

GENERAL ASSEMBLY OF IOWA

LEGAL COUNSELS

Douglas L. Adkisson
Mary M. Carr
Edwin G. Cook
Susan E. Crowley
Patricia A. Funaro
Michael J. Goedert
Leslie E. W. Hickey
Mark W. Johnson
Michael A. Kuehn
Carolyn T. Lumbard
Julie A. Smith

RESEARCH ANALYSTS

Kathleen B. Hanlon
Thane R. Johnson



LEGISLATIVE SERVICE BUREAU

STATE CAPITOL BUILDING
DES MOINES, IOWA 50319
(515) 281-3566
FAX (515) 281-8027

DIANE E. BOLENDER
DIRECTOR

RICHARD L. JOHNSON
DEPUTY DIRECTOR

JOHN C. POLLAK
COMMITTEE SERVICES ADMINISTRATOR

LOANNE DODGE
IOWA CODE EDITOR

PHYLLIS V. BARRY
ADMINISTRATIVE CODE EDITOR

JULIE E. LIVERS
LEGISLATIVE INFORMATION OFFICE DIRECTOR

September 29, 1993

MEMORANDUM

**TO: TEMPORARY CO-CHAIRPERSONS SENATOR VILSACK AND
REPRESENTATIVE BRANSTAD AND MEMBERS OF THE
PRIVATIZATION INTERIM STUDY COMMITTEE**

FROM: ED COOK, LEGAL COUNSEL

**RE: BACKGROUND INFORMATION FOR THE PRIVATIZATION INTERIM
STUDY COMMITTEE**

I. INTRODUCTION

The purpose of this memorandum is to provide general background information to the Privatization Interim Study Committee prior to its first meeting. Accordingly, the memorandum briefly addresses the charge of the Committee, Legislative Service Bureau staff for and membership of the Committee, recent legislative and privatization efforts, the Governor's Committee on Government Spending Reform and the Senate Appropriations Subcommittee on Privatization, applicable legal issues and legislative provisions, and examples of strategic privatization plans. I have included the following materials for your consideration:

1. Committee Membership List.
2. Selected excerpts from the Governor's Committee on Government Spending Reform, Final Report, December 1991.
3. Selected excerpts from the Privatization Task Force final report to the Governor's Committee on Government Spending Reform, November 18, 1991.
4. Agenda for the Senate Appropriations Subcommittee on Privatization meeting in March 1993.

5. William Eggers, Reason Foundation, Designing a Comprehensive State-level Privatization Program, January 1993.
6. John Rehfuss, Reason Foundation, Designing an Effective Bidding and Monitoring System to Minimize Problems in Competitive Contracting, February 1993.
7. Lawrence Martin, Reason Foundation, How to Compare Costs Between In-house and Contracted Services, March 1993.
8. Excerpts from Iowa Auditor of State, Report on a Special Investigation of the Intersectional United Advanced Planning Center, January 12, 1993.
9. North Dakota Legislative Council Staff, Privatization in Other States, September 1991.
10. Office of Management and Budget Circular No. A-76 (revised), Federal Register August 16, 1983.
11. Colorado State Auditor, Privatization in Colorado State Government Performance Audit, March 1989. (Does not include appendix)
12. National Institute of Justice, Research in Brief - Contracting for the Operation of Prisons and Jails, June 1987.
13. Excerpts from Comment, The Future of Privatization in Florida, 19 Stetson Law Review 899 (Summer 1990).
14. Department of Management letter regarding privatization initiatives in Iowa.

II. COMMITTEE CHARGE

The Legislative Council has provided the Committee with the following charge:

The Committee shall review the state's privatization efforts to date and make recommendations concerning implementation of a strategic plan for future state privatization efforts and the contracting of state services. The Committee shall consider recommendations of the Fisher Committee and the Senate Appropriations Subcommittee on Privatization, receive information and testimony from other sources, and make recommendations by November 15, 1993.

The Legislative Council has indicated that the Committee should complete its work in three meeting days.

Essentially, the charge directs the Committee to review the state's efforts into privatization and to examine possible plans or strategies to guide privatization efforts in the future. The potential scope of the charge is reflected by the fact that the privatization task force of the Governor's Committee on Government Spending Reform (Fisher Committee) established five separate subcommittees on privatization. Still, the focus of the charge, and this background memorandum, is on the contracting out generally of government services to the private sector.

III. MEMBERSHIP AND STAFF

The Legislative Council has appointed the following members to the Committee:

Senate

Senator Tom Vilsack,
Temporary Co-chairperson
Senator Randal Giannetto
Senator John Jensen

House

Representative Clifford Branstad,
Temporary Co-chairperson
Representative Gordon Burke
Representative Chuck Larson

Public Members

Mr. Paul Carlson
Ms. Jeanne Foster
Mr. Don McKee

A membership list with addresses is enclosed. Legislative Service Bureau staff for the Committee includes Ed Cook (281-3994) and Mary Carr (242-5822).

IV. RECENT LEGISLATIVE EFFORTS

Recent legislative efforts have generally sought to curtail or control privatization. Two bills introduced last session, House Files 399 and 530, sought to require certain guarantees for employees of private employers who were given a contract to perform a function previously performed by state employees; neither bill was adopted. In addition, section 7, subsection 1, paragraph "e," of Senate File 232, the transportation appropriation bill, provided that the Department of Transportation conduct a feasibility study on privatizing rest area maintenance and report the findings of the study to the Legislature prior to awarding a contract. In item vetoing this provision, Governor Branstad stated that the Department had already proceeded on the project, that the potential existed for significant cost savings, and that the Department would ensure that each bid would be evaluated on the basis of both cost and quality.

Senate File 425, the tenth budget bill, also contained several provisions on privatization. Section 86 would have provided for the establishment of a study committee on privatization. Section 87 would have provided that any state agency considering privatizing a function be required to consult with and consider alternatives proposed by employees of the agency. Both sections 86 and 87 were vetoed by the Governor. As to section 87, the Governor indicated that consultation already occurred as standard practice thereby making the provision unnecessary. However, section 30, subsection 4, of the bill was not vetoed and it directs the Department of Economic Development and the Institute for Decision-making at the University of Northern Iowa, in consultation with the Departments of Human Services and Corrections, to conduct a study to develop plans concerning the use of state institutions.

V. RECENT PRIVATIZATION EFFORTS

Several new efforts in contracting out public services to a private entity have occurred within the last couple of years. These efforts include, but are not limited to, receipt,

warehousing, and delivery of alcoholic beverages, food services and housekeeping services at the Iowa Veterans' Home, operation of a women's correctional facility at Broadlawns, interstate rest area maintenance, and pharmacy services at the Independence Mental Health Institute. A contrasting recent development, however, concerns indigent defense. In this case, cost savings were deemed to be gained by the use of public defenders instead of private attorneys.

VI. GOVERNOR'S COMMITTEE ON GOVERNMENT SPENDING REFORM -- PRIVATIZATION RECOMMENDATIONS

The Governor's Committee on Government Spending Reform, popularly referred to as the Fisher Committee, made several recommendations concerning the potential cost savings of privatizing certain state functions. In addition, the Committee established a separate Privatization Task Force to present a report to the full Committee. In developing its report, the Task Force divided into five subcommittees: Asset Sales, Costing, Empowering Managers to Manage, Model Programs, and Subcontracting. In its November 18, 1991, report, the Task Force noted that assumed cost savings for privatizing did not always exist and that state government was privatized to a larger extent than the Task Force had imagined. The Task Force identified several privatization opportunities. In addition, the Task Force recommended that a uniform process be established for reviewing cost-saving proposals from the private sector and that the Legislature consider the possibility of privatizing when any new program is established.

In its final report, the Fisher Committee provided a summary of its top opportunities for cost savings. Included in this list was the sale of state-owned farmland and the DNR nursery, and alternatives to the mental health institutes. Other recommendations involved the possible subcontracting of janitorial services, subcontracting of nursing services at the Veterans' Home, use of prison industries for printing services, subcontracting liquor operations, eliminating the state aircraft pool, eliminating seed testing at the Department of Agriculture, and partial elimination of the Weights and Measures Division. Attached to this memo are several reports and recommendations concerning privatization made by the full Fisher Committee and the Privatization Task Force.

VII. SENATE APPROPRIATIONS SUBCOMMITTEE ON PRIVATIZATION -- SUMMARY OF MARCH 1993 MEETING

On March 11, 1993, a Senate subcommittee on privatization was convened by Senators Vilsack and McLaren. Attached to this memo is a copy of the agenda. During the meeting, testimony was received from various state workers displaced, or about to be displaced, by privatization. Their testimony expressed doubts as to the actual cost savings from the contracting efforts, the upheaval experienced by long-time state workers being displaced from their jobs, and the loss of pay and benefits the workers would be required to accept if they took a job with the private contractor. A representative from the Attorney General's Office testified concerning the legal issues involved in privatizing. In addition, testimony was received from Mr. Paul Carlson of the Department of Management. Mr. Carlson commented

that the policy of the Department of Management is not to privatize policy-making and decision-making authority, but that privatization efforts in other areas would continue. Mr. David Fisher, Chairperson of the Governor's Committee on Government Spending Reform, also testified concerning the substantial cost benefits from privatization efforts. Mr. Hugh Williams, Vice President of Operations with the Jones Management Company, testified that his company is able to provide better food service to the Veterans' Home at lower cost not just due to lower labor costs but also due to other economies of scale in acquiring the food. Several speakers noted the advantage of developing a strategic plan concerning privatization efforts.

VIII. LEGISLATIVE PROVISIONS

The Iowa Code contains numerous provisions providing for contracts with private entities. For example, the Department of General Services and the Department of Transportation have broad authority to contract for the acquisition of certain goods and services. In both instances, the Code provides very specific competitive bid procedures. (See, Iowa Code Chapter 18 for General Services and Chapter 314 (highway construction) for Transportation.) In dollar terms, the Privatization Task Force of the Governor's Committee on Government Spending Reform noted that the Department of Transportation spends about \$300 million out of a \$500 million budget on contracting for services. The Code also provides very specific and limited authority for certain governmental entities to contract with private entities. (See, e.g., Iowa Code section 285.5, regarding school bus transportation.) In addition, section 11.36 requires that the Governor or a state agency, prior to awarding a service contract to a private entity, obtain a certification from the Auditor of State that the contractor has an adequate accounting system to effect compliance with the terms and conditions of the contract.

In contrast to the fairly specific code provisions outlined above, the Code also provides general authority to state and local governments to contract with private entities pursuant to Chapter 28E. In fact, sections 357B.3, 357F.10, 359.42, 361.3, and 455G.5 make specific reference to the fact that Chapter 28E agreements with private agencies can be made to carry out certain duties. As to the provisions in a Chapter 28E agreement, section 28E.5 provides that the agreement must specify the contract's duration, purpose, manner of financing, etc.

IX. LEGAL CONCERNS

Contracting with private entities for the performance of certain governmental duties presents some legal and constitutional concerns. Initially, the legal concerns deal with whether the contracting is a legal delegation of state authority. Once a contract is awarded, then the legal issues involve various labor and liability issues.

In determining whether contracting is legal, the primary issues concern whether the governmental entity involved has the authority to delegate certain of its functions to a private entity and whether the duty delegated is governmental or proprietary. In 1970, the Iowa Supreme Court determined that Chapter 28E agreements are not by their nature an

unconstitutional delegation of authority. Goreham v. Des Moines Metropolitan Area Solid Waste Agency, 179 N.W.2d 449 (Iowa 1970). A more extensive analysis of these concerns is presented in a recent Attorney General opinion. In this opinion, the Attorney General determined that the Department of Inspections and Appeals was permitted to enter into a Chapter 28E agreement with a private entity to perform inspections of certain food establishments. Attorney General opinion, April 8, 1992. The Attorney General noted that although the inspection of food service establishments is a governmental function, the Department could legally delegate its powers to a private entity for purposes of inspections so long as the Department established sufficiently narrow standards and guidelines. However, the opinion suggests that delegation of more traditional governmental functions might result in greater scrutiny by the courts.

Once the contract is awarded, several other legal issues may arise. Several articles have noted that new labor relations questions may arise since employees of a private contractor would not be public employees. As such, certain benefits and restrictions granted or imposed on state employees would not apply e.g., the inability of Iowa's state employees to strike. Other issues noted, specifically in the area of private prisons, concern questions of the state's liability for errors or torts committed by private contractors. Although the answer is not clear, some articles indicate that a state may not be able to avoid potential liability from a prisoner in a private prison who seeks relief under section 1983 of the Civil Rights Act.

X. PRIVATIZATION -- STRATEGIC PLANS

Efforts to create a strategic plan on privatization are most likely to be focused on three stages of privatization. The initial stage of a contracting out effort is the process of deciding whether a particular government function should be considered for privatization. One key aspect of this decision is who is authorized to make this decision and what factors the decision maker is required or likely to consider. The next stage in a contracting effort concerns the actual contracting of the governmental function. Considerations in this stage involve any bidding or contractual requirements and any possible contractual limitations placed on the governmental agency. The final stage in a contracting effort is the oversight and audit function. Once the contract is awarded, the issue then becomes what role the governmental entity maintains in ensuring compliance with the contract.

I have attached several documents that describe possible privatization plans or at least identify some critical questions any government must consider when deciding whether to privatize a particular government function. The following is a brief synopsis of some of the attached documents that deal with privatization proposals.

Federal -- Included in the enclosed materials is a copy of Office of Management and Budget Circular No. A-76 (revised) issued in 1983. This circular establishes procedures for determining whether commercial activities currently done by the federal government should be performed under contract with commercial sources or remain with the government. The process begins with a review of all operations within each federal agency to determine which activities are commercial and which are inherently governmental. If the activity is commercial, the agency then must determine whether that activity can be accomplished more

efficiently by the private sector or by the government. An interesting feature of the process is its method of determining the cost of the federal agency to perform the activity. Instead of determining what it currently costs to perform the activity, the agency determines what it would cost to perform the activity if the activity was performed in an efficient manner. It is this cost, and not the actual cost of performing the activity, that is then compared with private bidders. Under the procedure, a private contractor must then underbid the agency's cost estimate by 10 percent in order to be awarded the contract.

States -- Several states have conducted surveys of privatization within their own state. I have attached a report by the North Dakota Legislative Council staff that describes surveys done by Wisconsin and Colorado and lists various activities privatized by the states.

I have also attached a copy of the March 1989 Colorado State Auditor's report on privatization. In addition to providing a general review of privatization efforts around the country and in Colorado, the report also proposes a detailed two-step process for deciding whether to privatize a particular government activity. Initially, the agency must develop a privatization profile that provides an overall picture for privatizing a public service; then, the agency must perform a detailed cost analysis in order to compare the cost difference between performing the activity by the government and by the private sector.

General Literature -- I have also attached three articles by the Reason Foundation dealing with designing an effective privatization program. The Foundation is a nonprofit organization that operates, among other things, a privatization center and hotline and deals extensively in privatization issues. The articles provide background as to how to design a comprehensive privatization program, how to compare costs between in-house and contracted services, and how to establish an effective monitoring system for contracting. In addition, I have attached a portion of a law review article proposing a Florida privatization statute.

In a more specific case, I have also attached an article by the National Institute of Justice concerning the issues involved in contracting the operation of prisons and jails.

Iowa -- I have attached a letter from the Department of Management providing a brief outline of the privatization process in Iowa. Although dated February 1992, the letter was likely prepared and sent in February 1993.

XI. BIBLIOGRAPHY

The following is a list of documents I have obtained concerning privatization. Some of the listed documents are attached to this memo. However, if you desire a copy of any other document listed below, please contact me and I will provide you with a copy.

1. Governor's Committee on Government Spending Reform, Final Report, December 1991.
2. Privatization Task Force Final Report to the Governor's Committee on Government Spending Reform, November 18, 1991.

3. Letter from Department of Management regarding privatization initiatives in Iowa.
4. Comment, The Future of Privatization in Florida, 19 Stetson Law Review 899 (Summer 1990).
5. National Institute of Justice, Research in Brief - Contracting for the Operation of Prisons and Jails, June 1987.
6. North Dakota Legislative Council staff, Privatization in Other States, September 1991.
7. Iowa Legislative Fiscal Bureau, Privatization of Rest Area Maintenance, June 30, 1993.
8. Selected legislative proposals from the 1993 session:
 - a. House File 399
 - b. House File 530
 - c. Senate File 232 and item veto message
 - d. Senate File 425 and item veto message
9. Colorado State Auditor, Privatization in Colorado State Government Performance Audit, March 1989.
10. William Eggers, Reason Foundation, Designing a Comprehensive State-Level Privatization Program, January 1993.
11. John Rehfuss, Reason Foundation, Designing an Effective Bidding and Monitoring System to Minimize Problems in Competitive Contracting, February 1993.
12. Lawrence Martin, Reason Foundation, How to Compare Costs Between In-house and Contracted Services, March 1993.
13. Office of Management and Budget Circular No. A-76 (revised), Federal Register August 16, 1983.
14. Supplement, Office of Management and Budget Circular No. A-76 (revised), August 1983.
15. Agenda and information distributed for the Senate Appropriations Subcommittee on Privatization meeting in March 1993.
16. Iowa Auditor of State, Report on a Special Investigation of the Intersectional United Advanced Planning Center, January 12, 1993.
17. Wisconsin Legislative Audit Bureau, An Evaluation of Privatization of Government Services, June 1990.
18. National Criminal Justice Association, Private Sector Involvement in Financing and Managing Correctional Facilities, April 1987.
19. Public Employee Department, AFL-CIO, Reinvigorating the Public Service Union Innovations to Improve Government, post-October 1991.
20. Keon Chi, Council of State Governments, Privatization Trends in State Governments, post-October 1991.

21. Selected articles:

- a. Werner Hirsch, The Economics of Contracting Out: The Labor Cost Fallacy, 40 Labor Law Journal 536 (August 1989)
- b. Al Bilik, Privatization: Defacing the Community, 43 Labor Law Journal 338 (June 1992)
- c. Brian Clemow, Privatization and the Public Good, 43 Labor Law Journal 344 (June 1992)
- d. Michal Tingle, Privatization and the Reagan Administration: Ideology and Application 6 Yale Law & Policy Review 229 (1988) (discusses, inter alia, OMB circular A-76)
- e. Iowa Citizens' Aide/Ombudsman, Privatization: Optional Accountability, 1992
- f. Craig Becker, With Whose Hands: Privatization, Public Employment, and Democracy, 6 Yale Law & Policy Review 88 (1988).

6785RR

