GIBSON DUNN

Federal Court Extends Students for Fair Admissions to Invalidate Use of Certain Racial Preferences in Government Contracting

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On July 19, 2023, a federal district court held in *Ultima Servs. Corp. v. United States Dep't. of Agriculture*, No. 2:20-CV-00041 (E.D. Tenn.), that certain racial preferences in government contracting violate constitutional guarantees of equal protection. The case appears to be the first federal decision that extends *Students for Fair Admissions v. Harvard* and *Students for Fair Admissions v. University of North Carolina* ("*SFFA*") to the government contracting context. Although the case has no precedential effect and does not address the legality of private entities' use of racial preferences in procurement decisions or otherwise, future courts might apply *Ultima*'s reasoning to Section 1981 cases that challenge private companies' efforts to diversify their supply chains.

A. Background

Section 8(a) of the Small Business Act instructs the Small Business Administration (the "Administration") to contract with other agencies "to furnish articles, equipment, supplies, services, or materials to the Government, or to perform construction work for the Government." 15 U.S.C. § 637(a)(1)(A) (the "8(a) program"). The Administration is further authorized to "arrange for the performance of such procurement contracts by negotiating or otherwise letting subcontracts to socially and economically disadvantaged small business concerns." 15 U.S.C. § 637(a)(1)(B). A "socially and economically disadvantaged small business concern" is one that is majority-owned by "socially disadvantaged individuals"—"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." *Id.* § 637(a)(4)-(5). The Act vests the Administration with authority to determine "whether a group has been subjected to prejudice or bias." *Id.* § 637(a)(8).

Acting pursuant to this authority, the Administration adopted a regulation, creating a "rebuttable presumption" that "Black Americans; Hispanic Americans; Native Americans … Asian Pacific Americans … [and] Subcontinent Asian Americans" are "socially disadvantaged." 13 C.F.R. § 124.103(b)(1). Thus, businesses owned by members of these racial minorities are presumptively entitled to participate in the 8(a) program. Plaintiff Ultima, a small business owned by a white woman, filed suit, alleging that it was able and willing to perform on contracts set aside for the 8(a) Program, but was ineligible to do so because of the race of its owner.

B. Analysis

1. The District Court's opinion

The court held that the 8(a) program violates the equal-protection component of the Fifth

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Amendment. The court determined that Ultima had standing "because in equal protection cases, the injury-in-fact is the denial of equal treatment resulting from the imposition of the barrier, not the ultimate inability to obtain the benefit." This injury was redressable because a ruling prohibiting the Administration "from using the rebuttable presumption based on race would remove the race-based barrier that injures Ultima."

The court then held that the 8(a) program failed to satisfy strict scrutiny. First, the Administration did not assert a compelling interest supporting the program's racial classification. Quoting *SFFA*, the court reasoned that while the government "has a compelling interest in remediating specific, identified instances of past discrimination that violated the Constitution or a statute," it also "must present goals that are sufficiently coherent for purposes of strict scrutiny." But according to the court, "[t]he 8(a) program suffered a fatal lack of any stated goals." For example, the Administration did "not identify a specific instance of discrimination" that it sought to remedy via the rebuttable presumption. Although the government argued that the rebuttable presumption was necessary "to remedy the effects of past racial discrimination in government contracting," the court held that the government was just a "passive participant in such discrimination in the relevant industries in which Ultima operates" and did not "allow[] discrimination to occur in the industries relevant to Ultima." Additionally, the Administration did "not examine whether any racial group is underrepresented in a particular industry relevant to a specific contract in the 8(a) program" and therefore could not "measure the utility of the rebuttable presumption in remedying the effects of past racial discrimination," as the court believed to be required by *SFFA*.

Second, the court held that even if the Administration had a compelling interest in remediating specific past discrimination, the 8(a) program was not narrowly tailored to combatting discrimination. The court reasoned that *SFFA* "reaffirms that racially conscious government programs must have 'a logical end point,'" but that the 8(a) program "has no termination date." Further, the court believed the 8(a) program to be both underinclusive and overinclusive. It was underinclusive, the court reasoned, because it used what *SFFA* referred to as "imprecise" racial categories to determine "who qualifies for the rebuttable presumption"; the program excluded "Central Asian Americans and Arab Americans [who] have faced significant discrimination," and viewed "Hasidic Jews who have faced similarly appalling discrimination [as] ineligible for the rebuttable presumption." The court perceived the program to be overinclusive because it "swe[pt] broadly by including anyone from the specified minority groups, regardless of the industry in which they operate." The court therefore enjoined the Government from using the rebuttable presumption of social disadvantage in administering the SBA's 8(a) program.

2. Existing law governing contracting-discrimination claims against private companies

42 U.S.C. § 1981 ("Section 1981") prohibits racial discrimination in making and enforcing contracts. To prevail on a Section 1981 claim, a plaintiff must satisfy three elements. First, he must show that the defendant intended to discriminate on the basis of race. Second, he must demonstrate that the racial discrimination "interfered with a contractual interest," *Denny v. Elizabeth Arden Salons, Inc.*, 456 F.3d 427, 435 (4th Cir. 2006)—for example, that there was a "refusal to enter into a contract with someone" on the basis of race, or an "offer to make a contract only on discriminatory terms," *Patterson v. McLean Credit Union*, 491 U.S. 164, 176–77 (1989). *See also, e.g., Domino's Pizza, Inc. v. McDonald*, 546 U.S. 470, 476 (2006) (Section 1981 "offers relief when racial discrimination blocks the creation of a contractual relationship, as well as when racial discrimination impairs an existing contractual relationship."). Third, a plaintiff must establish that race discrimination was a "but-for" cause of his injury. *Comcast Corp. v. Nat'l Ass'n of African Am.-Owned Media*, 140 S. Ct. 1009, 1019 (2020).

A defendant can defeat a Section 1981 claim by demonstrating that it acted pursuant to a valid affirmative-action plan. *See, e.g., Johnson v. Transportation Agency, Santa Clara*

County, California, 480 U.S. 616, 626–27 (1987); *see also, e.g., Doe v. Kamehameha Sch./Bernice Pauahi Bishop Estate*, 470 F.3d 827, 836–40 (9th Cir. 2006) (en banc) (applying *Johnson* in Section 1981 case). A valid affirmative-action plan must be remedial in nature, and must rest "on an adequate factual predicate justifying its adoption, such as a 'manifest imbalance' in a 'traditionally segregated job category.'" *Shea v. Kerry*, 796 F.3d 42, 57 (D.C. Cir. 2015) (quoting *Johnson*, 480 U.S. at 631) (alteration omitted).

C. Implications for Section 1981 cases

Ultima was not a Section 1981 case. Indeed, in *Ultima*, the court dismissed the plaintiff's Section 1981 claim because the statute does not apply to the federal government. As a result, *Ultima* does not change existing law governing private actors' use of racial preferences in awarding contracts. Nevertheless, the case suggests that some federal courts will be receptive to challenges to other uses of racial preferences in government contracting, like state and local set-aside programs and requirements that contractors employ a certain number of minority employees. In addition, courts have held that "purposeful discrimination that violates the Equal Protection Clause also will violate § 1981." *Anderson v. City of Boston*, 375 F.3d 71, 78 n.7 (1st Cir. 2004); *see also Dunnet Bay Const. Co. v. Borggren*, 799 F.3d 676, 696 (7th Cir. 2015) ("Racial discrimination by a recipient of federal funds that violates the Equal Protection Clause also violates Title VI and § 1981."). *Ultima* therefore suggests that some future courts could hold that Section 1981 prohibits private companies that seek to diversify their supply chains from implementing plans similar to the 8(a) program.

Additionally, *Ultima* includes a footnote, in which the court observes that while "[t]he facts in *Students for Fair Admissions, Inc.* concerned college admissions programs … its reasoning is not limited to just those programs." *Ultima* applied *SFFA* to a government contracting program, and a future court could apply the same reasoning to bring challenges to employer or corporate programs under Section 1981, Title VII, and other anti-discrimination statutes. That said, the precedential effect of *Ultima* is limited, and the decision could be overturned on appeal. In the meantime, *Ultima* could represent another sign of an increasing trend towards reverse-discrimination claims in employment and contracting.

The following Gibson Dunn attorneys assisted in preparing this client update: Jason Schwartz, Molly Senger, Zakiyyah Salim-Williams, Mylan Denerstein, Dhananjay Manthripragada, Lindsay Paulin, Matt Gregory, and Josh Zuckerman.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Labor and Employment or Government Contracts practice groups, the authors, or the following practice leaders and partners:

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