction

The Oklahoma Department of Transportation (ODOT) and other state DOTs must implement the Federal Disadvantaged Business Enterprise (DBE) Program in order to receive funds from the U.S. Department of Transportation. The disparity study provides information to assist ODOT in making decisions concerning its implementation of the Federal DBE Program. Information in the report will aid ODOT when:

- Establishing its overall annual aspirational goal for DBE participation in ODOT contracts funded by the Federal Highway Administration (FHWA);
- Examining whether or not it can attain the annual DBE goal solely through race-neutral means or whether race- or gender-conscious measures such as DBE contract goals are appropriate under the federal regulations;
- Projecting the percentage of the overall annual DBE goal it will meet through race-neutral means;
- Choosing the specific program elements it will apply; and
- Identifying specific racial/ethnic/gender groups of DBEs that may be eligible for any race-, ethnic- and gender-conscious remedies such as DBE contract goals in implementing the federal regulations.¹

Although the Federal DBE Program also applies to contracts funded by the Federal Transit Administration (FTA) and Federal Aviation Administration (FAA), ODOT has relatively little funding from FTA and no FAA funding. Therefore, this study focuses on information to help ODOT implement the Federal DBE Program for its FHWA-funded contracts.

Information from the disparity study is also useful to ODOT as it seeks to ensure a non-discriminatory environment within its non-federally-funded contracting.

Section I of this report presents:

- a. Background on federal, state and local programs and why ODOT chose to initiate a disparity study;
- b. An introduction to the study team; and
- c. The scope of the study.

¹ “Race-conscious” means “race-, ethnic- and gender-conscious” in this report, unless otherwise noted. Similarly, “race-neutral” means “race- and gender-neutral” unless otherwise noted.

A. Background

The federal government requires state and local governments to implement the Federal DBE Program if they receive U.S. Department of Transportation (USDOT) funds for transportation projects.² ODOT has been implementing some version of a Federal DBE Program since the 1980s. After enactment of the Transportation Equity Act for the 21st Century (TEA-21) in 1998, the U.S. Department of Transportation established a new Federal DBE Program to be implemented by state and local agencies receiving USDOT funds.

Federal regulations (49 CFR Part 26) guide how state and local governments implement the Federal DBE Program.³ If necessary, under the federal regulations, the Program allows state and local agencies to use DBE contract goals, which ODOT has set on certain FHWA-funded contracts. When awarding FHWA-funded contracts, ODOT considers whether or not a bidder meets the DBE contract goal or shows good faith efforts to do so.

To further explain the context for this disparity study, it is useful to review:

1. Race-conscious and neutral elements of the Federal DBE Program;
2. Race -conscious elements of state and local programs;
3. Legal standards that race -conscious programs must meet; and
4. Some of the reasons for completing a disparity study.

1. Race -conscious and neutral elements of the Federal DBE Program. Setting DBE contract goals under certain circumstances is one potential element of the Federal DBE Program. Because DBE contract goals promote the utilization of firms based in part on their race or gender ownership, such programs must satisfy certain legal and regulatory standards in order to be valid, as discussed below.

Rules governing state and local government implementation of the Federal DBE Program also provide for government agencies to implement the Program without the use of race-conscious measures such as DBE contract goals, or with limited use of such measures. According to Program rules (49 CFR Section 26.51), a state or local agency must meet the maximum feasible portion of its overall goal for DBE participation through “race-neutral means.” Race-neutral measures include removing barriers to participation of firms in general or promoting use of small or emerging businesses. If an agency can meet its overall annual goal solely through race-neutral means, it must not use race-conscious measures.

² 49 CFR Part 26.21.

³ <http://www.fhwa.dot.gov/HEP/49cfr26.htm>.

Given this context, general approaches for a state or local government to implement the Federal DBE Program include:

a. Applying race-conscious measures such as DBE contract goals, as well as neutral measures, with all certified DBEs eligible for race- and gender-conscious elements.

Many states use both race-conscious and race-neutral program measures when implementing the Federal DBE Program. Their race-conscious measures include the DBE contract goals feature of the Federal DBE Program.

ODOT currently implements the Federal DBE Program in this fashion. On FHWA-funded construction contracts, ODOT specifies a goal for DBE participation in the contract (contract goals are expressed as a percentage of the contract dollars that might go to DBEs). Prime contractors bidding on the contract must include DBEs in a number that would meet the goal or show good faith efforts to do so. ODOT began setting DBE contract goals for certain USDOT-funded engineering contracts in the last six months of 2009.⁴

A number of non-minority contractors and other groups have filed lawsuits challenging the constitutionality of the Federal DBE Program, or the constitutionality of the state and local governments' implementation of the Program, or both. For example, contractors have filed lawsuits against state departments of transportation implementing the Federal DBE Program in Illinois, Minnesota, Nebraska and Washington. The Federal DBE Program and its implementation by a state were successfully defended in Illinois, Minnesota and Nebraska but not in Washington. (The legal standards applied in these and other cases are explained later in Section I and Appendix A of this report.)

b. Applying more restrictive race-conscious measures only in extreme circumstances (as well as neutral programs). The Federal DBE Program provides that a recipient may not set-aside contracts for DBEs, except that, in limited and extreme circumstances, a recipient may use set-asides when no other method could be reasonably expected to redress egregious instances of discrimination. (49 CFR Part 26.43). Quotas for DBE participation are prohibited under the Program.

c. Applying race-conscious measures, but limit application to a subset of DBEs. Some state DOTs limit participation in the race- and gender-conscious elements of the Program to certain racial, ethnic or gender groups. For example, the Colorado Department of Transportation received a waiver from USDOT that allowed CDOT to set contract goals for "Underutilized DBEs" (UDBEs), which might not necessarily include all DBE groups. CDOT has counted the participation of all DBEs toward CDOT's overall annual goal, but only UDBEs can be used to meet individual contract goals. Over a number of years, CDOT has tracked utilization of minority- and women-owned firms by group to identify the racial, ethnic and gender groups that are "underutilized" and therefore eligible to be UDBEs.

⁴ Because ODOT only began setting DBE contract goals for certain engineering and other professional services contracts since July 2009, none of the engineering-related contracts in the July 2004–June 2009 study period had DBE contract goals.

- d. **Operate an entirely race-neutral program.** Some state DOTs have operated the Federal DBE Program without DBE contract goals or other race-conscious measures. For example, the New Mexico Department of Transportation discontinued using DBE contract goals and began implementing the Federal DBE Program using solely race-neutral measures in the 1990s.

2. Race- and gender-conscious measures of state and local programs. ODOT and other state DOTs have transportation contracts funded solely through state and local sources. The Federal DBE Program does not apply to these contracts.

Some state and local governments have programs with elements similar to DBE contract goals that they apply to their non-federally-funded contracts. For example, the Texas Department of Transportation operates a Historically Underutilized Business (HUB) Program that includes contract goals on certain state-funded projects.

ODOT does not apply any race-conscious programs to its non-federally-funded contracts. However, the State once had the Oklahoma Minority Business Enterprise Assistance Act, which gave favorable consideration to minority business enterprises (MBEs) submitting bids on state-funded contracts. Under this program, a bid from an MBE was considered to be the lowest if it was within 5 percent of the lowest bid from a non-minority firm. Non-minority contractors successfully challenged this program. In 2001, the U.S. District Court for the Western District of Oklahoma ruled that the State of Oklahoma had not met the legal standards for a constitutionally permissible race-conscious contracting program. Appendix A includes a discussion of this case — *Kornhass Construction, Inc. v. State of Oklahoma, Department of Central Services*, 140 F.Supp.2d 1232 (W.D. OK. 2001) — as well as other court decisions concerning state and local minority business programs.

3. Legal standards that race-conscious programs must meet. The U.S. Supreme Court has established that government programs including race-conscious elements must meet the “strict scrutiny” standard of constitutional review. The two key U.S. Supreme Court cases in this area are:

- The 1989 decision in *City of Richmond v. J.A. Croson Company*, which established the strict scrutiny standard of review for race-conscious programs enacted by state and local governments;⁵ and
- The 2005 decision in *Adarand Constructors, Inc. v. Peña*, which established the same standard of review for federal race-conscious programs.⁶

⁵ *City of Richmond v. J.A. Croson*, 488 U.S. 469 (1989).

⁶ *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200 (1995).

The strict scrutiny standard is extremely difficult for a government entity to meet — it presents the highest threshold for evaluating the legality of race-conscious programs short of prohibiting them altogether. Under the strict scrutiny standard, a governmental entity must:

- Have a *compelling governmental interest* in remedying past identified discrimination; and
- Show that any program adopted is *narrowly tailored* to achieve the goal of remedying the identified discrimination. There are a number of factors a court considers when determining whether a program is narrowly tailored (see Appendix A).

A government agency must meet both components of the strict scrutiny standard; a program that fails either one is unconstitutional.

Examples of race-conscious programs that have been ruled as unconstitutional. As discussed in Appendix A, many state and local race-conscious programs have been challenged in court and found to be unconstitutional.

The *Kornhass* case in Oklahoma illustrates how a program failed to meet the strict scrutiny standard. In this case, the State of Oklahoma indicated that its compelling governmental interest was to “promote the economy of the State and to ensure that minority business enterprises are given an opportunity to compete for state contracts.” Thus, the district court found the State admitted that the MBE Act’s bid preference “is not based on past discrimination,” but is rather based on a desire to “encourag[e] economic development of minority business enterprises which in turn will benefit the State of Oklahoma as a whole.”⁷ The district court found that this articulated interest was not “compelling” in the absence of evidence of past or present racial discrimination. It found that the State’s program failed the narrow tailoring test as well. (See Appendix A for a detailed discussion of this case.)

Examples of race-conscious programs that have satisfied the strict scrutiny standard. The Federal DBE Program, on its face, has been held to be constitutional in legal challenges to date (see discussion in Appendix A of *Northern Contracting, Inc. v. Illinois DOT*,⁸ *Sherbrooke Turf, Inc. v. Minn DOT and Gross Seed v. Nebraska Department of Roads*,⁹ and *Western States Paving Co. v. Washington State DOT*¹⁰, *Adarand Constructors, Inc. v. Slater*¹¹).

In the *Northern Contracting* decision (2007), the Seventh Circuit Court of Appeals cited its earlier precedent in *Milwaukee County Pavers v. Fielder* to hold “that a state is insulated from [a narrow tailoring] constitutional attack, absent a showing that the state exceeded its federal authority. IDOT

⁷ *Kornhass Construction, Inc. v. State of Oklahoma, Department of Central Services*, 140 F.Supp.2d 1232 (W.D. OK. 2001) at 1240.

⁸ 473 F.3d 715 (7th Cir. 2007).

⁹ 345 F.3d 964 (8th Cir. 2003), cert. denied, 541 U.S. 1041 (2004).

¹⁰ *Western States Paving Co. v. Washington State DOT*, 407 F.3d 983 (9th Cir. 2005), cert. denied, 546 U.S. 1170 (2006).

¹¹ *Adarand Constructors, Inc. v. Slater*, 228 F.3d 1147 (10th Cir. 2000) cert. granted then dismissed as improvidently granted sub nom. Adarand Constructors, Inc. v. Mineta, 532 U.S. 941, 534 U.S. 103 (2001).

[Illinois DOT] here is acting as an instrument of federal policy and Northern Contracting ... cannot collaterally attack the federal regulations through a challenge to IDOT's program."¹²

The Seventh Circuit Court of Appeals distinguished both the Ninth Circuit Court of Appeals decision in *Western States Paving* and the Eighth Circuit Court of Appeals decision in *Sherbrooke Turf*, relating to an as-applied narrow tailoring analysis. The Seventh Circuit held that the IDOT's application of a federally mandated program is limited to the question of whether the state exceeded its grant of federal authority under the Federal DBE Program.¹³ The Seventh Circuit analyzed IDOT's compliance with the federal regulations regarding calculation of the availability of DBEs, adjustment of its goal based on local market conditions and its use of race-neutral methods set forth in the federal regulations.¹⁴ The court held that Northern Contracting failed to demonstrate that IDOT did not satisfy compliance with the federal regulations (49 C.F.R. Part 26).¹⁵ Accordingly, the Seventh Circuit Court of Appeals affirmed the district court's decision upholding the validity of IDOT's DBE program. (See the discussion of the *Northern Contracting* decision in Appendix A.)

However, in *Western States Paving*, the Ninth Circuit Court of Appeals found that the Washington State DOT failed to show its implementation of the Federal DBE Program to be narrowly tailored. Since that 2005 ruling, state DOTs in Ninth Circuit states operated entirely race-neutral programs until studies could be completed that would help show whether any race-conscious elements of the Federal DBE Program were appropriate in those states, and, if so, for which racial, ethnic and gender groups.¹⁶

Because Oklahoma is located within the jurisdiction of the Tenth Circuit Court of Appeals, neither the Seventh Circuit nor the Ninth Circuit ruling are controlling or binding on ODOT, yet they do indicate some differences in the analysis for legally defensible implementation of the Federal DBE Program. (See Appendix A of this report as well as USDOT Guidance¹⁷ for further discussion of the implications of these issues.)

In addition to the Federal DBE Program, some state and local government minority-business programs have been found to meet the strict scrutiny standard. Appendix A discusses the successful defense of state and local race-conscious programs, including *Concrete Works of Colorado v. City and*

¹² 473 F.3d at 722

¹³ *Id.* at 722.

¹⁴ *Id.* at 723-24.

¹⁵ *Id.*

¹⁶ Disparity studies have been completed or are underway for state DOTs in each state within the Ninth Circuit—Alaska, Hawaii, Washington, Idaho, Montana, Oregon, California, Nevada and Arizona — as well as many local transit agencies and airports in those states.

¹⁷ <http://www.osdbu.dot.gov/DBEProgram/dbeqna.cfm>.

*County of Denver*¹⁸ and *H.B. Rowe Company v. Tippet, North Carolina Department of Transportation, et al.*¹⁹

4. Summary of reasons to complete a disparity study. It is opportune for ODOT to develop more comprehensive information on which to base its implementation of the Federal DBE Program.

- The USDOT recommends that agencies implementing the Federal DBE Program conduct disparity studies;
- Some of the information most useful in setting overall annual DBE goals and fine-tuning implementation of the Program requires the types of research developed in a disparity study;
- When challenged in court, the states that have successfully defended their implementation of the Federal DBE Program relied on the types of information developed in a disparity study;
- Information developed in a disparity study provides insights to improve minority- and women-owned firms' access to non-federally-funded contracts; and
- An independent, objective review of minority- and women-owned business participation in a state's contracting is valuable to groups that may have concerns about that agency's practices. ODOT has come under scrutiny from minority business groups, the Oklahoma Legislative Black Caucus and others regarding its utilization of minority- and women-owned firms.

B. Study Team

ODOT commissioned BBC Research & Consulting to provide information to help it implement the Federal DBE Program.

The BBC disparity study team consists of:

- **BBC Research & Consulting (BBC)**, a Denver-based economic and policy research firm (prime consultant). BBC has overall responsibility for this study and performed most of the required quantitative analyses.
- **Holland + Knight LLP (H+K)**, a national law firm. H+K conducted the legal analysis that provides the basis for this study and also performed in-depth personal interviews of business owners and trade associations.

¹⁸ *Concrete Works of Colorado v. City and County of Denver*, 321 F.3d 950 (10th Cir. 2003), cert. denied, 540 U.S. 1027 (2003).

¹⁹ *H.B. Rowe Corp., Inc. v. W. Lyndo Tippet, North Carolina DOT, et al*; 589 F. Supp. 2d 587 (E.D.N.C. 2008), appeal pending in the Fourth Circuit Court of Appeals.

- **Technology and Management Solutions (TMS)**, an Oklahoma-based minority woman-owned firm specializing in operations and information technology. TMS assisted in analyzing ODOT contract databases and collecting contract, subcontract and bidding information. TMS also conducted some in-depth interviews with businesses in Oklahoma.
- **M&M Business Consultants (M&M)**, a minority woman-owned firm in Oklahoma that provides training and other services for MBE/WBEs. M&M staff conducted in-depth interviews with business owners and trade associations throughout the state.
- **Customer Research International (CRI)**, a minority-owned telephone survey firm in San Marcos, Texas. Under BBC's direction, CRI conducted telephone interviews with several thousand transportation construction and engineering companies across Oklahoma.

The study team began its research effort in July 2009 and completed the final report in fall 2010.

C. Study Scope

This study team examined the transportation contracting industry in Oklahoma and related ODOT contracts and subcontracts.

Information reviewed to develop disparity study framework. BBC's methodology for this disparity study reflects a review of information including:

- Provisions in 49 CFR Part 26;
- Guidance from USDOT related to implementing the Federal DBE Program and conducting related analyses;
- Relevant court decisions (see Appendix A);
- Recommendations for disparity studies by the U.S. Commission on Civil Rights;²⁰
- Suggestions made by critics of disparity studies;²¹ and
- Other disparity studies conducted throughout the country.

Racial/ethnic/gender groups examined in the study. Disadvantaged business enterprises (DBEs) are defined in the Federal DBE Program.²² A DBE is a small business owned and controlled by one or more individuals who are socially and economically disadvantaged. The Federal DBE

²⁰ U.S. Commission on Civil Rights. May 2006. *Disparity Studies as Evidence of Discrimination in Federal Contracting: A Briefing Before The United States Commission on Civil Rights Held in Washington, D.C., December 16, 2005.* <http://www.usccr.gov/pubs/DisparityStudies5-2006.pdf>.

²¹ See for example, La Noue, George R. 1991, revised edition 1994. *Local Officials' Guide to Minority Business Programs and Disparity Studies*. Washington, D.C.: National League of Cities. See also Transportation Research Board of the National Academies. 2010. *NCHRP Report 644 – Guidelines for Conducting a Disparity and Availability Study for the Federal DBE Program*. Prepared for the National Cooperative Highway Research Program. http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp_rpt_644.pdf.

²² 49 CFR Section 26.5.

Program specifies the racial, ethnic and gender groups that can be presumed to be socially disadvantaged:

- Black Americans (or “African Americans” in this study);
- Hispanic Americans;
- Native Americans;
- Asian-Pacific Americans;
- Subcontinent Asian Americans; and
- Women of any race or ethnicity.

Economic disadvantage is based on firm revenue and personal net worth limits, below which firms and firm owners must fall to be eligible for DBE certification:

- Gross revenue must not exceed \$22,410,000, with lower limits for certain lines of business.²³
- Personal net worth must not exceed \$750,000, not including equity in the business and in personal residence.²⁴

White male-owned firms can also meet the federal certification requirements and be certified as DBEs. (Few white male-owned firms, however, apply for DBE certification. ODOT currently has one certified white-male DBE.)

In this study:

- The term “DBEs” refers to disadvantaged business enterprises that have been certified as such according to the federal definitions in 49 CFR Part 26.
- “MBEs” and “WBEs” are firms owned and controlled by minorities or women, according to the race/ethnicity definitions listed above, regardless of whether they are certified or meet the revenue and net worth requirements for certification.
- BBC’s term “potentially-certified DBEs” refers to firms that are or could be certified as DBEs given BBC’s information about firm size and the race/ethnicity/gender of firm owners.

Quantitative, qualitative and other information examined in the study. The disparity study collected and analyzed information on topics including the following.

²³ <http://www.dotcr.ost.dot.gov/asp/dbe.asp>

²⁴ 49 CFR Subpart D. 75 However, the personal net worth limit may change. Federal Register 25815 (May 10, 2010) (Notice of proposed rulemaking) suggests that \$750,000 may be changed to \$1.31 million. The comment period for this proposed change closes July 9, 2010.

- The study team defined the geographic area and construction/engineering subindustries that are the focus of the study based on analysis of ODOT contractors and subcontractors (see **Section II**).
- **Section III** presents information on local marketplace conditions. The study team examined whether there is any evidence of barriers for minorities and women to enter, advance within and start construction and engineering businesses in the local marketplace. BBC also analyzed access to business credit, insurance and bonding; different measures of business success; access to prime contract and subcontract opportunities; and other issues potentially affecting minorities and women in the local marketplace. Quantitative and qualitative information is included in this assessment, including results of interviews with business owners throughout the state.
- Based on analysis of contract and subcontract opportunities, and information collected through telephone interviews on the availability of businesses to perform this work, BBC determined the relative availability of minority- and women-owned firms for ODOT contracts and subcontracts (see **Section IV**). BBC also presents information on ODOT's "base figure" for its overall annual DBE goal.
- The study team analyzed utilization of minority- and women-owned firms on ODOT construction and engineering contracts and subcontracts (see **Section V**).
- BBC compared ODOT's utilization of minority- and women-owned firms with the availability of firms to perform this work. **Section VI** presents this disparity analysis.
- **Section VII** examines possible explanations for why any disparities occurred. The study team compared utilization and availability for subsets of ODOT contracts, and analyzed how ODOT reviewed bids and proposals of minority- and women-owned firms across a random sample of past ODOT contracts.
- Based on the information discussed above, BBC presents information in **Section VIII** for ODOT to consider when establishing its overall annual goal for DBE participation.
- **Section IX** provides a framework and relevant information for ODOT to review and consider in its determination of what percentage of its overall annual DBE goal can be achieved through neutral means, whether any race-conscious programs are appropriate under the federal regulations, and what DBE groups might be eligible for any race-conscious programs.
- Information ODOT can use in its future implementation of the Federal DBE Program is summarized in **Section X**. The study team evaluated a range of potential changes to ODOT's implementation of the Program. **Section X** presents a similar summary of programs ODOT might implement for state-funded contracts.