

Court decision voids major small business contracting law (11/6/08)

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## **Court decision voids major small business contracting law**

By Elizabeth Newell [enewell@govexec.com](mailto:enewell@govexec.com) November 6, 2008

A federal appeals court has thrown out a law establishing a 5 percent goal for awarding defense contracts to small businesses owned by socially and economically disadvantaged individuals.

The decision has the potential to invalidate the small disadvantaged and 8(a) contracting programs, which help socially and economically disadvantaged firms win billions of dollars in federal contracts every year.

The opinion, issued by the U.S. Court of Appeals for the Federal Circuit, strikes down a legislative provision, first enacted in 1986 and renewed numerous times since, which sets a goal that 5 percent of federal defense contracting dollars each fiscal year must be awarded to certain entities, including small disadvantaged companies.

The court noted that this provision incorporates the 1953 Small Business Act's presumption that African-American, Asian-American, Hispanic-American and Native American business owners are socially disadvantaged.

The provision therefore violates the equal protection component of the Fifth Amendment right to due process, because it authorizes the Defense Department to afford preferential treatment on the basis of race and does not meet a "strict scrutiny" standard, the appeals court decided. Under this requirement, the government must prove that the preference is "narrowly tailored to serve a compelling government interest."

"Because Congress did not have a 'strong basis of evidence' upon which to conclude that DoD was a passive participant in pervasive, nationwide racial discrimination -- at least not on the evidence produced by DoD and relied on by the district court in this case -- the statute fails strict scrutiny," the decision stated.

Defense's practice of giving minority companies a 10 percent price credit meant that companies owned by certain socially and economically disadvantaged groups did not have to be the lowest bidder to win federal contracts, and helped the department achieve the congressionally mandated goal. Defense is required to waive price adjustments if it is meeting the small business goals, and has not employed adjustments since March 2007.

The initial suit was filed in 1998 by Rothe Development Corp., a Texas-based information technology company that lost a Defense contract to an Asian-American-owned business. Rothe, owned by a Caucasian woman, had been the lowest bidder.

David Barton, of the San Antonio-based Gardner Law Firm, who represented Rothe, said the decision will force minority-owned businesses to compete on an equal playing field.

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"If they know they're going to have to bid like everybody else, it's going to make their bidding more difficult, but it opens up bidding for nonminority businesses -- not certified minority businesses -- because they don't have to worry about putting in the lowest bid and still getting whacked down," Barton said.

Barton said in addition to a small \$10,000 monetary award limited by statute, Rothe was granted declaratory relief finding that the law was unconstitutional. The Defense Department was ordered not to employ the statute or race-based contracting preferences.

Guy Timberlake, chief executive officer of the American Small Business Coalition, said the full impact of the decision is unclear, but that it seems to invalidate elements of the small disadvantaged business program and the federal contracting component of the 8(a) business development program.

"This specifically applies to [small disadvantaged businesses and] does not on the surface directly impact 8(a) or the other social economic programs, but it potentially could depending on who was going to run this ruling up the flagpole," Timberlake said. "Woman-owned, 8(a), all the programs under [the Small Business Administration] are based on a socioeconomic designation. My concern is that this court is saying the entire small business program is unconstitutional."

Timberlake noted that elements of these programs have been rolled back in recent months, with SBA announcing that small disadvantaged businesses would be able to self-certify. SBA, along with the Justice Department, also used concerns about constitutionality to explain delays in implementing the women-owned small business program.

Agencies such as NASA, which also employed the 10 percent price credit, have rolled back that practice and Barton said that is a direct result of the ongoing lawsuit.

"Limitations on this [price credit] statute have been implemented since we filed suit in 1998. They just don't want to go far enough, because politically they feel they have to keep the program," Barton said.

Defense spokeswoman Cheryl Irwin said the department was reviewing the ruling, along with the Justice Department.

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CORRECTION: The original version of this story misstated the name of the judge who issued the appeals court decision. The ruling came from the U.S. Court of Appeals for the Federal Circuit, where Paul Michel is the chief judge.