CIVIL RIGHTS LITIGATION
AMERICAN BAR ASSOCIATION SECTION OF LITIGATION

Section 1981 Litigation: Making Free Markets Free

By Carmen D. Caruso

As the committee's first article on Section 1981 litigation, we begin with the observation that 42 U.S.C. § 1981, as amended, is a powerful statute that has historically been underused as a remedy for racial discrimination in contracting.

History of 42 U.S.C. § 1981

Of all of the civil-rights laws on the books, 42 U.S.C. § 1981, which was enacted as part of the post-Civil War Civil Rights Act of 1866, arguably has the most potential for helping racial minorities achieve a measure of economic parity in America. The core guarantee of § 1981(a) is that:

> All persons within the jurisdiction of the United States shall have the same right in every State and Territory to make and enforce contracts, to sue, be parties, give evidence, and to the full and equal benefit of all laws and proceedings for the security of persons and property as is enjoyed by white citizens, and shall be subject to like punishment, pains, penalties, taxes, licenses, and exactions of every kind, and to no other.

Without question, section 1981 was intended to protect the rights of the newly freed slaves and their descendants, and thus the act guaranteed them the same rights as enjoyed by "white citizens." There is not a definitive case as to what it means to be a "non-white" citizen, but the majority of federal courts have broadly construed section 1981 as protecting against discrimination based on ethnicity and national origin, such that persons of Lebanese and Indian origin have been protected, as has at least one person of French origin. *See* Danielle Tarantolo, "From Employment to Contract: Section 1981 and Antidiscrimination Law for the Independent Contractor Workforce," 116 Yale L. J. 170, 193, n 139 (2006). However, litigation to extend section 1981 to other "protected classes" based on sex, disability, age, or religion has not been successful. *Id*. at 193.

By far, most section 1981 claims allege employment discrimination, and are typically pled alongside a claim under Title VII of the 1964 Civil Rights Act. When intentional employment discrimination occurs on account of race, the section 1981 plaintiff enjoys the advantage that there is no cap on damages under section 1981, unlike in Title VII. Substantively, the courts construing section 1981 in employment litigation have by and large required the same proof that is needed in a Title VII case, i.e., by direct evidence, or by indirect proof under the well-known *McDonnell-Douglas* burden-shifting formulation. *See, e.g., Patterson v. McLean Credit Union*, 491 U.S. 164, 186 (1989). An important exception, however, is that the Supreme Court has held that section 1981 applies only to disparate treatment (intentional discrimination against the plaintiff) and not to disparate impact, in which a facially neutral policy has a disproportionate

pact on the protected class. *See General Building Contractors Ass'n v. Pennsylvania*, 458 U.S. 375, 387–88 (1982).

Despite its attractive remedies, section 1981 has been underused, particularly outside the employment area. First, the doctrine of sovereign immunity precludes the filing of section 1981 claims against states, for unlike Title VII, there has been no waiver of immunity against section 1981 liability. Second, it was not until 1976, in *Runyon v. McCrary*, 427 U.S. 160 (1976), that section 1981 was held applicable to contracting among private parties. Putting state sovereign immunity together with the old view that private contracts were not covered, in the 110 years from 1866 to 1976 before *Runyon,* it is not clear just exactly who the courts thought were the intended subjects of section 1981 remedies..

Then, after *Runyan* broadened the scope of section 1981, the Supreme Court narrowly construed the scope of conduct governed by the act in *Patterson*, *supra*, 491 U.S. at 171 (1989), holding that it did not apply to "conduct which occurs after the formation of a contract which does not interfere with the right to enforce established contractual obligations."

Two years later, Congress reinvigorated section 1981 by defining key terms in the Civil Rights Act of 1991. Section 1981(b) provides:

> For purposes of this section, the term make and enforce contracts includes the making, performance, modification, and termination of contracts, and the enjoyment of all benefits, privileges, terms, and conditions of the contractual relationship.

With the 1991 amendments in place, the stage is set for expanded use of section 1981 to redress intentional discrimination on the grounds of race and national origin in cases involving the entire life of a contract, and including all aspects of the relationship. Two "growth areas" for section 1981 come to mind: independent contracting and business-to-business contracting, especially in the area of franchising.

The Independent-Contracting Dilemma

Because Title VII protections are limited to employees, section 1981 may be the only remedy for independent contractors who suffer from discrimination on the grounds of race or national origin. The percentage of persons in the workforce who are working as independent contractors appears to be increasing, which suggests that more section 1981 claims might be expected going forward.

However, the narrow application of section 1981 remedies to discrimination on the basis of race and national origin leaves women and other classes of persons who enjoy statutory protection from discrimination in employment without a remedy against discrimination in contracting. To resolve this dilemma, either the employment laws would have to be amended to cover independent contractors, or section 1981 would have to be amended to cover other classes of persons that have received statutory protection in employment. Civil-rights advocates confronting this dilemma may need to tread carefully, for any efforts to expand the coverage of section 1981 to include other protected classes might lead the business community to lobby for a cap on damages under section 1981 akin to the cap that was imposed in Title VII cases in the

1991 amendment. In at least one sense, that would make sense, because it is fair to ask why an independent contractor might be able to recover unlimited damages, while an employee suing under Title VII would be subject to a cap. But, it is important to remember that section 1981 applies to contracting in general, and not only to work that is being performed on an independent-contracting basis. In business-to-business contracting cases, a cap on damages would be a very unfortunate setback to the cause of economic civil rights.

Franchising Cases

The underuse of section 1981 is puzzling in the context of business-to-business contracting. After all, the historic lack of contracts given to minority-owned firms has been documented sufficiently enough to spur the existence of "minority business enterprises" and "set-asides" and similar programs. Why is it, then, that so few minority-owned businesses have filed section 1981 claims when they perceive that they were wrongfully denied the opportunity to enter into a lucrative business contract?

Franchising is a subset of business-to-business contracting that deserves attention. It has been observed that minorities have historically lacked access to capital, resulting in fewer minority franchise applicants. *See* Carla Wong and Kelly J. Baker, "Discrimination Claims and Diversity Initiatives: What's A Franchisor To Do?"ABA Forum onFranchising, *Franchise* (Fall 2008) (collecting section 1981 cases in franchising). But due in part to substantial efforts to increase diversity in franchising, the number of minority franchisees is increasing. *Id*.

There have been several section 1981 claims arising in franchising relationships. *Id*. As more minorities enter franchising, will they be held tomore stringent standards of performance and perhaps terminated unfairly?Or, taking the 1991 amendments into account, will they find themselvesbeing denied all of the "benefits, privileges, terms, and conditions of the *contractual relationship*"—which, by definition, may be larger than the terms of the express contract?

The notion of discrimination in the course of a contractual relationship is especially powerful in franchising, as franchise agreements have been aptly characterized as long-term "relational contracts" because they require mutual performance over a number of years. Franchise agreements are necessarily incomplete in defining the parties' exact duties in every situation, and they necessarily vest discretion in both parties, but especially in the franchisor, as to exactly how the agreement will be performed over a period of years. *See* Gillian K. Hadfield, "Problematic Relations: Franchising and the Law of Incomplete Contracts," 42 Stan. L. Rev. 927 (1990).

In the common law of contracts, courts impose the implied covenant of good faith and fair dealing as a standard of care upon contracting parties in performing their express contract duties, and in exercising discretionary decision-making authority granted to them by the contacts. See Carmen D. Caruso, "Franchising's Enlightened Compromise: The Implied Covenant of Good Faith and Fair Dealing,"ABA Forum on Franchising, *Franchise* (Spring 2007). As stated in the section 205 of the Restatement of Contracts (2d):

> Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving

'bad faith' because they violate community standards of decency, fairness or reasonableness.

In other words, there are many potential cases in which a franchisor arguably performs to the letter of a franchise agreement, but nonetheless may be held in violation of the covenant of good faith and fair dealing. An example would be in inspecting the franchised premises and then issuing a default notice based on the perception that a particular unit did not pass the inspection. If there is evidence of a double standard being applied, from one franchise to the next, the aggrieved franchisee might have a claim for breach of contract based on the implied covenant. And, where the franchisee can plausibly allege that the breach was motivated by race, then the conduct that is actionable as breach of contract may also be actionable under section 1981, thus exposing the franchisor to potential punitive damages that would not be available for breach of contract alone. Surely intentional race discrimination offends "community standards of decency, fairness and reasonableness" and is inconsistent with the "justified expectations" of minority franchisees, and therefore franchisors who act in bad faith or who do not deal fairly with their minority franchisees over the life of the long-term franchise relationship do so at their peril. The battleground, of course, will be in the proof.

Proving the Violation

To review all of the permutations of Title VII law, for the purpose of stating that the same requirements will likely apply under section 1981, goes beyond the scope of this article. As a brief refresher, most discrimination plaintiffs lack "smoking gun" direct evidence and instead rely on the burden-shifting formulation first recognized in *McDonnell Douglas Corp. v. Green*, 411 U.S. 792, 802–4 (1973), whereby: (1) The plaintiff must make out a prima facie case of discrimination; (2) the defendant must articulate a "legitimate, nondiscriminatory reason" for its action; and, finally, the plaintiff must show that the defendant's stated reason "was in fact pretext. *See* Wong and Baker, *supra*, at 4. To get to first base under this approach for a section 1981 claim, the prima facie case, the plaintiff must typically offer proof that a similarly situated "white citizen" received better treatment. *Id*.

But arguably there is a better way for section 1981 plaintiffs to proceed, especially in business-contracting cases, where finding someone who is truly similarly situated can be challenging due to differences in capitalization, performance, market factors, and other variable conditions. For example, in *Home Repair, Inc. v. Paul W. Davis Systems, Inc.*, No. 98 C 4074 (N.D. Ill., Feb. 1, 2000), an African American who was denied the opportunity to buy a franchise in a white community survived a Rule 56 challenge to its section 1981 claim, but not by relying only on the *McDonnell-Douglas* formulation. As disclosure, the author represented that plaintiff, and we relied on cases holding that a plaintiff can state a prima facie claim under section 1981 by presenting "a mosaic of evidence which, taken together, would permit a jury to infer discriminatory intent." *Kennedy v. Schoenberg, Fisher & Newman, Ltd.*, 140 F.3d 716, 724–25 (7th Cir. 1998). The plaintiff's mosaic of evidence in *Home Repair* included:

- The franchisor had no other African American franchisees out of hundreds of franchises.

- The franchisor had been willing to franchise a predominantly African American portion of the city to the African American plaintiff, but was denying him the opportunity to franchise in predominantly white portions of the city and suburbs.
- The franchisor had attempted to steer this franchisee to various "urban" areas with relatively large African American populations including Detroit and Little Rock.
- There was sharply contested evidence of racially derogatory statements being made about the plaintiff, which while not sufficient as direct evidence of discrimination, sufficed at the summary judgment stage to constitute part of the "mosaic" of evidence.

This evidence went beyond the traditional *McDonnell-Douglas* formulation, as there was no comparison to similarly situated white franchise buyers, and the court considered the impact of racist statements even though, standing alone in a direct-evidence analysis, those statements might not have propelled the case past the summary-judgment motion.

The district court in *Home Repair* also considered substantial evidence of pretext, i.e. that the franchisor's stated reason for denying the franchise sale was unworthy of belief. The white franchisee that was attempting to sell his franchise to the African American buyer was seeking to compete against the franchise system post-sale. The franchisor acted inconsistently on whether it would permit that post-sale competition to occur. Significantly, when the African American franchisee was poised to buy the franchise, the franchisor refused to approve the sale on the grounds that it would not waive enforcement of its standard post-termination non-compete clause, but when the African American buyer appeared to drop out of the deal, the franchisor was suddenly willing to waive enforcement of the non-compete clause and allow a sale to proceed. But when the African American franchisee heard that the territory might be available after all, the franchisor suddenly flipped back to its original "no deal" position, and the section 1981 claim followed.

The district court in *Home Repair* construed all of the evidence together, at the summary-judgment stage, instead of separately determining whether there was enough indirect evidence to invoke burden-shifting, or enough direct evidence standing alone to reach a jury. From the plaintiff's perspective, the pretext evidence alone should have been enough to survive Rule 56, but without question the case was stronger when the entire "mosaic" was considered.

Further support for a more flexible approach to these cases is found in *Coleman v. Donahoe*, 667 F.3d 835 (7th Cir. 2012), in which a three-judge panel of the court of appeals, following the *McDonnell-Douglas* formula, unanimously agreed to reverse a summary judgment for the post office in Title VII case. Judge Diane Wood then added a concurring opinion, joined by the other two members of the panel, in which she questioned the need to follow *McDonnell-Douglas* strictly:

> I write separately to call attention to the snarls and knots that the current methodologies used in discrimination cases of all kinds have inflicted on courts and litigants alike. The original *McDonnell Douglas* decision was designed to clarify and to simplify the plaintiff's task in presenting such a case. Over the

> years, unfortunately, both of those goals have gone by the wayside. We now have, for both discrimination and retaliation cases, two broad approaches—the "direct" and the "indirect." But the direct approach is not limited to cases in which the employer announces "I have decided to fire you because you are a woman [or a member of any other protected class]." Instead, the direct method permits proof using circumstantial evidence, as we acknowledged in *Troupe v. May Dep't Stores Co.*, 20 F.3d 734 (7th Cir.1994). Like a group of Mesopotamian scholars, we work hard to see if a "convincing mosaic" can be assembled that would point to the equivalent of the blatantly discriminatory statement. If we move on to the indirect method, we engage in an allemande worthy of the 16th century, carefully executing the first four steps of the dance for the *prima facie* case, shifting over to the partner for the "articulation" interlude, and then concluding with the examination of evidence of pretext. But, as my colleagues correctly point out, evidence relevant to one of the initial four steps is often (and is here) equally helpful for showing pretext.
>
> Perhaps *McDonnell Douglas* was necessary nearly 40 years ago . . . By now, however, . . . the various tests that we insist lawyers use have lost their utility. Courts manage tort litigation every day without the ins and outs of these methods of proof, and I see no reason why employment discrimination litigation (including cases alleging retaliation) could not be handled in the same straightforward way. **In order to defeat summary judgment, the plaintiff one way or the other must present evidence showing that she is in a class protected by the statute, that she suffered the requisite adverse action (depending on her theory), and that a rational jury could conclude that the employer took that adverse action on account of her protected class, not for any non-invidious reason**. Put differently, it seems to me that the time has come to collapse all these tests into one. We have already done so, when it comes to the trial stage of a case. See, *e.g., EEOC v. Bd. of Regents of Univ. of Wisc. Sys.*, 288 F.3d 296, 301 (7th Cir. 2002). It is time to finish the job and restore needed flexibility to the pre-trial stage.

667 F.3d 862–63 (emphasis added).

There is no attempt here to improve on Judge Wood's concurrence. Suffice it to say that this opinion is consistent with the "mosaic" approach that was approved in the *Home Repair* decision. The lesson is that in litigating a section 1981 claim, any and all means of proving that race was the motivating factor for the defendant's conduct are fair game, and it would be a mistake for a defendant to rely on an overly rigid interpretation of either direct or indirect evidentiary standards.

Keywords: civil rights litigation, 42 U.S.C. § 1981, employment discrimination, Title VII, independent contractor

Carmen D. Caruso is the principal attorney at Carmen D. Caruso Law Firm in Chicago, Illinois.