State and Local Privatization: An Evolving Process

DONALD G. FEATHERSTUN, D. WHITNEY THORNTON II, AND J. GREGORY CORRENTI

Donald G. Featherstun and D. Whitney Thornton II, are partners in the San Francisco office of Seyfarth Shaw. J. Gregory Correnti is a Senior Associate in the Los Angeles office of Seyfarth Shaw.

I. Introduction

Although state and local privatization efforts have existed for years on an ad hoc basis, over the last decade a group of states have concentrated their efforts to create an overarching "framework" for deciding "whether and in what instances privatization should occur."[1] At the same time state court decisions on the impact of privatization on civil service employees have greatly influenced the evolution of the privatization process. Legal issues relating to the constitutional protection of individuals' rights in the privatization process have emerged. Furthermore, statutory schemes have attempted to resolve policy issues arising from the privatization process. This Article explores the current status of these developments.

The Article begins with a description of the breadth and scope of privatization efforts. It then outlines what constitutes privatization and reviews both the benefits and detriments of privatization. Next, the Article discusses how decisions to privatize are made at the state and local levels, and then addresses the efforts of a number of states during the past decade to organize their privatization efforts into a coherent policy. The Article then focuses on the legal issues litigated over the past decade stemming from the inherent tension between privatization projects and civil service protection. The Article also explores a series of emerging issues relating to how privatization projects fit within the broader statutory framework of state and local governments. Emerging issues concerning the impact of privatization on individual constitutional rights are explored. The Article concludes with a discussion on the future of state and local privatization efforts.

On a cautionary note, privatization raises a myriad of issues. An in-depth analysis of each such issue is beyond the scope of this Article. This Article attempts to provide an overview of this complex process in the hope that a survey of this important and emerging field will provide government contract practitioners with a useful introduction to the key issues.[2]

II. The Breadth and Scope of the Privatization Effort at the State and Local Level

Every facet of governmental function has been touched by privatization. During the 1990s, Indianapolis, Indiana, privatized over seventy municipal operations through a managed competition process.[3] These services included

1. *See* Kansas Council on Privatization, Privatize, Eliminate, Retain or Modify: A Strategy for Competitiveness in Government 3 (1995).

2. For a detailed summary of many of the cases in this field, *see* Robin Cheryl Miller, *Privatization of Governmental Services by State or Local Government Agency*, 65 A.L.R. 5th 1 (1999).

3. Adam Cohen, *City Boosters a New Breed of Activist Mayors Is Making City Hall a Hothouse for Innovation*, Time, Aug. 18, 1997, at 20, *available in* 1997 WL 10902777.

a wastewater treatment plant, the Indianapolis airport, and various information technology functions.[4]

In October 1999, the County of San Diego, California, awarded a $644 million contract to a private company that subsequently outsourced the county's entire information technology function.[5] This contract is scheduled to run for seven years.[6] The effort has been cited as the "biggest, broadest information technology (IT) privatization pact ever entered into by a U.S. state or local government."[7] In a similar effort, Orange County, California, recently awarded a $250 million contract to provide computing and telecommunications services for ten-and-a-half years.[8]

States have returned to the concept of privately financed toll roads.[9] Social services such as collecting child support payments, Medi-Cal program administration, probationary services, animal abuse services, and parking ticket collections all have been privatized.[10] Furthermore, prisons and schools have been privatized.[11]

Although privatization has been widely embraced, the projects present significant risks for both the contractors and the governmental entities involved. In California, a judge found that the state's decision to terminate for default a contract to develop a new child support enforcement computer system was a breach of contract and awarded the contractor $58.8 million.[12] Perhaps more importantly, the failure to implement the system in a timely manner exposed the State of California to literally hundreds of millions of dollars in federal penalties.[13]

At the same time, the risk to contractors for performing privatization pro-

4. *Id.*; City of Indianapolis 1999 Annual Budget, *available at* <http://www.indygov.org>.

5. Tom Field, *High Anxiety,* CIO Magazine (Sept. 1, 2000), *at* <http://w2.cio.com/archive/090100_anxiety_content.html>.

6. *Id.*

7. *Id.* at 2.

8. Wilson Dizard, *Lockheed Martin Leverages Defense Technology for Local Govt. Information Project,* 12 Mil. & Aerospace Elec., *available at* 2001 WL 12392709.

9. Prof'l Eng'rs in Cal. Gov't v. Dep't of Transp., 16 Cal. Rptr. 2d 599 (Cal. Ct. App. 1993).

10. General Accounting Office, Rep. No. GAO/HEHS-97–4, Child Support Enforcement Early Results on Comparability of Privatized and Public Offices (1996); California State Employees Ass'n v. Williams, 86 Cal. Rptr. 305 (Cal. Ct. App. 1970); Stanfield v. Salvation Army, 695 So. 2d 501 (Fla. Dist. Ct. App. 1997); Putnam County Humane Soc'y v. Woodward, 740 So. 2d 1238 (Fla. Dist. Ct. App. 1999); Chuck Finnie, *High-Tech City Parking Proposal Questioned,* S.F. Exam., Jan. 19, 1998, at A1, *available at* 1998 WL 5176796.

11. Douglas W. Dunham, *Inmates' Rights and the Privatization of Prisons,* 86 Colum. L. Rev. 1475 (1986); Julie Huston Vallarelli, *State Constitutional Restraints on the Privatization of Education,* 72 B.U. L. Rev. 381 (1992).

12. Ramon Coronado, *Judge: State Owes Lockheed $58.8 Million,* Sacramento Bee, June 28, 2000, at A1.

13. *See* 42 U.S.C. §§ 609(a)(8) & 655(a)(4) (West. Supp. 1999).

jects also is substantial. In Mississippi, a jury awarded the state $474 million in damages for a failed effort by a contractor to improve the state's tax processing system.[14] This award included $175 million in punitive damages.[15]

Clearly the size, scope, and risks of these projects indicate that privatization of governmental functions will have an increasingly important place in state and local government. To appreciate how privatization is impacting state and local government, one must first understand what constitutes privatization.

III. What Is Privatization?

Privatization, defined as any process aimed at shifting functions and responsibilities, in whole or in part, from the government to the private sector,[16] takes many forms. The three most common types are contracting out, asset transfer, and managed competition.

A. *Contracting Out*

Contracting out, the most prevalent form of privatization, occurs when a government entity uses a private contractor instead of public resources to provide a government service.[17] Contracting out usually involves identifying potential private sources, developing detailed specifications, conducting a competition, making an award, and then monitoring the successful contractor's performance. Contracting out can be implemented at the task level, such as collecting delinquent child support payments, or on a full-service basis, for example, contracting out for all local child support services.[18] Where a governmental entity contracts out only certain tasks, it maintains responsibility for the overall management of the governmental function. Even in situations involving contracting out for full services, the governmental entity retains responsibility for monitoring the contractor to ensure that performance is in accordance with the contract terms and governmental regulations.

14. Margaret Cronin Fisk, *Breach Suit Brings $185 Million to Mississippi—Management Firm to Pay for Failure to Deliver a Tax System*, NAT'L L.J., Sept. 11, 2000, at A10. Although the jury awarded the state $474 million, a settlement was reached where the contractor agreed to pay $185 million over thirteen years.

15. *Id.*

16. GAO REPORT GAO/GGD-97–48, PRIVATIZATION: LESSONS LEARNED BY STATE AND LOCAL GOVERNMENTS 1 (1997).

17. *Id.* at 44 ("[c]ontracting out is the hiring of private-sector firms or nonprofit organizations to provide a good or service for the government. Under this approach, the government remains the financier and has management and policy control over the type and quality of services to be provided. Thus, the government can replace contractors that do not perform well.").

18. GAO REPORT GAO/T-HEHS-98–22, CHILD SUPPORT ENFORCEMENT PRIVATIZATION: CHALLENGES IN ENSURING ACCOUNTABILITY FOR PROGRAM RESULTS 2 (1997).

B. *Asset Transfer*

Asset transfer, another form of privatization, occurs where a governmental entity divests itself of all responsibility for the service.[19] In an asset transfer, a governmental entity sells or leases a revenue-producing asset to a private sector entity that undertakes to provide services to the public on a for-profit basis or converts the asset to private use.[20] Examples of asset transfers include the sale of a state workers' compensation accident fund, sale of unused armories, sale of a state educational loan portfolio, and the sale of excess state property.[21]

Similar to an asset transfer, government service shedding happens when a governmental entity simply decides to stop providing a certain service or function, leaving it to the private sector to fill the need if a demand exists.[22] In the case of both asset transfers and service shedding, governmental entities cease involvement with the function or service. Unlike contracting out, once an asset is transferred to the private sector or a function shed, the governmental entity does not retain any management or oversight responsibility. Asset transfers are limited to areas that are determined not to be proper governmental functions or where a service can best be supplied by the private sector with the attendant release, or recapture, of the resources tied up in the asset.

C. *Managed Competition*

A managed competition, a relatively new process, allows public as well as private sources to compete in providing the service.[23] Public entities have the opportunity to submit proposals in competition against private firms with the "award" being made to the sector offering the best proposal, as evaluated in accordance with the terms of the competition. A managed competition

19. Lessons Learned by State and Local Governments, *supra* note 16, at 44 ("[a]n asset sale is the transfer of ownership of government assets, commercial type enterprises, or functions to the private sector. In general, the government will have no role in the financial support, management, or oversight of a sold asset. However, if the asset is sold to a company in an industry with monopolistic characteristics, the government may regulate certain aspects of the business, such as the regulation of utility rates.").

20. GAO Report GAO/RCED-97–3, Airport Privatization: Issues Related to the Sale or Lease of U.S. Commercial Airports 2 (1996).

21. Lessons Learned by State and Local Governments, *supra* note 16, app. III at 25.

22. Shirley L. Mays, *Privatization of Municipal Services: A Contagion in the Body Politic*, 34 Duq. L. Rev. 41, 44 (1995).

23. Lessons Learned by State and Local Governments, *supra* note 16, at 1. The GAO has described managed competition as follows: "[u]nder managed competition, a public-sector agency competes with private-sector firms to provide public-sector functions or services under a controlled or managed process. This process clearly defines the steps to be taken by government employees in preparing their own approach to performing an activity. The agency's proposal, which includes a bid proposal for cost-estimate, is useful to compete directly with private-sector bids."

requires detailed specifications and a formal evaluation structure, including a cost evaluation methodology.

A governmental agency's accounting and budgeting of costs will differ depending on whether in-house public resources performed the services or the government contracted them out to the private sector. A governmental agency's budget for an internal project often accounts only for operating costs, leaving capital costs and other indirect expenses lumped together in a department budget.[24] These "hidden" overhead expenses, and the fact that private contractors pay taxes whereas governmental agencies do not, may unfairly skew any cost evaluation of public and private sector bids. The Federal Government uses a standardized procedure for making cost comparison in A-76 competitions between public and private entities, which accounts for such budget and accounting differences. State and local government organizations conducting managed competitions must develop similar cost evaluation procedures.

IV. Benefits and Detriments of Privatization

Although privatization boasts many potential benefits, there are also some detriments and obstacles that must be considered.

A. *Benefits of Privatization*

The benefits of privatization depend largely on which privatization method is used. Contracting out is frequently cited as resulting in lower costs and improved quality. In theory, private contractors, motivated by profits, are more efficient and have more flexibility to be innovative than their public counterparts. The Federal Government reported that state and local governments save between 16 percent and 77 percent when they contract out, depending on the service.[25]

Apart from the goals of cost savings and better quality, a government entity contracts out simply because the public sector lacks the necessary skills or resources. Privatization also may be pursued because of a desire to reduce the size of government. Further, privatization may be prompted by the imposition of new services upon an agency without sufficient staff or budget to perform the added work. For example, the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 required that states establish automated registries of child support orders and directories of newly hired employees to track and locate parents owing support.[26] To meet this new requirement,

24. Jonas Prager, *Contracting-Out: Theory and Policy*, 25 N.Y.U. J. Int'l L. & Pol. 73, 92 (1992).

25. Joint Economic Comm. Staff Report, The $7.7 Billion Mistake: Federal Barriers to State and Local Privatization (Feb. 1996), <http://www.senate.gov/~jec/privatiz.html>.

26. Pub. L. No. 104–193, 110 Stat. 2105 (1996).

many states moved to privatize child support enforcement services that traditionally had been delivered by the public sector.[27]

Privatization by asset transfer may provide substantial capital to governmental entities. If the governmental service is transferred along with the asset, cost savings will result as public funds will no longer be required to support the transferred service. Also, the transfer of a public asset to a private owner places the asset on the tax rolls, thus providing new revenues for governmental purposes.

A managed competition may achieve cost savings and improved quality without contracting out. The crucible of competition can result in efficiencies being introduced into the performance of governmental entities. The threat of job losses to the private sector may prompt government unions to accept new work rules and other concessions making the public sector competitive with the private sector.

B. *Detriments and Obstacles to Privatization*

Some commentators argue that any cost savings and improvements in service from privatization are illusory, because there are hidden costs and quality issues with the contracting out process.[28] To effectuate a privatization a governmental entity must incur certain transaction costs to prepare the specifications and conduct the competition. In order to obtain the benefit of their bargain and ensure that private contractors adhere to contract requirements, governmental entities must closely monitor performance. The costs of monitoring may be substantial and in order to make a true evaluation of whether contracting out provides cost savings, monitoring costs must be accurately estimated and considered in the evaluation. This is an area of difficulty to governmental entities. If these costs are not accurately considered, there is a risk that any decision to privatize based on cost savings may be made in error. Also, the actual monitoring of contracted out duties has proven very difficult for governmental entities. With ineffective monitoring comes a lessening of quality, one of the expected goals of privatization. Since these administrative costs are difficult to estimate with any degree of precision, privatization based solely on cost savings possesses an element of risk.

A related risk is the degree of completeness and accuracy of the specifications. Whereas a public entity easily shifts emphasis and direction to meet the needs of its constituency, a private contractor, obligated only to perform to the contract requirements as reflected in the specifications, may not be so inclined. If the specifications are incomplete or inaccurate, any redirection of the contract effort may be costly and dissipate any savings upon which the decision to privatize was predicated. Governmental entities have been more successful at contracting out tasks than at privatizing full services. In part

27. Comparability of Privatized and Public Offices, *supra* note 10, at 1.
28. Prager, *supra* note 24, at 92.

this may be because of the difficulty inherent in drafting specifications for performance of a full-service function.[29]

There also may be legislative or regulatory obstacles to privatization of particular services. For example, several local government entities have sought to raise capital by privatizing airport facilities. These efforts have been unsuccessful due to the requirement that any federal grant, less depreciation, be repaid from the proceeds of sale and that any funds generated by airport activities be used only to support aviation.[30] In other words, the public entity cannot use revenue generated from the sale or lease of airport facilities to reduce general debt or to support new nonaviation programs. Likewise, profits generated by a private owner must be reinvested into the airport thus undermining the economics of any private purchase of public airport facilities.[31]

Another example of a legislative obstacle to privatization was the Internal Revenue Code provision that prevented the disclosure of tax return information to private entities.[32] Such data are critical in tracking delinquent child support obligors. The problem was partially alleviated by section 316(g)(4) of the Personal Responsibility and Work Reconciliation Act of 1996, which amended the Internal Revenue Code to permit state child support agencies to disclose to contractors the addresses and social security numbers of noncustodial parents and the amount of tax refunds withheld for past-due child support.

Politics and political considerations may be another obstacle to privatization. In many instances public employee unions challenge efforts to privatize government services. Apart from the legal merits of such challenges, the unions, with their organized member-voters, can present overwhelming political challenges to a privatization action that impacts public employment. The use of managed competitions as a privatization methodology has gone a long way towards neutralizing public employee unions' aversion to the process.

V. How Is the Decision Made to Select a Project for Privatization?

Many factors go into the decision to privatize a service. Decisions to do an asset sale or service shedding are generally based on an assessment that the service is not a core government function but one that is more commercial in nature and better supplied by the private sector. Finances may also have a large bearing on a decision by a state or local entity to conduct an asset sale. The expectation of a substantial monetary windfall for the public

29. Darrell A. Fruth, *Economic and Institutional Constraints on the Privatization of Government Information Technology Services*, 13 Harv. L. J. & Tech. 521, 547 (2000).

30. Airport Privatization, *supra* note 20, at 36–38.

31. *Id.*

32. I.R.C. § 6103 (2000). *See also* Comparability of Privatized and Public Offices, *supra* note 10, at 14–15.

coffers is a strong incentive to privatize, particularly where the service is not a traditional government function.

The decision to contract out or conduct a managed competition hinges on the expectation that cost savings and/or enhanced quality will result. However, the decision makers also need to consider the marketplace and the agency's own level of resources. Issues reviewed include whether there is substantial competition for the service and whether there are sufficient resources and expertise within the governmental entity to effectively administer and monitor a privatization effort. These questions and issues are but a few of the many a governmental entity must address in making an informed privatization decision.[33]

VI. Commissions to Study Privatization

In the face of expanded budgets due to federal mandates, new and increased public services, and the impact of the Federal Government's shift of functions to the state level, states during the past decade have established processes to organize and manage their, previously ad hoc privatization efforts.[34] States such as Colorado, Georgia, Illinois, Kansas, Michigan, New York, Texas, and Virginia formed commissions to study ways to create a formal process to their privatization efforts.[35]

The conclusions of many of these state commissions were summarized by the U.S. General Accounting Office (GAO) in a series of reports on privatization addressing state and local government issues.[36] In 1997, the GAO prepared a report for the House Republican Task Force on Privatization that compiled the lessons learned by state and local governments on privatization.[37] After investigating privatization efforts by the states of Georgia, Massachusetts, Michigan, New York, and Virginia as well as the city of Indianapolis, the GAO identified six major lessons learned.

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33. The GAO has prepared a report on the privatization decision. General Accounting Office, Rep. No. GAO/GGD-98–87, Privatization: Questions State and Local Decision Makers Used When Considering Privatization Options (1998).

34. A Strategy for Competitiveness in Government, *supra* note 1, at 3.

35. *Id.* at 11–22; Lessons Learned by State and Local Governments, *supra* note 16, at 10.

36. *See, e.g.*, Comparability of Privatized and Public Offices, *supra* note 10; Airport Privatization, *supra* note 20; GAO Report GAO/HEHS-97–11, Child Support Enforcement: States' Experience With Private Agencies' Collection of Support Payments (1996); GAO Report GAO/GGD-96–158, Private and Public Prisons: Studies Comparing Operational Costs and/or Quality of Service (1996); GAO Report GAO/HEHS-96–43FS, Child Support Enforcement: States and Localities Move to Privatized Services (1995); GAO Report GAO/T-GGD-95–194, District of Columbia: City and State Privatization Initiatives and Impediments (1995); GAO Report GAO/T-GGD-95–110, District of Columbia: Actions Taken in Five Cities to Improve Their Financial Health (1995).

37. Lessons Learned by State and Local Governments, *supra* note 16.

First, "privatization can best be introduced and maintained if there is a committed political leader to champion it."[38] Political champions are necessary in order to gain support for the process within those constituencies, that may oppose it, such as government workforces.

Second, governments must establish an organizational and analytical structure to implement privatization.[39] Such structures can take the form of commissions or staff offices but some form of organization is required to identify and implement privatization opportunities. Some state privatization organizations have included members from both the public and private sectors in order to ensure balance and to promote broad based support for the efforts.

"Third, governments may need to enact legislative changes and/or reduce agency resources in order to encourage privatization."[40] Legislative enactments include statutes encouraging privatization and civil service reform, thereby making it easier to implement privatization initiatives. Budget cuts and management reductions also prove effective in encouraging privatization.

Fourth, reliable and complete cost data on government activities are required in order to properly evaluate privatization initiatives and accurately baseline cost evaluations.[41] Some governmental entities developed systems to account for all costs associated with performing a government function or service. Others attempted to develop best estimates of such costs. However, estimates have less reliability than accumulated actual costs and are subject to criticism as to the validity of projected savings.

Fifth, governments must develop strategies to manage any workforce transition that may result from privatization.[42] These strategies include early involvement of state employee unions in privatization planning and training of employees so that they are more capable of competing in managed competitions or in monitoring performance in an effected transition. Providing a safety net for displaced workers is an important part of transition strategy. The safety net strategy includes such options as early retirements, severance pay, or a buyout.

Finally, enhanced monitoring and oversight of performance is needed when privatization is used.[43] This effort is necessary in order to ensure compliance with the contract terms as well as to ensure that performance is meeting the needs of the ultimate recipients of the service.[44]

38. *Id.* at 4–5, 8–9.
39. *Id.* at 5, 10–11.
40. *Id.* at 5, 11–12.
41. *Id.* at 5, 12–14.
42. *Id.* at 5–6, 14–16.
43. *Id.* at 6, 16–18.
44. In 1997, the Colorado commission issued a report with six recommendations that appear consistent with the GAO model. First, the commission recommended the creation of a permanent commission on government efficiency to determine ongoing privatization

VII. The Ongoing Tension Between the Policies of Civil Service Protection and the Perceived Benefits of Privatization

As the GAO study discussed above indicates, one of the inherent policy issues that must be resolved is how to handle the effects of privatization on the existing civil service workforce. State courts split between permitting or prohibiting privatization. But even when a state legislature chooses to emphasize civil service protections over the perceived benefits of privatization, the judiciary has carved out exceptions.

A. *The Policy Debate Concerning Civil Service Protection*

The most litigated privatization issue at the state and local level is whether existing civil service statutes prohibit a public entity from privatizing a certain area of government. The policy issue was succinctly explained in the dissent in a California appellate decision where the issue hinged on whether the California Department of Transportation could contract out engineering services in view of Article VII of the California Constitution. The article provides that "[i]n the civil service permanent appointment and promotion shall be made under a general system based on merit ascertained by competitive examination."[45] In this case the dissent stated:

> History has shown that patronage hiring of public employees corrupts the political process, leads to waste, and depletes the quality of the public workforce. The People enacted Article VII to avoid this. Early on the California Supreme Court recognized that the civil service provisions will not work if the merit appointment system can be circumvented by simply contracting out civil service jobs.[46]

It is this long-established concern over political patronage that collides with the modern era desire to privatize government.

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implementation. Second, a recommendation to institute a reliable and complete cost accounting function throughout the state was made. Third, the commission stated that market testing should be used to compare in-house costs to private market prices to help justify a decision to change the way a service is delivered. Fourth, the commission believed that the state should permit government agencies to prepare work proposals and submit bids to compete with private bidders. Fifth, the use of performance-based contracting and effective monitoring of contractor performance was urged. Finally, the commission recommended that Colorado create a public sector management cooperation council within state agencies to increase the ability of Colorado's current employees to make a meaningful contribution to the process. *See* Colorado Commission on Privatization, Promoting A More Competitive Government (1997), <http://www.state.co.us/gov_dir/gss/edo/priv/privtext.html>.

45. Cal. Const. Art. VII, § 1(b).

46. Prof'l Eng'rs in Cal. Gov't v. Dep't of Transp., 51 Cal. Rptr. 2d 465, 485 (1996) (Cal. Ct. App. 1996), *rev'd*, 936 P.2d 473 (Cal. 1997). In this case, the majority upheld the privatization effort. This decision was reversed by the California Supreme Court in *Prof'l Eng'rs in Cal. Gov't v. Dep't of Transp.*, 63 Cal. Rptr. 2d 467 (Cal. 1997), discussed below.

B. *Civil Service Protection Emphasized*

Adopting the view of the appellate court dissent, the California Supreme Court recently held that a statute permitting contracting out of engineering services violated Article VII of the California Constitution as long as the state could "adequately and competently" perform the services itself.[47] The court stated:

> If the constitutional civil service mandate is to retain any vitality as a protective device against the deterioration of the civil service system through private contracting, we must hold that Chapter 433 represents an invalid or ineffectual attempt to circumvent that constitutional mandate.[48]

In its decision, the California Supreme Court conceded that nothing in the California Constitution explicitly prohibits or restricts contracting for services by a state agency.[49] However, the court based its decision on an implicit need to protect civil service from destruction.[50] Recently, courts in Colorado, Hawaii, Nevada, and Washington issued similar decisions.[51]

Colorado's case law evolved in a manner similar to that of California. In *Colorado Ass'n of Public Employees v. Department of Highways*, the Colorado Supreme Court found the highway's department's privatization initiative violated the Colorado Constitution and state law directed at the protection of civil servants.[52] The department could not lay off workers and replace their services with privatization contracts. The court articulated the purpose of the civil service laws as securing efficient public servants for positions in government and freeing the state personnel system from pressures of political patronage.[53] The court also recognized that "[p]rivatization of government services has significant policy implications for the state personnel system. Privatization can provide important benefits by reducing costs and increasing governmental efficiency and productivity. On the other hand, privatization operates as labor policy in that it affects the qualifications and conditions of employment of persons who will perform services for the government."[54]

Later, in *Horrell v. Department of Administration*, the Colorado Supreme Court again ruled on the legality of a state department obtaining services previously performed by state employees from private companies.[55] The court began its analysis by describing the instant legal issue as "substantially similar"

47. Prof'l Eng'rs in Cal. Gov't v. Dep't of Transp., 63 Cal. Rptr. 2d 467 (Cal. 1997).
48. *Id.* at 469.
49. *Id.*
50. *Id.*
51. Colorado Ass'n of Pub. Employees v. Dep't of Highways, 809 P.2d 988 (Colo. 1991); Horrell v. Dep't of Admin., 861 P.2d 1194 (Colo. 1993); Konno v. County of Hawai'i, 937 P.2d 397 (Haw. 1997); Washington Fed'n of State Employees v. Dep't of Social and Health Servs., 966 P.2d 322 (Wash. Ct. App. 1998).
52. *Colorado Ass'n of Pub. Employees*, 809 P.2d at 988.
53. *Id.* at 991–92.
54. *Id.* at 994.
55. Horrell v. Dep't of Admin., 861 P.2d 1194 (Colo. 1993).

to *Colorado Ass'n of Public Employees*.[56] Not surprisingly, the privatization effort of the Department of Administration faired no better than that of the highway department.

In *Konno v. County of Hawai'i,* the Hawaii Supreme Court ruled the "merit principle" set forth in Article XVI, Section 1 of the Hawaii Constitution prohibited the county from privatizing solid waste disposal services.[57] State law implementing the constitutional provision set forth a broad definition of civil servants who were to be afforded job protection on a merit basis.[58] The court invalidated the agreement for solid waste disposal based on its reading of state constitutional and statutory provisions. The court recognized the two policy concerns of privatization expressed by other courts. "On the one hand, privatization purportedly can improve the efficiency of public services. On the other hand, privatization can interfere with the policies underlying our civil service, i.e., elimination of the spoils system and the encouragement of openness, merit, and independence [of employees]."[59] The court invited the legislature to participate in the shaping of these "two important, but potentially conflicting, policy concerns."[60]

In *University of Nevada v. State of Nevada Employees Ass'n,* the Supreme Court of Nevada examined the University of Nevada's decision to privatize food services at the Reno campus in light of the state's merit system law.[61] Under Nevada law, state personnel are employed on the basis of "merit and fitness."[62] The Nevada court recognized that in some instances the replacement of state employees with commercial service providers might merely supplant state employees "tantamount to a sham abolition of established civil service positions."[63] Drawing on decisions from other jurisdictions with employment merit systems, the court recognized a need for a safeguard against politically motivated replacement of state workers with private sector workers. "Authorities universally affirm the proposition that the executive departments of government may lay off a merit system employee by abolishing the position which he holds, with the limitation that it be for a bona fide reason and not a subterfuge to evade the merit system laws."[64] The court thereafter held that "an appointing authority may not abolish civil service positions and obtain substitute services through a private contractor, unless it not only acts in good faith, to effect a real and not fundamentally sham

56. *Id.* at 1200.
57. 937 P.2d 397 (Haw. 1997).
58. *Konno,* 937 P.2d at 406–08.
59. *Id.* at 410.
60. *Id.*
61. 520 P.2d 602 (Nev. 1974).
62. *Nevada Employees Ass'n*, 520 P.2d at 604 n.2.
63. *Id.* at 604.
64. *Id.* at 606 (quoting Ball v. Bd. of Tr. of State Colleges, 248 A.2d 650, 654 (Md. 1968)).

reorganization, but also for substantial rather than arbitrary and capricious reasons."[65]

Washington has an extensive line of cases on this subject.[66] Most recently, in *Washington Federation of State Employees v. Department of Social and Health Services*, a Washington appellate court ruled that Washington's civil service law prevented the Department of Social and Health Services (DSHS) from contracting out job placement services with a third-party contractor.[67] Traditionally, the state's Department of Employment Security (ES) provided job placement for the department. To obtain services from a third-party contractor, Washington law requires that those services must have been regularly purchased from third parties prior to April 23, 1979, and requires that renewal lead to the termination of employees or the elimination of positions.[68] The court examined the service obtained through third-party contractors (job training followed by job placement) prior to 1979 and compared that with services traditionally provided by ES state employees (job placement).[69] The court was unpersuaded by DSHS's argument that because third parties performed limited job placement work in connection with job readiness prior to 1979, DSHS was somehow now allowed to contract out all job placement work.[70]

Similarly, in *Washington Federation of State Employees v. Joint Center for Higher Education,* the appellate court enjoined a contract for janitorial services at a public institution.[71] Both of these cases relied on the reasoning adopted by the Washington Supreme Court in the earlier case of *Washington Federation of State Employees v. Spokane Community College*.[72] The supreme court case involved a custodial service contract at a community college. The Washington Supreme Court rejected an argument that since the positions were new positions, the civil service laws did not apply. Specifically, the court stated:

> In view of the basic purpose and policy of the State Higher Education Personnel Law, we conclude that the general power of the purchasing director to procure services for community colleges granted in RCW 43.19.190 cannot be constructed to authorize contracts for services ordinarily provided, and capable of being provided by civil servants. The interpretation suggested by the College would derogate substantially from the rights, both express and necessarily implied, of civil service employees. We are not persuaded the legislature intended such a derogation, in the absence of any clear legislative expression to that effect. We recognize that some services have historically been procured by contract. We agree with the Federation, however, that RCW

65. *Id.* at 606.
66. Nancy Buonanno Grennan, *A Legal Roadmap to Privatizing Government Services in Washington State,* 72 Wash. L. Rev. 153 (1997).
67. 966 P.2d 322 (Wash. Ct. App. 1998).
68. *Washington Fed'n of State Employees*, 966 P.2d at 325.
69. *Id.*
70. *Id.*
71. 933 P.2d 1080 (Wash. Ct. App. 1997).
72. 585 P.2d 474 at (Wash. 1978).

> 43.19.190 was not intended to enlarge the authority of the Director of General Administration with regard to the types of services which may be so procured. The contract entered into here would be such an enlargement. We therefore hold the contract was unauthorized, and is void.[73]

Although this case and the ones above express a rigid approach to privatization, a series of case-developed exceptions also exist.

C. *Evolving Case Law Exceptions*

Even though the general policy in California favors civil service protection, the California courts developed a series of exceptions that make certain types of privatization projects possible. The first exception involves new functions not previously undertaken by the state.[74] For instance, in *California State Employees Ass'n v. Williams*, the court held that a contract to conduct the state's Medi-Cal program did not violate the civil service provisions of the state constitution as the program was a new state function and did not displace current employees.[75] In explaining this exception, the California Supreme Court stated, "[a]ccording to *Williams*, the civil service mandate is aimed at protecting 'the existing civil service structure' and does not compel the state to fulfill every new state function through its own agency."[76]

A second exception the courts recognize is a statutorily created exemption permitting cost savings if done without displacement of state workers.[77] California Government Code § 19130 provides certain conditions under which the State of California can contract for personal services.[78] The statute permits contracting out to achieve cost savings, but only when the contract does not result in the displacement of civil service employees.[79] The courts have ruled that this section does not violate the constitutional protection afforded to the civil service system.[80]

A third exception involves experimental projects that transfer formerly state functions to private enterprise.[81] In *Professional Engineers in California Government v. Department of Transportation*, the court ruled that a statute authorizing CalTrans to enter into contracts to develop toll roads with private

73. *Washington Fed'n of State Employees*, 585 P.2d at 478–79.
74. Kennedy v. Ross, 170 P.2d 904 (Cal. 1946); San Francisco v. Boyd, 110 P.2d 1036 (Cal. 1941); California State Employees Ass'n v. Williams, 86 Cal. Rptr. 305 (Cal. Ct. App. 1970).
75. *Williams*, 86 Cal. Rptr. at 305.
76. Prof'l Eng'rs in Cal. Gov't v. Dep't of Transp., 63 Cal. Rptr. 2d 467, 469 (Cal. 1997).
77. California State Employees Ass'n v. California, 245 Cal. Rptr. 232 (Cal. Ct. App. 1988).
78. Cal. Gov't Code § 19130.
79. *Id.*
80. *California State Employees Ass'n*, 245 Cal. Rptr. at 232.
81. *Prof'l Eng'rs*, 63 Cal. Rptr. 2d at 470.

developers did not violate Article VII of the state constitution.[82] This was true even though the court conceded that the work in question involved work previously performed by state workers. One distinguishing point in the court's view was that private, rather than public, money would be used to finance the construction of the toll road.[83] Interestingly, the California Supreme Court, in its 1997 case concerning engineering services, reviewed the 1993 appellate court opinion involving the toll road projects and stated that "[s]imilar experimentation may be permissible under Article VII if justified by considerations of economy and efficiency and if otherwise consistent with applicable civil service requirements, despite the use of state funding."[84]

This most recent pronouncement of a willingness to consider pilot projects that displace government employees even when public funds are used may very well signal a shift in the willingness of the California courts to permit privatization projects. Furthermore, the exceptions already developed provide an outline for other jurisdictions to consider as they develop their own policies.

D. *The Policy of Privatization Emphasized*

In contrast to the prevailing view in California, Colorado, Hawaii, Nevada, and Washington, courts in Alaska, Maryland, New York, Ohio, and Vermont have adopted an approach more favorable to privatization. In *Moore v. Department of Transportation and Public Facilities*, the Alaska Supreme Court examined the state constitutional provision that commands the legislature to "establish a system under which the merit principle will govern the employment of persons by the State."[85] The court determined that the state constitutional provisions and applicable laws did not prohibit the privatization of airport maintenance work. The constitutional provision is relatively similar to the provision examined by the Hawaii Supreme Court in *Konno v. County of Hawai'i*.[86] The Alaska court, however, appears to take a stronger position in favor of the economic incentives that drive state and local governments to privatize services[87] than the Hawaii court.[88] Like the court in *Konno*, the Alaska Supreme Court examined the related state laws implementing the public employment merit principle.[89] The court weighed the

82. Prof'l Eng'rs in Cal. Gov't v. Dep't of Transp., 16 Cal. Rptr. 2d 599 (Cal. Ct. App. 1993).
83. *Id.* at 604, n.4.
84. *Prof'l Eng'rs in Cal. Gov't*, 63 Cal. Rptr. 2d at 481 (emphasis added.).
85. 875 P.2d 765 (Alaska 1994).
86. 937 P.2d 397 (Haw. 1997).
87. *Moore*, 875 P.2d at 769.
88. *Konno*, 937 P.2d at 404–05 (considering policies in favor of preserving merit principles of government employment).
89. *Moore*, 875 P.2d at 768–71.

same policy considerations both for and against a rigid merit principle.[90] The court concluded, however, that "[w]e think it clear, then, that the merit principle, as expressed in [the relevant section] of the Alaska Constitution, ordinarily allows state agencies broad description to eliminate positions and order layoffs for reasons of efficiency and economy, provided that their decisions are not politically motivated."[91]

New York courts have long indicated a willingness to permit privatization as long as the efforts were not blatant attempts to circumvent the civil service laws. In *Corwin v. Farrell,* the Court of Appeals of New York ruled that the New York City Housing Authority acted legally when it dismissed a group of civil service title examiners from its employment after awarding a contract to a private company to perform the same functions.[92] In this case the employers raised the issue of whether the New York State constitutional provisions relating to civil service employment prohibited the privatization effort.[93] The court rejected the argument based on the position that the state constitution did not require that all governmental functions be performed by civil servants. The court expressed a willingness to permit privatization efforts as long as they were done in good faith and not in an attempt to "evade the civil service laws."[94]

In *Haub v. Montgomery County,* the Maryland appellate court ruled that the county's decision to privatize 156 county jobs did not violate county code provisions that implement an employee merit system.[95] By its terms the merit system provided "the means to recruit, select, develop, and maintain an effective, nonpartisan, and responsive work force with personnel actions based on demonstrated merit and fitness."[96] Further, the employees failed to preserve their jobs because both the county executive and the county council approved the appropriations measure calling for privatization. So while the court found the privatization initiative consistent with the employee merit system, it also stated that "the decision to contract out or privatize specific functions is made as a later legislative enactment, by the same legislative body [i.e., county council] which earlier had enacted the collective bargaining ordinances and merit system ordinances, the later enactment prevails to the extent of any inconsistency."[97]

In *State* ex rel. *Sigall v. Aetna Cleaning Contractors of Cleveland, Inc.*, the

90. *Id.*
91. *Id.* at 770.
92. 100 N.E. 2d 135 (N.Y. 1951).
93. *Corwin*, 100 N.E. 2d at 135.
94. *Id.* at 139.
95. 727 A.2d 369 (Md. 1999); *see also* Timothy E. Lengkeek, *Home Rule—The Court of Appeals of Maryland Holds Privatization Does Not Violate County Charter Provisions Relating to the Merit System* Haub v. Montgomery County, *727 A. 2d 369 (Md. 1999)*, 31 Rutgers L. J. 1582 (1999).
96. *Haub*, 727 A.2d at 378 (quoting Montgomery County, Md., Code § 401).
97. *Id.* at 376.

Supreme Court of Ohio ruled that the state civil service laws, established on a merit system, did not by their terms prohibit the contracting out of custodial services by Kent State University.[98] Further, the court determined that a resulting savings of $300,000 in state funds was a proper motive for privatization of custodial services.[99] Like Nevada, however, courts in Ohio will examine the motive behind privatization. Therefore, in *Local 4501, Communications Workers of America v. Ohio State University*, the Supreme Court of Ohio ruled in a four-three decision that Ohio State University's initial contracts to privatize custodial services during an indefinite hiring freeze "sidestepped completely" the laudable purpose of the civil service system.[100] Two years later, however, the court allowed the renewed contracts by Ohio State University, which privatized these same positions originally designed. By then, the hiring freeze had been lifted and the evidence demonstrated clearer economic motives.[101]

In *Vermont State Employees' Ass'n, Inc. v. Vermont Criminal Justice Training Council*, the court ruled that the state attorney general was within his discretion when he certified a privatization contract for food services at the state police academy.[102] Employment by the state of Vermont affords employees with merit principles intended to "improve the effectiveness and efficiency of state government."[103] Under Vermont law, the attorney general possesses broad discretion when exercising the statutory authority to certify privatization contracts that do not violate the "spirit and intent" of the state's classification plan and merit system principles.[104] The parties did not dispute that the state realized a savings by privatizing the food services at the academy.[105] The court ruled that cost savings was an appropriate factor for the attorney general to consider in certifying the contract's consistency with the merit system. "As other courts have recognized, government agencies operating under the merit system 'have traditionally been accorded broad latitude to eliminate jobs for economic, as opposed to political reasons.'"[106]

E. *Collective Bargaining Agreements*

In addition to relying on state civil service laws, occasionally employee unions attempt to use collective bargaining agreements to block privatization projects, with mixed success.

In *Johanson v. Department of Social and Health Services*, the court held that

98. 345 N.E.2d 61, 64 (Ohio 1976), *aff'd*, 345 N.E.2d 61 (Ohio Ct. App. 1976).
99. *Aetna Cleaning Contractors*, 345 N.E. 2d at 65.
100. 466 N.E.2d 912, 915 (Ohio 1984).
101. 494 N.E.2d 1082 (Ohio 1986), *rev'g in part*, 466 N.E.2d 912 (Ohio 1984).
102. 704 A.2d 769 (Vt. 1997).
103. *Vermont State Employees Ass'n*, 704 A.2d at 773.
104. *Id.* at 771–72.
105. *Id.* at 773.
106. *Id.* (quoting Moore v. Dep't of Transp. & Pub. Facilities, 875 P.2d 765 (Alaska 1994)).

the Department of Social and Health Services initiative to privatize a state-run mental health program impaired obligations of the collective bargaining agreement between the department and the union for those state employees with positions to be privatized.[107] Under the court's analysis, "any form of legislative action that impairs the obligations of contracts is presumed unconstitutional."[108] Under Washington case law, a court first decides if a contractual relationship exists that the legislation substantially impairs. Next a court determines if the substantial impairment is "reasonable and necessary to serve a legitimate public purpose."[109] Here the court ruled that state law replacing the state program with a state-funded private program substantially impaired the affected employees' rights under its collective bargaining agreement with the state.[110] In deciding if the legislation authorizing the private contracts was reasonable and necessary, the court held that "[the department] relies only upon financial considerations to justify its action under [the privatization law]."[111]

In *City of Belvidere v. Illinois State Labor Relations Board*, the court overturned the state labor relations board's unfair labor practice ruling.[112] The court held that the city was not required to engage in mandatory collective bargaining with city firefighters about the privatization of paramedic services. Under Illinois law and the historic interaction between the city fire department and private ambulance services, the decision to privatize was a relatively inconsequential change to the job performed by city firefighters, and paramedic services were not services traditionally performed by the city firefighters.

In *Connecticut Independent Labor Union v. Town of Hamden*, the court held the plaintiff union was not entitled to a preliminary injunction against the leasing of a city golf course.[113] The four union employees working at the golf course were assigned to similar positions elsewhere with the city. The court found that the union enjoyed little chance of success at trial on its claim that the city was required to engage in collective bargaining as part of the privatization of the city golf course.

In light of the developing case law relating to civil service and collective bargaining agreements, at least one commentator has suggested that public employees and their unions need to take a more proactive approach to privatization.[114] The author suggests that unions need to be aware of proposed privatization projects, get involved early in the political process to shape a

107. 959 P.2d 1166 (Wash. Ct. App. 1998).
108. *Johanson*, 959 P.2d at 1170.
109. *Id.*
110. *Id.*
111. *Id.* at 1172.
112. 670 N.E.2d 337 (Ill. App. Ct. 1996), *aff'd*, 692 N.E.2d 295 (Ill. 1998).
113. CV 436939, 2000 WL 992163 (Conn. Super. Ct. 2000).
114. Michael Glanzer, *Union Strategies in Privatizations: Shakespeare-Inspired Alternatives*, 64 Alb. L. Rev. 437 (2000).

project to benefit the union, and provide alternative financial and operational structures.[115] Without adopting this type of approach, public employees may find themselves overtaken by the growing adoption of statutory schemes that authorize privatization.

VIII. Statutory Implementation Schemes[116]

In a response to both the labor-associated case law described above and the commission report recommendations, a series of states adopted statutory schemes in an attempt to resolve the employment issues while at the same time address the need for an over arching framework for all privatization projects. For state and local governments that are considering the adoption of a statutory scheme to balance the need to protect civil service principles with the desire to privatize governmental functions, it is advisable to review the various statutes that have been adopted.[117]

California, predating the recent surge in privatization, has long maintained a statute that defines when a state agency can contract out for personal services.[118] This statute permits personal service contracts when the following criteria are met: (1) the proposed contract will result in an overall cost savings to the state; (2) the contract does not displace civil service employees; (3) the contract does not adversely affect the state's affirmative action program; (4) the contract is awarded through publicized competitive bidding; and (5) the potential economic advantage of contracting is not outweighed by the public's interest in having a particular service performed by state employees.[119] This statute also requires that the state specifically include salaries and benefits for additional staff needed to perform the work, along with the cost of additional space, equipment, and materials in its cost comparison.[120] However, the state's indirect overhead costs are excluded from the comparison unless the costs are solely attributable to the service in question.[121]

115. *Id.* at 484.

116. The intent of this section is to provide a representative sample of the types of statutory schemes that have been adopted. For additional examples, *see* Miller, *supra* note 2.

117. This section focuses on statutory schemes that emphasize a general policy regarding the manner in which all privatization projects should be conducted in a given state. It should be noted that a variety of states have statutes that authorize privatization of a specific type of project (e.g., wastewater treatment plants, correctional facilities, child support collections). For examples, see Local Government Privatization Act of 1985, CAL. GOV'T CODE §§ 54250–54256 (West 2000); ARK. CODE ANN. §§ 8–5–601 to –612 (West 1999); COLO. REV. STAT. § 19–2-411 (1996); FLA. STAT. ANN. § 125.3401 (West 2000); GA. CODE ANN. § 12–5-23.3 (1999); OHIO REV. CODE ANN. § 9.06 (1999); VA. CODE ANN. §§ 63.1–249.1 (1998).

118. CAL. GOV'T CODE § 19130 (1985).

119. *Id.*

120. *Id.*

121. *Id.*

Any comparisons of contractor costs are required to include the state's cost of inspection, supervision, and monitoring.[122] Furthermore, contractor wages must be at or above industry levels and not undercut "significantly" state pay rates. The statute also includes several other provisions that attempt to protect against economic fluctuations that might impact in a given year a decision to contract out certain services.[123]

Perhaps more typical of statutes passed in response to the recent interest in privatization at the state level are provisions in Colorado, District of Columbia, Massachusetts, Kentucky, Texas, Vermont, and Virginia. In 1993, Colorado passed HB 93–1212, which sets out the conditions that privatization efforts must meet in order to avoid a conflict with the Colorado constitutional provisions discussed above. Colorado's statute distinguishes between personal service contracts that implicate the state personnel system, and those that do not.[124] If a contracting out project involves services provided by employees covered by Colorado's civil service constitutional protections, a contract may be awarded only if (1) separation of state employees will not occur and (2) the proposed contract will result in lower cost to the government.[125] Similar to California, Colorado has a series of cost comparison guidelines that must be applied to determine costs.[126] In addition, Colorado excludes the analysis of cost savings associated with lower health insurance. Colorado requires a demonstration that the quality of service will be equal to those currently provided by state employees, and that the contract provides provisions for termination by the state for breach of contract by the contractor.[127]

The second portion of the Colorado statute deals with new state functions. Section 24–50–504 permits personal service contracts if (1) state employees have not previously provided the services; (2) there is a statute that authorizes the contracting out of the new function; (3) the services are not available within the personnel system of the state; (4) the contract involves equipment materials and support services not available within the state personnel system: and (5) the contract requires training of state personnel in the area in question.[128] The District of Columbia Code also contains a general provision

122. *Id.*

123. Section (a)(6) provides that savings must be large enough to ensure that savings will still exist even if anticipated economic fluctuations occur. Furthermore, section (a)(9) requires that potential economic risk to the state due to increased wages in the future is minimal.

124. Colo. Rev. Stat. §§ 24–50–503, 24–50–504.

125. *Id.*

126. *Id.* § 24–50–503(1)(a)-(f).

127. *Id.* § 24–50–503(1)(a)(IV),(b),(e).

128. *Id.* § 24–50–504; *see also* Colorado Commission on Privatization, Promoting a More Competitive Government (1997), <http://www.state.co.us/gov_dir/gss/edo/priv/privtext.html>, for a discussion of a series of proposed changes to Colorado laws intended to make privatization more effective.

to protect city workers in the face of privatization.[129] In the District, however, contractors are required to offer any displaced worker a "right of first refusal" to employment and a guarantee of employment for at least six months.[130] Furthermore, any of the displaced employees hired by the contractor must be paid benefits equal to those set forth in the Service Contract Act.[131]

Kentucky has taken a slightly more favorable approach. First, Kentucky specifically permits privatization if a state agency can demonstrate that (1) there is a need for service; (2) the services are not being performed efficiently; and (3) that the agency cannot perform the services efficiently.[132] Even if the agency is able to perform the work efficiently, the statute permits a privatization contract if the agency sends a report to the Finance and Administration Cabinet that: (1) explains the tangible benefits to the project; (2) discusses any state or federal legal restraints that prohibit privatization; and (3) provides a list of multiple private providers of the service.[133] The statute further requires a cost-benefit analysis, a plan for assisting displaced state employees, and a process for monitoring the performance of the contract.[134]

In 1993, the Massachusetts legislature adopted a policy that the use of private contractors, in lieu of state workers, to perform public services is not always in the public's interest.[135] The statute sets up a managed competition process under which state workers submit a bid to compete against a private contractor.[136] In somewhat of a departure from the Colorado model, Massachusetts requires contractors to offer employment to state workers whose jobs are eliminated due to the contract.[137] Furthermore, the head of the agency and the commissioner of administration awarding a privatization contract must certify that (1) they have complied with this law; (2) the quality of services will equal or exceed current state services; (3) the costs will be less than the costs of doing the work in house; (4) the contractor and its supervisors have not violated state or federal statutes; and (5) the proposed privatization is in the public interest.[138] Once the required certification occurs, the state auditor is empowered to review and object to the awarding of a given contract based on a failure by the agency to meet the privatization statute's requirements.[139] The state auditor has invalidated a contract award at least once, and the courts upheld the decision.[140]

129. D.C. Code Ann. § 1–1181.5(b) (1999).
130. *Id.*
131. 41 U.S.C. § 351.
132. Ky. Rev. Stat. Ann. § 45A.551 (Banks-Baldwin 1998).
133. *Id.*
134. *Id.*
135. Mass. Gen. Laws Ann. ch. 7 § 52 (West 1994).
136. *Id.* § 54(4), (7).
137. *Id.* § 53(3).
138. *Id.* 7 § 54(7).
139. *Id.* 7 § 55.
140. Massachusetts Bay Transp. Auth. v. Auditor of the Commonwealth, 724 N.E.2d 288 (Mass. 2000).

In 1993, the Texas legislature passed House Bill 2626, which created the Texas Council on Competitive Government.[141] The enabling legislation tasked the council to identify and study services being performed by state agencies to determine if the services could be better provided by the commercial sector.[142] The statute empowered the council to require a state agency to engage in a process developed by the council to select a new provider of the service, which may either be another state agency or a commercial provider.[143] Similar to other states, the council is given specific guidelines for how to perform cost comparisons, which include the cost of supervising the work of a private contractor and the cost of a state agency's performance of the service.[144] The state agency's costs must include the costs of the comptroller, attorney general, other support agencies, and "other indirect costs."[145] Furthermore, any cost analysis must consider health care benefits, retirement and workers' compensation insurance similar to benefits provided to state workers.[146]

Vermont's statutes proclaim a hostility to privatization but set out relatively straightforward provisions for analyzing when a privatization project is permitted. In the preamble to its statute, Vermont states that "[a] personal services contract is contrary to the spirit and intent of the classification plan and merit system and standards of this title . . ."[147]

The statute, however, permits personal services contracts if (1) the agency will not supervise the work on a day-to-day basis except to ensure performance of contract standards; (2) the services are different from those currently provided by state employees; and (3) the contractor is one that truly engages in an independently established occupation.[148] If the contractor is not one that truly engages in an independently established occupation, then a contract may still be let if any of the following items apply: (1) the services are either not available within any agency or are highly specialized; (2) the services are incidental to the acquisition of real property by either purchase or lease; (3) there is a demonstrated need for audit or investigation; (4) the location of the services makes it difficult for the state to provide the services in a cost-effective manner; (5) the need for services is urgent; (6) efforts to obtain state employees to do the job were unsuccessful; or (7) the cost of contracting out is lower than performing the services with state employees.[149]

Vermont has several provisions that are different from the previous states

141. Texas Council on Competitive Government, http://www.ccg.state.tx.us; *see* A Strategy for Competitiveness in Government, *supra* note 1, at 11 (1995).
142. Texas Gov't Code Ann. § 2162.102(a) (Vernon 1995).
143. *Id.* § 2162.102(b).
144. *Id.* § 2162.103.
145. *Id.*
146. *Id.*
147. Vt. Stat. Ann. tit. 3, § 342(a) (1999).
148. *Id.*
149. *Id.*

discussed. For instance, the state has a thirty-five day period prior to bid opening on a privatization contract where the agency is required to discuss with any state union affected by the contract ideas the union may have to suggest alternatives.[150] Furthermore, Vermont specifically requires a demonstration of at least a ten percent cost savings before privatization can occur.[151] The statute requires a cost analysis, which considers the life of the contract and, specifically, excludes from consideration possible cost reductions based on concessions from state employees.[152]

Similar to Texas, Virginia passed a statute creating a full time commission to implement privatization. In 1995, Virginia enacted the Virginia Government Competition Act (VGCA) of 1995, which created the Commonwealth Competition Council.[153] The VGCA empowered the council to (1) find state run programs which could be performed by the private sector; (2) develop an institutional framework to promote innovation and competition in state services; (3) create a process to encourage the use of feasibility studies to evaluate where competition could reduce costs; (4) monitor state agencies to ensure that they adopt a spirit of innovation so that they can compete with the private sector; (5) create a process of managed competition between state and private providers of service; (6) create a reporting process of its activities; (7) conduct public and private performance analysis; (8) work with the secretary of finance to create criteria to be used in evaluating privatization efforts; and (9) make its services available to other political subdivisions within Virginia.[154]

Recognizing privatization's likely impact on its workforce, Virginia also passed the Workplace Transition Act of 1995.[155] In this statute, the legislature provided that cost savings achieved by an agency using privatization would stay with the agency.[156] In addition, the statute established a series of benefits to be available to state employees who were displaced as the result of privatization.[157] The state established a transitional severance benefit.[158] At the maximum, an employee could receive thirty-six weeks of pay.[159] Furthermore, health and life insurance benefits could continue for a year.[160] In addition, there are a variety of retirement benefit options provided to the employees.[161]

It is interesting to note that virtually all of the statutory schemes discussed above focused personnel and cost issues. There is little or no discussion con-

150. *Id.*
151. *Id.*
152. *Id.*
153. Va. Code Ann. § 9–335 (Michie 1996).
154. *Id.*
155. *Id.* §§ 2.1–391, 2.1–116.20–26.
156. *Id.* § 2.1–391.
157. *Id.* § 2.1–116.20.
158. *Id.*
159. Va. Code Ann. § 2.1–116.21(Michie 2000).
160. *Id.* § 2.1–116.23.
161. *Id.* § 2.1–116.24–26.

cerning which type of services are core governmental functions and therefore should not be privatized. In addition, there is scant attention paid to more subtle issues such as whether a privatization contractor performing a state function must comply with all the same laws as the agency and/or employers that were replaced by the privatization project. Furthermore, there seems to be no recognition that privatization raises special issues relating to a contractor's right to be protected by immunities afforded governmental organizations. Also, the statutory schemes do not address how, if at all, the privatization project may impact the constitutional rights of the citizens for whom the project is designed to benefit. These are the types of emerging issues that are beginning to surface in the courts and in academia.

IX. Emerging Issues Relating to State and Local Privatization Efforts

As the states begin to resolve the policy issues associated with the tension between civil service protection and perceived benefits of privatization efforts, a series of more refined legal issues have begun to appear in the courts and in academia that may very well guide the future of privatization efforts at the state and local level. Issues have been raised relating to privatization efforts that focus less on the personnel issues and more on the legality of privatization schemes within the broader legal framework surrounding state and local governments. Questions have also been raised concerning the relationship between privatization efforts and such issues as constitutional tort immunity and individual constitutional rights.

A. *Structural Privatization Issues*

In addition to the civil service issues raised above, privatization projects have faced a series of questions concerning whether a given project fits within the statutory schemes of the given public entity. In addition, questions have arisen concerning a private contractor's obligations as a substitute governmental entity.

1. Challenge to the Privatization Process

A series of cases have begun to appear that are focused less on the personnel issues and more on whether a given privatization project fails to comply with other laws such as appropriation laws, procurement laws, or constitutional rights. In *Abedi v. City of Atlanta*, employees of the city water department sued to block a twenty-year privatization contract for operation and maintenance of the city's water system.[162] The employees attacked the plaintiffs' contract on several fronts, and argued the contract violated Georgia laws, including (1) rate restrictions, (2) broad municipality water service provisions, and (3) municipal debt limitations. The court disagreed. No stat-

162. 536 S.E.2d 255 (Ga. Ct. App. 2000).

utory provision cited by the employees prohibited the city water department from contracting out the operation and maintenance of the water system.

In *Civil Service Employees Ass'n, Inc. v. O'Rourke*, the county executive for Westchester County, New York, had implemented measures to downsize the county government,[163] including privatizing data processing, communications, and dietary service positions. The court ruled the county executive violated county appropriations laws by transferring money to privatization contracts contrary to the annual appropriations established by the Board of Legislators. This rendered the multiyear privatization contracts established by the county executive illegal and invalid. The court also ruled that the county executive was within his authority to veto appropriations to add certain government employee positions in data processing, communications, and dietary services. The county charter did not require the county executive to hire and fill these positions. The legislators did not override the veto. The county, therefore, was left with sufficient appropriations to fund the privatization contracts. The leftover funds, however, were not allocated to the departments performing data processing, communications, or dietary service functions. Thus, these fields ended up understaffed in the county.

In a more recent case, the Court of Appeals of New York blocked an effort to privatize a hospital in New York City based on an argument that the state's Health and Hospitals Corporation Act precluded privatization. In *Council of the City of New York v. Giuliani*, the issue was whether the Act permitted the city to privatize Coney Island Hospital by awarding a lease to run the hospital to a private company.[164] After reviewing the terms of the statute along with the legislative history, the court ruled that nothing in the statute or history explicitly permitted the award and, therefore, the court ruled the lease illegal.[165] The court did note that the privatization plan offered many benefits for the city but felt compelled to reject the lease absent legislative action to the contrary.[166]

In *Advocacy Center for Persons with Disabilities, Inc. v. Department of Children and Family Services*, a Florida court ruled that recipients of services to be privatized do not have standing to protest the agency bid process under Florida state law.[167] In *American Federation of State, County, and Municipal Employees v. Lewis*, union members and individual taxpayers sued to block efforts to privatize a portion of the state prison system.[168] The court ruled that the evidence negated any invalid delegation of tax funds. The preliminary work conducted by the governor's office did not involve the use of direct tax funds. The action was not ripe because no implementation of the pri-

163. Civil Service Employees Ass'n, Inc. v. O'Rourke, 660 N.Y.S.2d 929 (N.Y. Sup. Ct. 1997).
164. 710 N.E.2d 255 (N.Y. 1999).
165. *Giulani*, 710 N.E. 2d at 70.
166. *Id.*
167. 721 So. 2d 753 (Fla. Dist. Ct. App.1998).
168. 797 P.2d 6 (Ariz. Ct. App. 1990).

vatization had occurred and plaintiffs could not demonstrate any present injury at this phase of the litigation.

In *Communications Workers of America v. Whitman*, the New Jersey Superior Court, Appellate Division, held that union members who claimed to have lost their jobs in violation of their First Amendment rights failed to state a cognizable claim for relief.[169] In this case, New Jersey decided to privatize Department of Motor Vehicles functions, a seemingly uncontroversial activity. However, when private contractors began to perform the work, allegedly, they would only hire former state employees that were registered Republicans. The ex-employees claimed the First Amendment, as interpreted by the U.S. Supreme Court, prohibited state employees from being terminated based on political beliefs.[170] The New Jersey court rejected the concept that employees were terminated for their political beliefs. The court pointed out that the terminations occurred because of a policy decision to privatize the function. The private party hired to perform the function, rather than the state, decided to make hiring decisions based on political affiliations. This decision by a private party was not actionable under the First Amendment.

In *Maryland Classified Employees Ass'n, Inc. v. Maryland*, a public employee labor group and several of its members argued employees had a substantive due process right to their positions as government employees.[171] Relying on the Maryland Constitution and the U.S. Constitution, the employees urged recognition of a substantive right to retain their job and the "rights" that accompany it, such as rights to seniority, reinstatement, annual leave time, and disciplinary action proceedings.[172] The court refused to recognize a lifetime constitutional right to continued state employment. Although in some instances, government employees are entitled to procedural due process prior to dismissal, such procedural safeguards do not apply to legislative initiatives that reduce the workforce.[173]

In Oklahoma, the Fraternal Organization of Police and a taxpayers' organization challenged the privatization of the Tulsa County, Oklahoma, jail system.[174] This suit was based on three arguments. First, the plaintiffs argued the Oklahoma statutes permitting privatization of jails were unconstitutional because they unlawfully delegated legislative power. Second, the plaintiffs argued the statutes were unconstitutional because they allow counties to alter the duties of sheriffs. Third, the plaintiffs argued the Tulsa project violated the enabling statute.

The Oklahoma Supreme Court rejected each of the plaintiff's arguments.

169. 762 A.2d 284 (N.Y. Super. Ct. App. Div. 2000).
170. *Communications Workers of Am.*, 762 A.2d at 284.
171. 694 A.2d 937 (Md. 1997).
172. *Maryland Classified Employees*, 694 A.2d at 946–47.
173. *Id.* at 947.
174. Tulsa County Deputy Sheriff's Fraternal Order of Police v. Bd. of County Comm'rs, 995 P.2d 1124 (Okla. 2000).

First, it ruled the statutes were not an unconstitutional delegation of legislative powers because the state legislature had the authority to delegate power to implement clear, consistently mandated policies. Second, the court ruled it constitutional for the legislature to use its power to alter the duties of the sheriffs, as opposed to the counties. Finally, the court ruled that the privatization project had not violated a public trust provision of the enabling statute.

As these cases indicate, as the battle over privatization shifts from the realm of civil service protection to more traditional procurement issues, privatization projects are finding a greater level of acceptance by the courts. As such, the focus begins to shift away from the state employees to the issues of how these projects affect the citizens' ability to interact with its government.

2. Contractors' Obligations as a Substitute Governmental Entity

As private contractors begin to perform a larger role in governmental functions, cases are beginning to appear concerning whether private contractors must comply with the same statutes as the governmental agencies that they replace. For instance, in 1999, the Florida Supreme Court had to decide whether a lessee of a public hospital was subject to the state's Public Records Act.[175] In ruling in the affirmative, the court made a distinction between a company that merely undertakes to provide a service or supplies to a public agency and a company that relieves a public body from the operation of a public obligation.[176] In the later case, the court believed that a contractor was subject to Florida's Public Records Act.[177]

The logic set forth in the *Memorial Hospital* case has been followed in a variety of additional cases in Florida.[178] In *Stanfield v. Salvation Army,* the Salvation Army was required to produce records under the Public Records Act because it had a contract to provide probationary services with a county in Florida.[179] In *Prison Health Services, Inc. v. Lakeland Ledger Publishing,* a private prison health services provider was ordered to comply with the Public Records Act because it had contracted to undertake a function previously provided by the sheriff.[180] Even the Putnam County Humane Society was required to produce documents not because it had a contract with a state agency, but rather because it was statutorily authorized to investigate animal abuse by a Florida statute.[181] When it undertook to perform these powers, the court ruled that the society acted as an agent for the state.[182]

175. Memorial Hospital-West Volusia, Inc. v. News-Journal Corp., 729 So. 2d 373 (Fla. 1999).

176. *Id.*

177. *Id.*

178. The Florida legislature amended the state's statutes to effectively exclude private companies that are granted a lease to run a public hospital from coverage under the Public Records Act. *See* FLA. STAT. ANN. § 155.40.

179. 695 So. 2d 501 (Fla. Dist. Ct. App. 1997).

180. 718 So. 2d 204 (Fla. Dist. Ct. App. 1998).

181. 740 So. 2d 1238 (Fla. Dist. Ct. App. 1999).

182. *Id.*

In *Memorial Medical Center, Inc.*, the New Mexico Supreme Court examined whether a state prevailing wage law applied to a construction contract awarded by an entity that had been awarded a long-term lease to operate a previously publicly operated medical center.[183] The court reversed a lower court ruling that the private contractor was required to comply with the law. However, it did so only because the lower court had applied the wrong legal standard. The court remanded the case to the lower court to apply the correct standard. At issue was whether the private corporation stood in place of the government, and, therefore, any construction contract the private corporation awarded would be considered a government contract covered by the prevailing wage law. The New Mexico Supreme Court stated:

> It is therefore our view that under current New Mexico law there are circumstances in which a private corporation must be deemed a political subdivision or a local public body because the private entity has so many public attributes, is so controlled and conducted, or otherwise is so affiliated with a public entity that as a matter of fairness it must be considered the same entity.[184]

Assuming this standard can be met, it is quite possible that the private corporation will face the prospect of being viewed as a public entity such that it must force its construction contractor to comply with the state's prevailing wage law. Alternatively, if a different decision is reached, citizens have lost a protection that would otherwise exist, but for privatization.

B. *Immunity for Performing Government Services*

Contractors bidding on state and local privatization projects need to assess the risks of performing such work. Federal contractors who are accustomed to the "government contractor defense" against tort liability at the federal level may be surprised to find that similar protections may not exist at the state level. In *Boyle v. United Technologies Corp.*, the U.S. Supreme Court ruled the procurement of supplies by the Federal Government is a uniquely federal interest. A contractor for the Federal Government benefits from sovereign immunity if it can prove that "(1) the United States approved reasonably precise specifications; (2) the equipment conformed to those specifications; (3) the supplier warned the United States about the damages in the use of the equipment that were known to the supplier but not to the United States."[185] Although certain commentators criticize the *Boyle* decision, it has been routinely applied.[186]

The U.S. Supreme Court takes a different approach to immunity for contractors performing state privatization projects. In *Richardson v. McKnight*, an inmate in a Tennessee correctional center run pursuant to a privatization contract sued the contractor under 42 U.S.C. § 1983. He alleged that the

183. Memorial Med. Ctr., Inc. v. Tatsch Constr., Inc., 12 P.3d 431 (N.M. 2000).
184. *Id.* at 440–41.
185. Boyle v. United Tech. Corp., 487 U.S. 500, 512 (1988).
186. *See* Ronald A. Cass & Clayton P. Gillette, *The Government Contractor Defense: Contractual Allocation of Public Risk*, 77 VA. L. REV. 257 (1991).

contractor running the prison violated his Eighth Amendment right to be free from cruel and unusual punishment because restraints placed upon him caused serious injury.[187] Section 1983, originally the Civil Rights Act of 1871,[188] provides that:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the constitution and laws, shall be liable to the party injured in an action at law, suit inequity, or other proper proceeding for redress. For the purposes of this section, any Act of Congress applicable exclusively to the District of Columbia shall be considered to be a statute of the District of Columbia.[189]

At issue in *Richardson* was whether private prison guards are entitled to a qualified immunity from suit by prisoners for alleged violations of constitutional rights.[190] In an earlier case, the U.S. Supreme Court provided qualified immunity to publicly employed prison guards under similar circumstances.[191] The Court in *Richardson* held that the prison guards were not entitled to immunity, although it limited its application to the facts of the case and specifically left open the issue of whether a private person "briefly associated with a government body, serving as an adjunct to government in an essential governmental activity, or acting under close official supervision" could qualify for the immunity traditionally available for public officials.[192] Although commentators have criticized the opinion for failing to consider the economic realities of the market, federal contractors stepping into the state arena need to realize that the U.S. Supreme Court is less likely to protect the contractor from constitutional tort liability at the state level.[193]

Akin to the *Richardson* case, there is at least one other case where the court denied immunity to a doctor providing services under a private correctional facility. In *Jensen v. Lane County,* the plaintiff was incarcerated for "menacing with firearms" after brandishing a firearm. During his confinement, a senior mental health specialist evaluated Jensen and recommended placement in a county psychiatric facility. The plaintiff sued the treating doctor for violating his constitutional right by committing him without due process of law.[194] Following the ruling in *Richardson,* the Ninth Circuit re-

187. 521 U.S. 399 (1997); Oliver Barber, *Civil Rights—Lock Up for Government Contractor Impunity: Private Prisons Denied Section 1983 Immunity;* Richardson v. McKnight, *117 S. Ct. 210*, 71 Temp. L. Rev. 417 (1997).

188. Barber, *supra* note 187, at 421.

189. 42 U.S.C. § 1983 (1996).

190. 42 U.S.C. § 1983 (1996).

191. Procunier v. Navarette, 434 U.S. 555 (1978).

192. *Id.* The Court split five-to-four in making its ruling. Lower courts have distinguished the ruling on the facts. *See, e.g.,* Bartell v. Lohiser, 215 F.3d 550 (6th Cir. 2000).

193. Clayton P. Gillette & Paul B. Stephan, Richardson v. McKnight *and the Scope of Immunity After Privatization,* 8 Sup. Ct. Econ. Rev. 103 (2000).

194. Jensen v. Lane County, 222 F.3d 570 (9th Cir. 2000).

cently refused to extend qualified immunity to the physician who treated the plaintiff.[195]

The issue of the breadth of a contractor's liability for both a constitutional tort as discussed in *Richardson* and a state common law tort is also currently being debated. In his 1997 article, Jack M. Sabatino argues that government contractors performing privatized governmental functions should be subject to punitive damages.[196] The article acknowledges that public entities performing governmental functions are typically immune from such damages under the doctrine of sovereign immunity.[197] Sabatino argues that exposure to punitive damages is necessary because monitoring by public agencies is not likely to keep government contractors accountable and, therefore, punitive damages provide an augmentation to public oversight to ensure proper performance by private contractors.[198] Finally, Sabatino warns that public agencies should not indemnify contractors for punitive damages.[199]

C. *Loss of Constitutional Protections Due to Privatization*

Public administrators considering the privatization of public functions should consider what, if any, loss of constitutional protections their citizens will incur as the result of contracting out that function. At least three commentators warned that contracting of services by state governments runs the risk of jeopardizing certain constitutional rights.[200] In her article, *Privatization of Municipal Services: A Contagion in the Body Politic*, Shirley L. Mays states as follows:

> Rights secured by the United States Constitution are protected from infringement by the government. The Fourteenth Amendment proscribes state actions that will "deprive any person of life, liberty or property, without due process of law." It also requires that all similarly situated individuals be treated equally. When governmental actions directly impact citizens, it is without question that the government is bound by constitutional constraints. On the other hand, when private actors, rather than governmental agencies, perform the same functions as the government, they are not necessarily subject to the same constitutional restraints. Therefore, transferring governmental services to private corporations will diminish the constitutional protections afforded individuals.[201]

In support of her proposition, Mays points to cases where privatization of electrical services and the process of resolving private disputes led to the U.S. Supreme Court finding no state action present, and, therefore, no constitu-

195. *Id.*

196. Jack M. Sabatino, *Privatization and Punitives: Should Government Contractors Share Sovereign's Immunities From Exemplary Damages*, 58 Ohio St. L.J. 175 (1997).

197. *Id.*

198. *Id.*

199. *Id.*

200. Mays, *supra* note 22, at 41; Daphne Barak-Erez, *A State Action Doctrine for an Age of Privatization*, 45 Syracuse L. Rev. 1169 (1995); Christina N. Smith, *The Limits of Privatization: Privacy in the Context of Tax Collection*, 47 Case W. Res. L. Rev. 627 (1997).

201. Mays, *supra* note 22, at 45–46 (footnotes omitted).

tional due process right existed.[202] The article implies privatization of governmental services may occur on any service found not "exclusively reserved to the state," and therefore, result in the implicit waiver of constitutional protections for those using the services as "state action" would no longer be present.[203]

In an article written in the same year, Daphne Barak-Erez also reviewed current case law on "state action" as it relates to state privatization of services.[204] Barak-Erez suggests recent case law on state action doctrine could trigger a loss of constitutional protections in Medicaid, prisoners, education, and welfare services.[205] She suggests a need to shift the state action doctrine to one where a "private" activity "should be considered as a state action if: (i) it is public in nature (according to present understanding of the responsibilities of the state); and (ii) the state refrains from operating an equivalent service (and thereby renders citizens to be dependent on the public services supplied by the private entities)."[206]

X. The Future of State and Local Privatization

The future of privatization at the state and locals level is as complex and diverse as the fifty states and thousands of local entities involved. However, trends have begun to develop. First, the courts seem to be more willing to accept privatization projects that are not clear attempts to circumvent civil service protection. Second, it seems certain that the size and complexity of projects will continue to increase. As the San Diego and Orange County, California, projects indicate, information technology is a prime area for privatization. Perhaps state and local agencies' inability to meet the compensation packages available in the private sector explains this growth. As such, public entities may be more concerned with providing a higher level of service to the citizens than merely attempting to save money. However, as the size and complexity of privatization contracts increase, particularly where the effort is fixed price, state and local agencies run the risk of contract claims. As the Federal Government has experienced, large and complex fixed-price contracts are fertile breeding grounds for price adjustment claims from contractors seeking to recover unanticipated losses and cost overruns.

A separate trend involves financing of privatization projects. As noted above, wastewater treatment plants are privatized in response to dwindling federal financing.

As the size and complexity of projects continue to grow, it is apparent that

202. *Id.* (citing Jackson v. Metropolitan Edison Co., 419 U.S. 345 (1974); Flagg Bros. v. Brooks, 436 U.S. 149 (1978)).
203. *Id.*
204. Barak-Erez, *supra* note 200.
205. *Id.*
206. *Id.*

more subtle issues will need to be addressed, such as extending sovereign immunity to contractors performing state actions. Furthermore, more attention must be paid to how privatization projects affect people's constitutional rights. No doubt these and other issues will be addressed in the near future. Regardless of the outcome of these issues, privatization will continue to expand at the state and local levels.