Federal Court Enjoins the SBA's Presumption of Racial Disadvantage

A federal district court in Tennessee struck down a key pillar of the 8(a) Program that is intended to boost contracting with minority-owned businesses.

BY STEPHEN BACON

The 8(a) Business Development Program (8(a) Program) was established 70 years ago and has expanded opportunities for countless small and minority-owned businesses. Participants in the 8(a) Program receive training, technical assistance, and contracting preferences including opportunities for set-aside contracts and sole-source awards.

To qualify for the 8(a) Program, firms must be "unconditionally owned and controlled by one or more socially and economically disadvantaged individuals."[1] Since 1986, the Small Business Administration (SBA) has applied a presumption that individuals in certain designated minority groups qualify as "socially disadvantaged," meaning that they "have been subjected to racial or ethnic prejudice or cultural bias."[2]

The Supreme Court recently ruled

that raced-based preferences in college admissions violated the U.S. Constitution's Equal Protection Clause. Specifically, the court held that an applicant "must be treated based on his or her experiences as an individual – not on the basis of race."[3]

On July 19, 2023, a federal district court in Tennessee applied a similar rationale to enjoin the SBA's use of the "rebuttable presumption" in reviewing applications to the 8(a) Program.[4] The court concluded that the SBA's rule denied equal protection of the laws to non-minorities that are not entitled to the presumption and instead must prove their status as "socially disadvantaged" to be admitted to the 8(a) Program.

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In response to the court's ruling, the SBA has temporarily suspended all new 8(a) Program applications. It is also requiring current 8(a) Program participants that previously relied on the "rebuttable presumption" to submit evidence of "social disadvantage" based on their individual circumstances to maintain eligibility. This imposes a significant new requirement on many current 8(a) participants that is likely to reduce the number of minorities that ultimately qualify.

The Rebuttable Presumption

The 8(a) Program was established in the 1950s to develop the capacity of small businesses. In the late 1970s, Congress limited eligibility for the 8(a) Program to "socially and economically disadvantaged small business concerns."[5]

Under the law, "[s]ocially disadvantaged individuals are those who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their individual qualities."[6] Congress limited eligibility to socially disadvantaged groups because it found that they "have suffered the effects of discriminatory practices or similar invidious circumstances over which they have no control."[7]

For the past 35 years, the SBA has applied a "rebuttal presumption" that members of certain minority groups are "socially disadvantaged."[8] The SBA has afforded this presumption to Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and Subcontinent Asian Americas.[9] An individual who does not belong to one of these groups is required to prove that they are socially disadvantaged by a "preponderance of the evidence."[10]

Ultima's Racial Discrimination Claim

Ultima is a white-owned small business that provides administrative and technical support services. Ultima provided these services to the United States Department of Agriculture (USDA) under four regional indefinite delivery, indefinite quantity (IDIQ) contracts.

In 2018, however, the USDA declined to exercise further options on the IDIQ contracts and task orders awarded to Ultima. USDA instead began awarding some of the work previously performed by Ultima to firms in the 8(a) Program. Ultima could not compete for that work because it was not an eligible 8(a) participant.

Ultima's lawsuit alleged that the government engaged in unlawful racial discrimination in violation of Ultima's right to equal protection under the Fifth Amendment to the

U.S. Constitution. Specifically, Ultima claimed that the SBA's use of the rebuttable presumption illegally discriminated on the basis of race.

The Fifth Amendment provides that no person may be "deprived of life, liberty, or property, without due process of law."[11] The protection afforded by the Fifth Amendment's Due Process Clause prohibits the federal government from denying any person equal protection of the laws.[12]

The government may violate an entity's equal protection rights by "making distinctions that (1) burden a fundamental right; (2) target a suspect class; or (3) intentionally treat one individual differently from others similarly situated without any rational basis."[13] Courts review racial classifications under "a daunting two-step examination known. . . . as 'strict scrutiny.'"[14] Race-based classifications will survive strict scrutiny analysis "only if they are [(1)] narrowly tailored measures that further [(2)] compelling governmental interests."[15]

The Court applied this strict scrutiny test to determine whether the 8(a) Program's rebuttable presumption supports a compelling governmental interest and is narrowly tailored to achieve that interest.

The Presumption Does Not Support a "Compelling Government Interest"

In its recent decision invalidating race-based preferences in college admissions, the Supreme Court opined that the government only has a compelling interest in "remediating specific, identified instances of past discrimination that violated the Constitution or statute."[16] The court in *Ultima* found that the rebuttable presumption did not remediate past racial discrimination in federal contracting because the government lacks "stated goals for the 8(a) program or an understanding of whether certain minorities are underrepresented in a particular industry."[17]

Current participants must establish that they qualify as "socially disadvantaged" by completing a . . . narrative . . . . [detailing] two specific instances of discrimination or bias experienced by the 8(a) participant's owner.

Moreover, the court concluded there was not a "strong basis in evidence" to support the rebuttable presumption.[18] Although the government presented evidence of national disparities faced by minority-owned businesses across different industries, the court found that the government did "not identify a specific instance of discrimination which they seek to address with the use of the rebuttable presumption."[19]

The court determined that remediation of "societal discrimination" was not a "compelling interest" under the law.[20] And while the court did "not doubt the persistence of racial barriers to the formation and success of" minority-owned businesses, the court did not find sufficient evidence "that the government was a passive participant in such discrimination in the relevant industries in which Ultima operates."[21]

The Presumption Was Not "Narrowly Tailored"

The court also agreed with Ultima that the rebuttable presumption was not "narrowly tailored" to achieve the government's stated interest in remediating the effects of past racial discrimination. This second prong of the strict scrutiny test considers "the necessity for the race-based relief, the efficacy of alternative remedies, the flexibility and duration of the relief, the relationship of the numerical goals to the relevant labor market, and the impact of the relief on the rights of third parties."[22]

The court determined that the rebuttable presumption was inflexible because, in practice, there was not a process to overcome the presumption and "individuals who do not receive the presumption must put forth double the effort to qualify for the 8(a) program."[23] Further, the court concluded that although an 8(a) participant's eligibility is capped at nine years, the SBA's use of the rebuttable presumption "does not have a termination date" and therefore "exceeds the concept of narrow tailoring."[24]

The court criticized the SBA for engaging in "arbitrary line drawing for who qualifies for the rebuttable presumption" by leaving out groups such as Hasidic Jews that have faced discrimination but are not entitled to the presumption.[25] In the court's view, the rebuttable presumption was also overinclusive "by including anyone from the specified minority groups, regardless of the industry in which they operate."[26]

Additionally, the court was not convinced that the SBA adequately considered race-neutral alternatives to achieving its interests since the rebuttable presumption was adopted in 1986. Finally, the court concluded that the rebuttable presumption had a significant impact on Ultima by impeding its ability to compete for 8(a) set-aside contracts.

The Court's Injunction

The court's ruling enjoins the SBA "from using the rebuttable presumption of social disadvantage" in administering the 8(a) Program. The SBA has responded to the court's decision by temporarily halting all new applications to the 8(a) Program.

The SBA has also issued interim guidance that explains how the court's decision will impact current 8(a) participants that previously relied on the "rebuttable presumption" to qualify for the 8(a) Program. These participants must establish that they qualify as "socially disadvantaged" by completing a social disadvantage narrative.

The narrative must detail at least two specific instances of discrimination or bias experienced by the 8(a) participant's owner in education, employment, or business. To comply with the SBA's guidance, owners must describe who, what, where, why, when, and how the discrimination or bias occurred.

If an 8(a) participant previously relied on the "rebuttable presumption," they will not be able to receive new 8(a) contracts until the SBA makes an affirmative determination that the individual owner qualifies as "socially disadvantaged" based on the narrative submitted. Given the large number of minority-owned 8(a) participants, the SBA is going to have to review a significant number of social disadvantage narratives in a short timeframe to avoid potential impacts to pending awards.

As of this writing, the court is considering potential further remedies requested by the plaintiff. This may include remedies that could impact current 8(a) contracts that the plaintiff in Ultima could not compete for because it was not an eligible 8(a) participant. Businesses and individuals impacted by the court's decision should continue to monitor these proceedings and the SBA website at www.sba.gov for the latest developments and guidance. CM

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Stephen L. Bacon is a shareholder in the Washington, D.C. office of the law firm Rogers Joseph O'Donnell, where he represents government contractors in bid protests, claims, investigations, and suspension and debarment proceedings. He frequently litigates cases at the Court of Federal Claims, the Government Accountability Office, the Boards of Contract Appeals, and the Small Business Administration's Office of Hearings and Appeals. He also provides advice and counseling to clients on a broad range of contractual and regulatory compliance issues that confront government contractors.

ENDNOTES

1 15 U.S.C. § 637(a)(4)(A); 13 C.F.R. § 124.105
2 13 C.F.R. § 124.103(a)-(b).
3 Students for Fair Admissions, Inc. v. President and Fellows of Harvard Coll., 143 S. Ct. 2141, 2176 (2023).
4 Ultima Servs. Corp. v. U.S. Dep't Agric., Case No. 2:20-CV-00041-DCLC-CRW, 2023 WL 4633481 (E.D. Tenn. Jul. 19, 2023).
5 P.L. 95-507.
6 15 U.S.C. § 637(a)(5).
7 Id. § 631(f)(1)(B).
8 13 C.F.R. §124.103(b).
9 Id.
10 Id. §124.103(c)(1).
11 U.S. Const. amend. V.
12 United States v. Windsor, 570 U.S. 744, 774 (2013).
13 Johnson v. Bredesen, 624 F.3d 742, 746 (6th Cir. 2010).
14 Students for Fair Admissions, 143 S. Ct. at 2162.
15 Adarand Constructors, Inc. v. Pena, 515 U.S. 200, 227 (1995).
16 Students for Fair Admissions, 143 S. Ct. at 2162.
17 Ultima, 2023 WL 4633481, at *11.
18 Id.
19 Id. at *12.
20 Id.
21 Id. at *14.
22 Id.
23 Id. at *15.
24 Id. at *15-16.
25 Id. at *17.
26 Id.
27 Id. at *18.