January 22, 2014

Mr. Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 205551
By Email: regs.comments@federalreserve.gov.

Re: Docket No. OP-1465,
Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies and Request for Comment, 78 Fed. Reg. 64052 (Oct. 25, 2013).

Dear Mr. Frierson:

In light of federal court rulings restricting the use of race by federal agencies, we recommend that the Proposed Interagency Policy Statement ("Proposed Statement") be changed so that it does not require or encourage the use of racial classifications and preferences based on race or sex by banks or other regulated entities. We also urge that it be limited to federal contracting (like the language of the Dodd-Frank Act on which it is based[1]), rather than more broadly reaching private entities that merely happen to be regulated by federal agencies (which violates basic axioms of statutory construction).

I. The Constitution Limits the Use of Race or Gender to Promote Diversity

We call your attention to rulings striking down as unconstitutional agencies' use of race and gender to promote diversity or remedy "underrepresentation" of women and minorities among regulated entities, even when such use of race or gender does not rise to the level of a quota. *See Lutheran Church—Missouri Synod v. FCC*, 141 F.3d 344 (D.C. Cir. 1998) (invalidating FCC's race and gender preferences, even though they were merely hiring goals for regulated broadcasters, and not quotas); *Lamprecht v. FCC*, 958 F.3d 382 (D.C. Cir. 1992) (invalidating FCC's gender preferences to promote diversity).

In particular, we urge that the Proposed Statement be revised to avoid judging the diversity policies of regulated entities based on their use of numerical goals, metrics, or percentages with regard to diversity in hiring or contracting, because using such goals and metrics may lead to unlawful discrimination by the regulated entities.

[1] Pub. L. 111-203, 124 Stat. 1376, 1541 (July 11, 2010), codified as 12 U.S.C. 5452.

The Proposed Statement requires, or at least strongly encourages, financial institutions to use numerical quotas based on race, ethnicity, and sex to ensure compliance. For example, the Proposed Statement endorses using "metrics to track and measure the inclusiveness of the[] workforce (e.g., race, ethnicity, and gender)"; "metrics to evaluate and assess workforce diversity"; "metrics and analytics related to . . . [p]ercentage spent with minority-owned and women-owned business contractors by race, ethnicity, and gender; [and] [p]ercentage of contracts with minority-owned and women-owned business sub-contracts"; and "metrics used to measure success in both workplace and supplier diversity."

A mere desire for diversity is generally not a valid reason to use race or gender, much less to pressure a regulated entity to use race or gender. *See, e.g., Lamprecht v. FCC*, 958 F.2d 382 (D.C. Cir. 1992) (striking down the FCC's use of gender to promote diversity in broadcasting as a violation of the Fifth Amendment's equal-protection component); *Lutheran Church—Missouri Synod v. FCC*, 141 F.3d 344 (D.C. Cir. 1998) (striking down agency's race and gender diversity mandates).[2] Moreover, even if the Proposed Statement merely provides incentives to consider race and gender, rather than absolutely commanding it, it is still unconstitutional if the use of race it promotes is not for an interest recognized as valid and compelling by the Supreme Court.

As the D.C. Circuit Court of Appeals noted in the *Lutheran Church* decision, "we do not think it matters whether a government hiring program imposes hard quotas, soft quotas, or goals. Any one of these techniques induces an employer to hire with an eye toward meeting the numerical target. As such, they can and surely will result in individuals being granted a preference because of their race."[3]

Moreover, not just bank employees,[4] but also the banks themselves, have standing to challenge the constitutionality of this illegal pressure to use race, and an employer such as a bank has standing to object "if the government requires or encourages as a condition of granting" an

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[2] *See also, e.g., Police Association of New Orleans v. City of New Orleans*, 100 F.3d 1159, 1169 (5th Cir. 1996) (city could not promote blacks based on race "to give a better reflection of the racial composition of the city," or "remedy racial imbalances in the police department," absent "specific evidence of past discrimination" by the city).

[3] *Lutheran Church-Missouri Synod v. FCC*, 141 F.3d 344, 351 (D.C. Cir. 1998); *see also Western States Paving Co. v. Washington State Department of Transportation*, 407 F. 3d 983 (9th Cir. 2005) (invalidating federal contracting racial preference even though it required only "good faith efforts" to hire more minorities, not a rigid quota).

[4] *See Truax v. Raich*, 239 U.S. 33, 38 (1915) (private employee could bring equal-protection challenge to law that required his private employer to consider national origin in hiring; law was invalid discrimination even though his employer could voluntarily have fired him without violating the constitution; "The fact that the employment is at the will of the parties, respectively, does not make it one at the will of others. The employee has manifest interest in the freedom of the employer to exercise his judgment without illegal interference or compulsion").

The Court has recognized the distinction between what a private employer can voluntarily do in hiring employees, and what the government can force the employer to do, in terms of discrimination. *See, e.g., Peterson v. City of Greenville*, 373 U.S. 244, 247, 248 (1963) (finding unconstitutional a city ordinance which required restaurants to be segregated, because imposing the requirement on restaurant owners violated the equal protection rights of patrons); *see also Bras v. California Public Utilities Commission*, 59 F.3d 869 (9th Cir.1995) (white contractor could sue over state law requiring public utility to increase minority contracting, even though the statute did not directly regulate it).

institution "a benefit that" it "discriminate against others based on their race or sex."[5] Although the Constitution does not prevent a private employer from *voluntarily* engaging in discrimination – that is the subject of anti-discrimination statutes, not the Constitution – it does forbid the government from *commanding* such discrimination by private employers.[6]

The Supreme Court has only permitted race to be used in diversity policies *voluntarily* adopted by *colleges and universities* in the *higher-education* setting, in furtherance of those universities' First Amendment *academic freedom* right to choose "who may be admitted to study" on their campus. *See Univ. of California. v. Bakke*, 438 U.S. 265, 312-15 (1978), *quoting Sweezy v. University of New Hampshire*, 354 U.S. 234 (1957). That freedom gives them "wide discretion in making the sensitive judgments as to who should be admitted," which enables them to consider race as one of many factors even though such consideration of race would otherwise be forbidden. *Bakke*, 438 U.S. at 314. Such discretion reflects a *voluntary* decision, not a *regulatory* mandate, and accordingly, no federal agency can order, or even pressure, an institution to use race. Moreover, the academic-freedom rationale for allowing the use of race has no logical application outside the higher-education context, to the financial-services sector or the banking industry. Academic freedom applies only to academia, not the financial sector.

No other justification for using race applies here. The only justification recognized as valid by the Supreme Court for the government using race outside of academia is to remedy the present effects of the government's *own* intentional discrimination against minorities and women, not purely private discrimination by regulated entities.[7] Nothing in the hearings surrounding the Dodd-Frank Act suggest that Section 342 (the basis of the Proposed Statement) in fact is tailored to remedy any such federal discrimination, much less that there are lingering present effects of such discrimination that can only be remedied by racial preferences.

To use race, the government must show that the discrimination it is "remedying" through race-based affirmative action is the government's *own* discrimination, and by discrimination, that means *intentional* discrimination, not mere racial imbalances or "disparate impact."[8] And even a

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[5] *Lutheran Church-Missouri Synod v. FCC*, 141 F.3d 344 (D.C. Cir. 1998) (radio broadcaster has standing to challenge racial or gender preferences that discriminate against its white or male employees), *quoting Monterey Mechanical Co. v. Wilson,* 125 F.3d 702, 707 (9th Cir.1997).

[6] *See Truax v. Raich,* 239 U.S. 33 (1915) (finding unconstitutional a state law requiring that at least 80% of each employer's employees be native-born citizens or qualified electors, because imposing the requirement on employers violated the equal protection rights of employees).

[7] *See Wygant v. Jackson Board of Education*, 476 U.S. 267 (1986); *Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989); *Adarand Constructors v. Pena*, 515 U.S. 200 (1995).

[8] *People Who Care v. Rockford Board of Education*, 111 F.3d 528, 534 (7th Cir. 1997) (racial balancing or classifications to prevent disparate impact are unconstitutional; racial preferences can only be used to remedy present effects of intentional discrimination)(to justify racial preferences or classifications, there must be a "finding that" the government using them has "discriminated intentionally," not mere "statistical disparities, which need not reflect discrimination, intentional or otherwise"); *Builders Association v. County of Cook*, 256 F.3d 642, 644 (7th Cir. 2001); *accord Brunet v. City of Columbus*, 1 F.3d 390 (6th Cir. 1993) (gender-based hiring preference was invalid, for failure to show "intentional discrimination" against women); *Milliken v. Michigan Road Builders*, 489 U.S. 1061 (1989) (summarily affirming the Sixth Circuit's invalidation of both race and gender-based affirmative-

history of discrimination against minorities by the government cannot justify the use of race now unless the discrimination is recent.[9]

Using race-conscious measures to try to increase minority representation in a field to a higher "percentage" is "facially invalid," according to the Supreme Court.[10] Trying to offset or remedy "societal discrimination" – as opposed to the government's *own* discrimination -- is also an invalid reason for using race, it has ruled.[11] Other goals such as providing minority role models are also not a valid reason for using race under Supreme Court precedent.[12] Nor is remedying minority underrepresentation in a field within the private sector a constitutionally-valid justification for a government-mandated use of race,[13] even when the government pervasively regulates that sector,[14] and even though a private employer would be free to adopt a *voluntary* plan to remedy manifest racial imbalances.[15]

II. Statutory Overreach

The Proposed Statement amounts to overreaching insofar as it attempts to regulate the hiring and business practices of *regulated* financial institutions, rather than just federal *contracting*. The Statement is supposedly based on Section 342 of Dodd-Frank, which is aimed at federal contracting, yet it seeks to broadly micromanage the hiring of the financial sector as a whole. Section 342 says that "This section shall apply to all **contracts** of an agency for services of any kind," not that it shall apply to all regulated entities. (See Section 342(d)). It speaks in terms of diversity in federal *procurement and contracting*, addressing "procurement, insurance, and all types of contracts" (see Section 342 (c)(1)), "contract proposals" (see Section 342(c)(2)), and practices by an "agency contractor" (see Section 342(c)(3)).

Yet somehow, the Proposed Statement ends up prescribing proposed standards for the regulated financial services sector as a whole, not just contracting.[16] Agencies should not broadly impose

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action programs in contracting, which the appeals court had struck down since the race and gender preferences were not designed to remedy the government's own discrimination against minorities and women), *summarily affirming*, 834 F.2d 583, 593, 595 (6th Cir. 1987) (invalidating racial preferences due to failure to show it was necessary to remedy the government's own "intentional discrimination" against minorities, and invalidating gender preference aimed only at "societal discrimination" rather than governmental discrimination).

[9] *See, e.g., Brunet v. Columbus*, 1 F.3d 390 (6th Cir. 1993) (discrimination that occurred 17 years ago does not support affirmative action today); *Hammon v. Barry*, 813 F.2d 412 (D.C. Cir. 1987).

[10] *Bakke*, 438 U.S. at 307.
[11] *See id.; Richmond v. J.A. Croson Co.*, 488 U.S. 469 (1989).
[12] *Wygant v. Jackson Board of Education*, 476 U.S. 267 (1986) (rejecting the role-model rationale).
[13] *Bakke*, 438 U.S. at 310. *See also Lutheran Church-Missouri Synod v. FCC*, 141 F.3d 344 (D.C. Cir. 1998) (rejecting "underrepresentation" rationale for FCC diversity policy).
[14] *See Lutheran Church-Missouri Synod v. FCC*, 141 F.3d 344 (D.C. Cir. 1998).
[15] *United Steelworkers v. Weber*, 443 U.S. 193 (1979).

[16] *Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies and Request for Comment*, 78 Fed. Reg. 64052, 64054-55 (Oct. 25, 2013) ("These proposed standards address a **regulated entity's** employment practices and . . . procurement"; "The **regulated entity** includes diversity and inclusion considerations in both employment and contracting as an important part of its strategic plan including hiring, recruiting, retention and promotion.") (emphasis added).

racial classifications or race-conscious hiring beyond Congress's intent – to the financial sector as a whole – especially since that raises serious constitutional questions. Agencies are supposed to construe race-conscious mandates as narrowly as possible, in light of the canon of constitutional doubts, or constitutional-avoidance principle,[17] and other basic axioms of statutory construction.[18]

Agencies should not impose racial preferences any more broadly than Congress commands, from the relatively narrow ambit of federal contractors to the vastly greater number of regulated entities.[19] Moreover, Congress has not delegated regulation of employment practices to financial regulators, but rather to other federal agencies.[20] Applicable civil-rights statutes often forbid the use of race and gender by private institutions,[21] and Section 342(c)(2) expressly states that "consideration" given "to the diversity of the applicant" should be given only "to the extent consistent with applicable law."

Sincerely,

Hans Bader

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[17] *Miller v. Johnson*, 515 U. S. 900, 923 (1995) ("Although we have deferred to the [agency's] interpretation in certain statutory cases . . . we have rejected agency interpretations to which we would otherwise defer where they raise serious constitutional questions. . . When the Justice Department's interpretation of the Act compels race-based districting, it by definition raises a serious constitutional question . . . and should not receive deference").

[18] Even when an agency would otherwise receive great deference in interpreting a statute, it will not receive any deference from the courts where its interpretation would raise potential constitutional problems. *See Edward J. DeBartolo Corp. v. Florida Gulf Coast Building & Constr. Trades Council*, 485 U. S. 568, 574-575 (1988) (construing National Labor Relations Act narrowly to avoid potential free-speech problems, despite the broad deference that the NLRB's interpretation usually receives); *NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490 (1979) (construing statutory language in federal labor laws extremely narrowly not to cover religious schools to avoid potential constitutional issue – even though doing so was much harder than construing the Fair Housing Act not to include disparate-impact claims); *Northwest Austin Municipal Utility District No. 1 v. Holder*, 129 S. Ct. 2504, 2513 (2009) (construing Voting Rights Act narrowly to avoid possible constitutional federalism problems).

[19] *See Miller v. Johnson*, 515 U. S. 900, 923 (1995) (refusing to construe race-conscious provisions of Voting Rights Act broadly); *cf. Carepartners LLC v. Lashway,* 545 F.3d 867, 880 (9th Cir. 2008)("regulated entities" enjoy more protection than government employees or contractors in constitutional First Amendment challenge).

[20] *See Chamber of Commerce v. Reich*, 74 F.3d 1322 (D.C. Cir. 1996) (executive branch could not ban federal contractors from replacing strikers, since this area is regulated by the Wagner Act and the NLRB, an independent agency; fact that government has broader power over contractors than regulated entities was insufficient basis.).

[21] *Compare Taxman v. Board of Education*, 91 F.3d 1547 (3d Cir. 1996) (construing Title VII of the Civil Rights Act, which reaches both public and private employers, to forbid using race even as a tie-breaker to promote a diverse department within a school, and categorically forbidding the use of race in terminations as "unduly trammeling" Title VII rights); *Messer v. Meno*, 130 F.3d 130 (5th Cir. 1997) (construing Title VII, which reaches public and private employers alike, to ban the consideration of race in hiring to promote diversity in employment).