OFFICE OF THE COUNTY ATTORNEY

Douglas M. Duncan
County Executive

Charles W. Thompson, Jr.
County Attorney

MEMORANDUM

August 19, 2004

TO: Joseph Beach
Assistant Chief Administrative Officer

VIA: Marc Hansen, Chief MPH
General Counsel Division

FROM: Clifford L. Royalty CLR
Associate County Attorney

RE: *Bill 23-04, Contracts and Procurement - Local Small Business Reserve Program*

Bill 23-04 proposes several amendments to Chapter 11B, Contracts and Procurement. The Bill would require County departments to "post . . . on a County website" certain planned purchases "valued at $1,000 to $25,000." (See § 11B-17A, lines 3-6). The Bill would also create a "Local Small Business Reserve Program" ("Program") whereby each County department would allot to "small businesses" 10% of the "combined total dollar value" of the department's contracts. (See § 11B-66, lines 70-74). A "small business" is defined to include "a minority owned business as defined in § 11B-58(a)" or a business that meets a litany of criteria, including a requirement that "[a]t least 50%" of a business' employees "work in the County." [1] (See § 11B-65, lines 29-64). The Bill is intended to rectify the "competitive disadvantage" that local small businesses encounter, when bidding on County contracts, by creating a "separate defined market in which small businesses will compete against each other, not against larger firms for County contracts." (See Memorandum dated July 9, 2004, from Sonya E. Healy to County Council).

Summary of Opinion

The local preference created by the Bill raises serious legal concerns. To respond to these concerns, we recommend that the legislative record be supplemented with credible evidence, including expert analysis, that identifies the evils that a local preference is meant to

[1] We understand that the Bill is not intended to allow all "minority owned" businesses to participate in the Local Small Business Reserve Program, only those that qualify as a "small business." We also understand that the Bill will be amended to clarify its intended scope. We note that such an amendment is more than a technical matter; if the Program were to include all minority businesses it might violate the United States Constitution under the reasoning adopted by the Supreme Court in *Richmond v. J.A. Croson Co.* 488 U.S. 469 (1989).

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remedy and that demonstrates that the degree of local preference employed bears a close relation to the evils identified. In the alternative, as is discussed below, we believe it would be prudent to delete those provisions of the Bill that provide for a local preference.

We also recommend that the definition of small business be amended to eliminate the criterion that a small business must not be "dominant" in its field of operation. (See, § 11B-65, line 35). As we discuss below, that criteria will be difficult to apply.

Analysis

The Bill is modeled after a recently adopted State law that creates its own small business reserve program, although there are significant differences between the Bill and the State law. (See Senate Bill 904). Foremost among these is the scope of each. All small businesses may participate in the State program, whereas only "local" small businesses may avail themselves of the County program. The Bill's proposed Program, with its locality restrictions, necessitates a more involved legal analysis.

As is evidenced by the State program, the County's proposed Program is a variation on a not uncommon theme. Vendor preference laws are frequently enacted and just as frequently challenged. The success of those challenges often turns on the facts, rather than bright-line legal principles. Subtle factual distinctions sometimes yield disparate results. Nevertheless, we will endeavor to lay down some guiding principles that can be ferreted out of the case law.

Insofar as it affects commerce and advantages a subset of the business community (to wit, local businesses), the Program touches upon provisions of both the United States and Maryland constitutions. Vendor preference laws have been challenged in the federal courts under the Commerce Clause, the Equal Protection Clause, and the Privileges and Immunities Clause. While there have not been comparable challenges to vendor preference laws in the Maryland courts, there have been analogous challenges to regulatory acts under Article 24 of the Maryland Declaration of Rights. We will address each constitutional provision in turn.

Commerce Clause challenges to vendor preference laws have not met with success. The Commerce Clause vests in the United States Congress the power to regulate interstate commerce. The courts have read the Clause as impliedly limiting the authority of state and local governments to regulate commerce. *Hughes v. Oklahoma*, 441 U.S. 322 (1979). The Supreme Court has emphasized that the Clause applies to state and local government only when they act in their regulatory capacity. In contracting for goods and services, the Supreme Court has reasoned, a government acts as a market participant, not a market regulator. *See Hughes v. Alexandria Scrap*, 426 U.S. 794 (1976); *White v. Massachusetts Council of Construction Employers, Inc.*, 460 U.S. 204 (1983). Therefore, the Commerce Clause is no impediment to vendor preference laws in general, or Bill 23-04 in particular.

The Equal Protection Clause of the 14th Amendment prohibits state and local governments from denying to any person "the equal protection of the laws." The provision

ensures that like persons will be treated in a like manner. By favoring some vendors more than others, vendor preference laws create a statutory classification that must satisfy the Equal Protection Clause. Insofar as a vendor preference law does not impinge upon a fundamental right or impact a suspect class, it will be subject to rational basis review, meaning that if a rational purpose can be articulated in support of the law and the law furthers that purpose, the law will be upheld. *Smith Setzer & Sons, Inc. v. South Carolina Procurement Review Panel*, 20 F.3d 1311 (1994). The federal courts (but not necessarily the Maryland courts) have accepted, as rational, a local government's desire to promote local businesses or alleviate tax or other burdens that impact local businesses. *See Smith Setzer & Sons, Inc. v. South Carolina Procurement Review Panel*, 20 F.3d 1311 (1994); *Associated Gen. Contractors of California, Inc. v. San Francisco*, 813 F.2d 922 (9th Cir. 1987). The Bill does just that and should survive the rational basis scrutiny to which it would be subject in the federal courts under a 14th Amendment challenge.

The Privileges and Immunities Clause contained in Article IV of the United States Constitution presents a more formidable impediment to vendor preference laws. The Privileges and Immunities Clause entitles "[t]he Citizens of each State to all Privileges and Immunities of Citizens in the several States." Its purpose is to "foster a national union by discouraging discrimination against residents of another state on the basis of [their state] citizenship." *Salem Blue Collar Workers Association v. Salem*, 33 F.3d 265, 267 (1994). The Clause protects "fundamental interests that promote "interstate harmony." *United Building & Construction Trades Council v. Mayor and Council of Camden*, 465 U.S. 208 (1984) (internal citations omitted). That protection extends to the acts of local governments. The Supreme Court so held in *United Building & Construction Trades Council v. Mayor and Council of Camden*, a case that is particularly pertinent to our review of the Bill.

In *Camden*, a municipality enacted an ordinance requiring "40% of the employees of contractors and subcontractors working on city construction projects be Camden residents." *Id.* at 210. The Supreme Court was called upon to decide whether an "out-of-state resident's interest in employment on public works contracts" in Camden was protected by the Clause. *Id.* at 219. The Court found that it was. The "pursuit of a common calling is one of the most fundamental of those privileges protected by the Clause." *Id.* And, insofar as the Camden ordinance infringed upon a nonresident's ability to seek employment with a private contractor, even one working on a public project, it was found to be discriminatory within the meaning of the Privileges and Immunities Clause. But the Court also found that the Clause "is not absolute" and, thus, that discrimination against nonresidents will be upheld if there is a "substantial reason" for it. *Id.* at 222. "The inquiry in each case must be concerned with whether such [substantial] reasons do exist and whether the degree of discrimination bears a close relation to them." *Id.* (internal citations omitted). The Court remanded the case to allow the state court to "decide . . . on the

best method for making the necessary findings." *Id.* at 223. [2] By so doing, the Court implied that it may not be giving the usual deference to legislative rationale that is afforded under the rational basis test.

Camden creates a measure of uncertainty as to the legality of the local preference created by the Bill. While the Bill contains no residency requirement, it does require that "at least 50 percent" of the employees of a small business "work in the County." (See lines 38-39). Further, in order to qualify as a small business, the Bill requires that a business have "a principal place of business in the County" and pay "personal property taxes to the County . . . . (See lines 36-37, 40-43). If the courts were to equate the Bill's location requirements with a residency requirement, then the County would be charged with demonstrating a substantial problem justifying the discriminatory impact of the Bill.

However, insofar as the courts view a residency requirement as qualitatively different than a work location requirement, the *Camden* decision may be distinguishable. Choosing one's residence may be viewed as more personal, therefore more fundamental, than choosing one's workplace. If the location requirements do not infringe a fundamental right, such as pursuing one's livelihood, then the Bill's legislative rationale may be adequate to repel a challenge under the Privileges and Immunities Clause.

Maryland law further complicates our analysis of the Bill, particularly Article 24 of the Maryland Declaration of Rights. While Article 24 is the state analog to the 14th Amendment to the United States Constitution, the Maryland courts have long reserved the right to read protections in Article 24 that are not contained in the 14th Amendment. *See Attorney General of Maryland v. Waldron*, 289 Md. 683, 426 A.2d 929 (1981). Thus federal decisions upholding vendor preference laws under the 14th Amendment are persuasive, but not controlling, authority. Unlike the federal courts, the Maryland courts have not had occasion to squarely address the validity of vendor preference laws. The closest Maryland cases involve local regulations that discriminate against nonresident persons or entities; these cases address the role of government as market regulator, rather than market participant. *See Frankel v. Board of Regents of the University of Maryland System*, 361 Md. 298, 761 A.2d 324 (2000); *Verzi v. Baltimore County*, 333 Md. 411, 635 A.2d 967 (1994); *Bruce v. Director, Department of Chesapeake Bay Affairs*, 261 Md. 585, 276 A.2d 200 (1971). Nevertheless, the Maryland courts may apply a more rigorous form of equal protection review to the Bill than the deferential form applied by the federal courts. In fact, review by the Maryland courts is likely to be analogous to that of the federal courts under the Privileges and Immunities Clause. *See Verzi v. Baltimore County,* 333 Md. 411, 635 A.2d 967 (1994). The Maryland courts are not likely to summarily approve a procurement program that discriminates against nonresident businesses or employees, especially

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[2] The City of Camden contended that the ordinance was "necessary to counteract grave economic and social ills . . .," including "[s]piraling unemployment, a sharp decline in population, and a dramatic reduction in the number of businesses located in the city . . . ." *Id.* at 222.

those located within Maryland. The Maryland courts will probably demand substantial justification for such a program, as did the Supreme Court in *Camden*.

Conclusion

Unfortunately, the existing legislative record does not precisely define the scope of the problem that the Bill's local preference is meant to address or substantiate the existence of that problem. In order to ensure that the Bill survives a challenge in the courts, we recommend that the legislative record be supplemented with information, data, findings, expert analysis, or the like, that identifies the social and economic evils that the local preference is meant to remedy and that describes how the Program will remedy those evils. The record should also show that the Program does not unnecessarily burden those who do not benefit from it. Without that supplementation of the record, the Bill's legal fate is precarious. In the alternative, the local preference provisions could be deleted from the Bill.

In addition to the need for supporting data, the Bill is in need of a minor clarifying amendment. The Bill provides that a small business must be not be "dominant in its field of operation." (See line 35). Lacking a definition of the term "dominant" or standards by which that dominance can be adjudged, the provision will be difficult to implement. And we question whether this criterion is needed; it seems unlikely that a small business will be "dominant in its field of operation." Therefore, we recommend that this criterion be stricken.

Lastly, on an admittedly nonlegal note, we feel constrained to discuss a potential policy implication of the Bill. We are aware that Virginia and Pennsylvania have adopted laws that authorize the imposition of a penalty on a business seeking a government contract if the business is located in a jurisdiction that awards a preference to local businesses. [3] In competing for government contracts from Virginia and Pennsylvania, County businesses may be disadvantaged by such laws, even if the County businesses have never benefitted (or could not benefit) from the County's proposed Program. Passage of the Bill, with the local preference provision intact, might have the unintended effect of dissuading businesses from locating in the County.

If you have any questions or concerns regarding this memorandum, please feel free to contact us.

cc: Charles W. Thompson, Jr., County Attorney
Edward Stockdale, Office of Procurement

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[3] The State of Maryland has enacted a similar law. *See Md. Ann. Code art. 24, § 8-102 (2003).*