

# Business Owned by Low-Income Individuals Entitled to Damages for Violation of Section 3

In what appears to be a case of first impression, the U.S. Court of Appeals for the Third Circuit recently upheld the award of a substantial damage claim against a Pennsylvania township that failed to award a rehabilitation contract, funded with Department of Housing and Urban Development (HUD) money, to a very low income contractor that should have been given preference for the contract under Section 3 of the Housing and Urban Development Act of 1968.<sup>1</sup> That section requires HUD grantees to take affirmative steps to ensure that a percentage of the contracts funded with HUD grants are awarded to business concerns operated by low- and very low-income persons in the HUD grantee's geographic area.<sup>2</sup>

In 1999, the plaintiffs, very low-income individuals doing business as Southwestern Community Ventures, filed a Section 1983 action against a Pennsylvania township and the chair of its board of supervisors claiming a violation of Section 3 and seeking damages. The trial court held that plaintiffs are members of the class intended to benefit by Section 3, were qualified to be awarded the contract<sup>3</sup> and were thus entitled to \$16,225 for loss of income.<sup>4</sup> The defendants appealed.

On appeal the defendants argued that the plaintiffs were not residents of the township and hence not entitled to a preference for the contract.<sup>5</sup> Alternatively, defendants argued that they solicited the plaintiffs to participate in the request for proposals (RFP) and awarded points in the evaluation process for being a Section 3 business and thereby satisfied the

obligations under Section 3.<sup>6</sup> The United States Court of Appeals for the Third Circuit upheld the judgment against the defendants for a failure to comply with Section 3. The court reasoned that Section 3 requires to the "greatest extent feasible . . . contracts awarded for work to be performed in connection with a housing rehabilitation . . . are [to be] given to business concerns" operated by low and very low-income persons who reside within the non-metropolitan county in which the assistance is expended.<sup>7</sup> The court also noted that the Section 3 regulations provide 22 "Examples of Efforts to Award Contracts to Section 3 Business Concerns" and that providing notice is only one of those concerns.<sup>8</sup> Therefore, because the defendants offered no basis to conclude that their solicitation efforts, either standing alone or coupled with the award of points, satisfied the "greatest extent feasible" mandate, the district court's decision was affirmed.

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Although the decision is unpublished<sup>9</sup> and brief, it is important to note that the court found that there is a class of Section 3 beneficiaries. In addition, implicit in the opinion is a finding that once a member of that class is found to be qualified to be awarded the contract, the entity subject to Section 3 cannot claim that merely notifying the Section 3 business of the RFP and providing points in the application process to the applicant Section 3 business is sufficient to achieve the Section 3 goals. If the Section 3 business concern is qualified, more is required of the recipient of housing and community development funds to meet the goals and priorities of Section 3. ■

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<sup>1</sup>*Mannarino v. Morgan*, 2003 WL 1972491 (3<sup>rd</sup> Cir., April 29, 2003)(unpublished). Plaintiffs also sued HUD, but HUD was dismissed from the action.

<sup>2</sup>12 U.S.C.A. § 1701u (West 2001) (Section 3).

<sup>3</sup>The appellate decision does not indicate what showing plaintiffs made regarding qualifications. However, the Section 3 rules allow a Section 3 business to submit evidence to demonstrate the ability to complete the contract. 24 C.F.R. § 135.36(c) (2002).

<sup>4</sup>Section 3 places different obligations on recipients of federal housing and community development funds depending upon whether the recipient is a PHA or other entity. It appears from the facts of this case that the defendant is not a PHA and is a recipient of other HUD covered programs. Each non-PHA recipient of federal housing and community development funds over certain threshold amounts should award to Section 3 businesses 10 percent of building trades work for housing rehabilitation and construction and at least 3 percent of all other Section 3 covered contracts. 24 C.F.R. § 135.30(c) (2002). In evaluating compliance with this provision, "a recipient that has not met the numerical goals . . . has the burden of demonstrating why it was not feasible to meet the numerical goals set forth in this section." *Id.* § 135.30(d).

<sup>5</sup>The preferences for Section 3 business concerns in contract opportunities under housing and community development programs include: category 1, those Section 3 business concerns that provide economic opportunities for Section 3 residents in the service area or neighborhood in which the Section 3 project is located; category 2, applicants selected to carry out HUD Youthbuild programs; and category 3, other Section 3 businesses. 24 C.F.R. § 135.36(a)(2) (2002); 12 U.S.C.A. § 1701u(d)(2)(B) (West 2001).

<sup>6</sup>24 C.F.R. § 135.5 (2002). A Section 3 business is defined as: a business owned by 51 percent or more Section 3 residents; a business in which at least 30 percent of permanent, full-time employees are persons who are currently Section 3 residents; or a business that provides evidence of a commitment to subcontract in excess of 25 percent of the dollar award of all subcontracts to be awarded to business concerns that meet the qualifications set forth above. A Section 3 resident is: a public housing resident, or an individual who resides in the metropolitan area or nonmetropolitan county in which the Section 3 covered assistance is expended, and who is defined as a low-income person (80 percent of the median income for the area) or a very low-income person (50 percent of the median income for the area).

<sup>7</sup>12 U.S.C.A. § 1701u(d)(2)(A) (West 2001).

<sup>8</sup>24 C.F.R. § 135, Appendix to 135 (2002).

<sup>9</sup>In the Third Circuit, citations to federal decisions that have not been formally reported are permissible if they identify the court, docket number and date, and refer to electronically transmitted decisions. 3<sup>rd</sup> Cir.LAR, Rule 28.0, 28.3(a) U.S.C.A.