K&L GATES LLP
1601 K STREET, N.W.
WASHINGTON, DC 20006

ATTORNEY-CLIENT PRIVILEGE

MEMORANDUM

TO: John L. Longstreth
Bill Kirk

FROM: Phil Griffin

DATE: July 8, 2015

RE: Application of DBE Goal Requirements to Airports that Levy Passenger Facility Charges But Do Not Accept Federal Grants

Airport development projects are funded in a number of ways. Two in particular are relevant here. First, the Secretary of Transportation is authorized to fund airports through "project grants" paid out of the federal Airport and Airway Trust Fund. 49 U.S.C. § 47104(a). Second, airports are authorized to levy a "passenger facility charge" ("PFC") of up to $4.50 per passenger each time a passenger boards an aircraft. 49 U.S.C. § 40117(b)(1). The fee is imposed directly on the passenger and an airport may impose it regardless of whether the passenger's journey is originating or terminating at the airport or whether the passenger is merely connecting through the airport en route to a final destination. 49 U.S.C. § 40117(b)(3).

As a condition to receive project grants from the federal government, airports must make a number of assurances about their operations. One particular assurance requires grant-receiving airports to ensure that at least 10 percent of all businesses in the airport that sell consumer products are "small business concerns . . . owned and controlled by a socially and economically disadvantaged individual." 49 U.S.C. § 47107(e). The term "socially and economically disadvantaged individual" is defined to include African Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, women, and certain other minorities or individuals found to be disadvantaged by the Small Business Administration. 49 U.S.C. § 47113(a)(2). Department of Transportation regulations, which refer to businesses owned by such individuals as "disadvantaged business enterprises" ("DBEs"), set forth the standards and procedures for use in determining whether a company qualifies as a DBE. 49 C.F.R. § 26.5. The statute authorizing airports to levy PFCs does not contain an analogous DBE goal requirement.

Recently, several airports have considered whether to stop accepting federal grant money and to begin relying solely on PFCs to fund their development projects. This memorandum addresses the application of DBE goal requirements to airports that charge PFCs but do not accept federal grants. While a federal grant of authority to charge PFCs is not alone sufficient to trigger the DBE goal requirement found in the project grant statute, Congress may constitutionally amend the PFC-authorizing statute to incorporate DBE goals. Numerous courts have upheld the constitutionality of DBE goal provisions. Further, the necessity of a DBE goal program for airports that charge PFCs but do not accept federal grants is supported by a strong basis in evidence, and air travel is sufficiently national to warrant federal legislation.

I. A federal grant of authority to charge PFCs is not alone sufficient to trigger the DBE goal provision found in the project grant statute.

While the project grant and PFC-authorizing statutes are similar in many ways, they are not sufficiently linked for the DBE goal provision found in the project grant statute to apply to the PFC-authorizing statute. In general, states are prohibited from taxing individuals engaged in air travel. Specifically, the Anti-Head Tax Act prohibits states, including state subdivisions like airport authorities, from levying or collecting "a tax, fee, head charge, or other charge" on: (1) an individual traveling in air commerce; (2) the transportation of an individual traveling in air commerce; (3) the sale of air transportation; or (4) the gross receipts from that air commerce or transportation. 49 U.S.C. § 40116(b). However, Congress created an exception to that prohibition when it authorized airports to levy PFCs. Because the PFC authorization is a federal grant of authority, like project grants are federal grants of money, one could attempt to argue that PFCs are analytically equivalent to project grants and therefore the DBE goal provision applies to airports that charge PFCs in the same way that it applies to airports that accept federal grants.

However, nothing in the statutory text or the case law indicates either that authorization to levy PFCs is enough to trigger the DBE goal provision found in the project grant statute or more generally that a grant of authority is analytically equivalent to a grant of funds. While the federal project grant statute specifically ties acceptance of grants to participation in the DBE goal program, the PFC-authorizing statute contains no such language. Therefore, requiring airports that charge PFCs but do not accept federal grants to participate in a DBE goal program would necessitate amending the PFC-authorizing statute.

II. Congress may constitutionally amend the PFC-authorizing statute to incorporate DBE goals.

A. Numerous courts have upheld the constitutionality of DBE goal programs.

Federal programs designed to provide contracts to DBEs are constitutional as long as they satisfy strict scrutiny, or are narrowly tailored to further a compelling government interest. *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 227 (1995) ("*Adarand III*"). In *Adarand III*, the Supreme Court reviewed the constitutionality of a "subcontractor compensation clause," which provided that a general contractor selected by the federal government would receive additional compensation if it hired subcontractors certified as DBEs. *Id.* at 205. The case arose when the Central Federal Lands Highway Division, a division of the United States Department of Transportation, awarded the prime contract for a Colorado highway construction project to Mountain Gravel & Construction Company, which then solicited bids from subcontractors for the guardrail portion of the contract. *Id.* Adarand, which was not certified as a DBE, submitted the low bid on the project, but Mountain Gravel selected Gonzales Construction Company, which was certified as a DBE, to complete the guardrail work. *Id.* Adarand sued, claiming that the federal government's practice of giving contractors on government projects a financial incentive to hire DBE subcontractors violated the equal protection component of the Fifth Amendment's Due Process Clause. *Id.*

In hearing Adarand's challenge, the Supreme Court paid little attention to the particular facts of the case, focusing instead on whether benign race-conscious programs are subject to strict scrutiny, a question it answered in the affirmative. The Court began its analysis by

tracing the history of its Fifth and Fourteenth Amendment jurisprudence through its decision in *Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989), which established that the Fourteenth Amendment requires strict scrutiny of all race-based action, including remedial race-based action, by state and local governments. *Adarand III*, 515 U.S. at 214-22. In *Adarand III*, the Court overruled a contrary line of precedent and made clear that the Fifth Amendment requires strict scrutiny for such actions taken by the federal government as well. *Id.* at 227. The Court then remanded the case to the lower courts for further consideration in light of its newly announced standard. *Id.* at 237.

On remand, the Tenth Circuit examined a newer version of the DBE program challenged in *Adarand III*. *Adarand Constructors, Inc. v. Slater*, 228 F.3d 1147, 1155 (10th Cir. 2000) ("Adarand VII"). Since the specific subcontractor compensation clauses at issue in *Adarand III* were no longer in use, the court reviewed a provision in the Small Business Act that established a government-wide goal of DBE participation of "not less than 5 percent of the total value of all prime contract and subcontract awards for each fiscal year." *Id.* at 1160-61. The court found that the program was narrowly tailored to further a compelling state interest and was therefore constitutional. *Id.* at 1155.

The court first determined that the federal government "has a compelling interest in not perpetuating the effects of racial discrimination in its own distribution of federal funds and in remediating the effects of past discrimination in the government contracting markets created by its disbursements." *Id.* at 1165. While the framework at issue in *Adarand VII* was "in part an exercise of Congress's power under the Spending Clause, that does not affect the constitutional analysis." *Sherbrooke Turf, Inc. v. Minnesota Dep't of Transp.*, 345 F.3d 964, 969 n.3 (2003). Indeed, nothing in either of the relevant *Adarand* decisions or any of the federal appellate decisions on the matter suggests that the constitutionality of DBE goal provisions turns on their connection to grants. The Supreme Court has never clearly stated whether private discrimination that is in no way funded with public tax dollars can, by itself, justify a remedial race-based program, but a plurality of the Court has suggested that remedial measures could be justified by a showing that a municipality "had essentially become a 'passive participant' in a system of racial exclusion" practiced by elements of an industry. *Adarand VII*, 228 F.3d at 1167, quoting *Croson*, 488 U.S. at 492.

Courts have also held that state entities implementing a congressionally mandated program may rely on "the federal government's compelling interest in remedying the effects of discrimination in the national . . . market." *Northern Contracting, Inc. v. Illinois*, 473 F.3d 715, 720 (7th Cir. 2007). *See also Western States Paving Co., Inc. v. Washington State Dep't of Transp.*, 407 F.3d 983, 997 (9th Cir. 2005) ("When Congress enacted [the act], it identified a compelling nationwide interest in remedying discrimination in the transportation contracting industry. Even if such discrimination does not exist in Washington, the State's implementation of [the act] nevertheless rests upon the compelling interest identified by Congress."); *Sherbrooke*, 345 F.3d at 970 ("When the program is federal, the inquiry is (at least usually) national in scope. If Congress or the federal agency acted for a proper purpose and with a strong basis in the evidence, the program has the requisite compelling government interest nationwide, even if the evidence did not come from or apply to every state in the Nation.").

The Tenth Circuit next determined that the DBE goal provision was narrowly tailored to further the compelling interest. *Adarand VII*, 228 F.3d at 1187. Factors relevant to determining whether a remedial race-based program is narrowly tailored include: (1) the availability of race-neutral alternatives; (2) limits on the duration of the program; (3) flexibility; (4) numerical

proportionality; (5) the burden on third parties; and (6) over- or under-inclusiveness. *Id.* at 1178. Because the implementing regulations required state highway funding recipients to "meet the maximum feasible portion of [their] overall goal[s] by using race-neutral means of facilitating DBE participation" and limited the duration of each particular company's DBE status, included a waiver provision, included proportional goals, retained procedures allowing disadvantaged non-minorities to participate in the program, and required an individualized showing, the court held that the DBE provision was sufficiently narrowly tailored to survive strict scrutiny. *Id.* at 1177-1187. For a race-conscious remedial program to be narrowly tailored as applied by a state, it must also be limited to those locations where it is demonstrably needed, which depends on the presence or absence of discrimination or its effects in the relevant state industry, and must be limited to those specific groups that have actually suffered discrimination or its effects. *Western States*, 407 F.3d at 996-98.

Other federal courts of appeals that have reviewed the constitutionality of programs designed to provide contracts to DBEs have utilized similar reasoning to reach the same conclusion. *See Northern Contracting*, 473 F.3d at 724 (evaluating a state's implementation of the Transportation Equity Act for the 21st Century ("TEA-21"), which involved setting goals for DBE participation in federally funded state highway projects, and finding it to be constitutional); *Western States*, 407 F.3d at 1002-03 (evaluating TEA-21 and finding it to be constitutional, but finding the state's application of it to be unconstitutional for lack of evidence of discrimination in the state's highway contracting industry); *Sherbrooke*, 345 F.3d at 974 (evaluating TEA-21 and finding both the statute and the state's application of it to be constitutional).

B. The necessity of a DBE goal program for airports that charge PFCs but do not accept federal grants is supported by a strong basis in evidence.

While an articulated interest may be compelling in theory, the proponent of a remedial race-based program must demonstrate as a "factual predicate" whether there exists a "strong basis in evidence" for the proponent's conclusion that remedial action is necessary. *Adarand VII*, 228 F.3d at 1166 (citation omitted). Both statistical and anecdotal evidence are appropriate in the analysis, although anecdotal evidence alone is not. *Id.* In *Adarand VII*, the government offered evidence of barriers to the formation of qualified minority subcontracting enterprises and to fair competition between minority and non-minority subcontracting enterprises due to private discrimination, local disparity studies of minority subcontracting, and studies of local subcontracting markets after the removal of remedial race-based programs. *Id.* at 1168. The court determined that the evidence, which consisted of numerous congressional investigations and hearings as well as outside studies of statistical and anecdotal evidence, was sufficient to support the government's "articulated, constitutionally valid, compelling interest." *Id.* at 1175 (citation omitted).

Evidence showing that DBE participation in the relevant market drops sharply when race-conscious programs are discontinued supports a finding that there are significant barriers to DBE participation in the market, "raising the specter of racial discrimination" and supporting a claim that remedial action is necessary. *Id.* at 1174. *Compare Sherbrooke*, 345 F.3d at 973-74 (concluding that Minnesota and Nebraska's applications of TEA-21 were narrowly tailored and constitutional as applied because of the evidence the states presented; states hired outside consulting firms to conduct statistical analyses of the availability and capacity of DBEs in their local markets), *with Western States*, 407 F.3d at 1002 (concluding that Washington's application of TEA-21 was not narrowly tailored and was therefore unconstitutional as applied

because the evidence of discrimination in the Washington highway contracting industry was insufficient; the state did not conduct statistical studies to establish the existence of discrimination in the relevant market, its calculation of the capacity of DBEs to complete work was flawed, and a 2.17% disparity between the proportion of DBE firms in the state and the percentage of funds awarded to DBEs in race-neutral contracts was not enough to demonstrate discrimination).

A study completed by Martin Associates reflects a significantly lower utilization of DBEs on PFC-funded airport capital improvement projects, which do not have a federally mandated DBE goal program, than on grant-funded capital improvement projects, which do have a federally mandated DBE goal program. The overall average DBE participation rate for grant-funded projects from 2009-2013 across the country's 15 largest airports was 21.2%. However, the overall average DBE participation rate for PFC-funded projects was only 12.4%.[1] Congress has also already made a determination that a DBE goal program is necessary in the airport industry. The same logic applies for airports that only charge PFCs as it does for airports that receive federal grants. Accordingly, the necessity of a DBE goal program for airports that charge PFCs but do not accept federal grants is supported by a strong basis in evidence.

C. Air travel is sufficiently national to warrant federal legislation.

While airports would likely object to a condition on their ability to levy PFCs on the grounds that the passengers being taxed are their local passengers and a mandated DBE goal program would constitute an impermissible federal regulation of a local activity, passenger data defeats that argument. Airports classify every passenger who enters the airport as either an "origin and destination" ("O&D") passenger or as a connecting passenger. O&D passengers are passengers who enter the airport at the origin of their trip and passengers who leave the airport having arrived at their final destination. Connecting passengers are passengers whose stop at the airport is merely a layover on the way to another destination. The following chart lists, for calendar year 2013, the busiest 20 airports in the United States by passenger volume, the total number of passengers who travelled through each airport, the total number of domestic O&D passengers who travelled through each airport, and the percentage of each airport's total passengers that were O&D passengers.[2]

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[1] The 12.4% DBE share of PFC-funded projects resulted primarily from a 35% DBE share of PFC-funded projects at Hartsfield-Jackson Atlanta International Airport and a 30% DBE share of PFC-funded projects at Chicago O'Hare International Airport. Aside from these two airports, DBE participation in PFC-funded projects was quite low. However, since DBE goals are not required for PFC projects, some airports do not track DBE spending data for PFC projects or do not have it in a reportable format. As a result, the average DBE participation in PFC projects may be underestimated.

[2] The total domestic O&D passenger statistics were obtained from http://www.orlandoairports.net/statistics/ranking/OandD_Rank.pdf. The total passenger statistics were obtained from each individual airport's website. The airports may have used slightly different methodologies to calculate the total number of passengers traveling through the airport.

Rank	City	Airport Name	Total Passengers	Total Domestic O&D Passengers	Percentage O&D Passengers
1	Atlanta	Hartsfield - Jackson Atlanta International	94,431,224	25,402,768	26.90%
2	Chicago	Chicago O'Hare International	67,087,921	26,316,333	39.23%
3	Los Angeles	Los Angeles International	66,667,619	33,428,868	50.14%
4	Fort Worth	Dallas/Fort Worth International	60,436,739	21,094,877	34.90%
5	Denver	Denver International	52,556,359	26,652,264	50.71%
6	New York	John F Kennedy International	51,927,584	17,292,154	33.30%
7	San Francisco	San Francisco International	45,011,764	24,794,820	55.09%
8	Charlotte	Charlotte/Douglas International	44,015,419	9,507,265	21.60%
9	Las Vegas	McCarran International	41,857,059	28,807,235	68.82%
10	Miami	Miami International	40,562,948	9,247,613	22.80%
11	Phoenix	Phoenix Sky Harbor International	40,341,614	20,362,150	50.47%
12	Houston	George Bush Intercontinental/Houston	39,799,414	16,636,050	41.80%
13	Newark	Newark Liberty International	36,274,900	16,636,050	45.86%
14	Seattle	Seattle-Tacoma International	34,826,741	21,169,254	60.78%
15	Orlando	Orlando International	34,768,945	26,172,985	75.28%
16	Minneapolis	Minneapolis-St Paul International/Wold-Chamberlain	33,897,335	15,378,095	45.37%
17	Detroit	Detroit Metropolitan Wayne County	32,389,544	13,431,887	41.47%
18	Philadelphia	Philadelphia International	30,504,112	14,791,109	48.49%
19	Boston	General Edward Lawrence Logan International	30,218,631	22,228,518	73.56%
20	New York	LaGuardia	27,676,653	22,183,863	80.15%
					48.34%

The data demonstrates that air passengers cannot be generalized as "local" passengers. Passengers flying through the nation's busiest airport, Hartsfield-Jackson Atlanta International Airport, were overwhelmingly connecting passengers who would have had no connection to the city of Atlanta but for the fact that the passenger's airline routed the passenger through Atlanta en route to a final destination. Only 26.9 percent of passengers flying through Atlanta's airport actually began or ended their journey in Atlanta. The O&D data demonstrates that air travel is not a local activity and airports do not merely serve state citizens beginning their trip at the airport or tourists arriving at the airport to visit the state. Rather, more than half of all passengers across the 20 busiest airports in the United States are connecting passengers, visiting an airport only as a layover between an origin and a destination. Since air passengers cannot be generalized as local passengers, a mandated DBE goal program would not constitute impermissible federal regulation of a local activity.

III. Conclusion

Nothing in the statutory text or the case law indicates that authorization to levy PFCs is enough to trigger the DBE goal provision found in the project grant statute or that a federal grant of authority is analytically equivalent to a federal grant of funds. However, Congress may constitutionally amend the PFC-authorizing statute to incorporate a DBE goal program. Numerous courts have upheld the constitutionality of DBE goal provisions. Further, the necessity of a DBE goal program for airports that charge PFCs but do not accept federal grants is supported by a strong basis in evidence, and air travel is sufficiently national to warrant federal legislation.