

DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: 06/21/2017
POSITION: Oppose

BILL NUMBER: AB 1250
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Byron

BILL SUMMARY: Counties: contracts for personal services.

Effective January 1, 2018, this bill requires counties to satisfy specified standards before executing new contracts or renewing existing contracts for personal services that are currently or customarily provided by county employees.

This bill does not apply to the City and County of San Francisco. We also understand that amendments were accepted in the Senate Committee on Governance and Finance, but not yet placed in print, that will exempt Santa Clara County's health system from the bill's requirements.

FISCAL SUMMARY

Many counties contract for a variety of services where it is cost-prohibitive or impractical to hire county employees to perform them. In these cases, counties will have little choice but to comply with this bill's requirements if they want to maintain the contracted services.

If this bill is enacted and a test claim is filed with the Commission on State Mandates, the Commission may determine those counties are "practically compelled" to perform the contract cost analysis required by this bill, even though the decision to contract for those services is itself discretionary. If these counties do not perform the contract cost analysis required by this bill, they will either have to cancel the contracts and suffer reduced service levels, or cancel the contracts and incur the added cost to hire county staff with the requisite expertise to perform the services previously provided via contract.

Although the potential mandated costs are unknown, we estimate they can easily range from \$1 million to \$10 million per year.

COMMENTS

Finance is opposed to this bill because it applies a one-size-fits-all approach to contracting for personal services that could severely restrict the ability of counties to provide services in an efficient manner. It is unclear if all county contracts for personal services should be limited or if a certain type of contract is problematic. This bill makes a sweeping change—potentially affecting hundreds of contracts—when the extent of the problem is unknown. Additionally, the bill uses ambiguous phrases that are open to interpretation, will be difficult to implement, and may lead to significantly higher costs. Specifically, Finance is opposed to this bill for the following reasons:

- The bill potentially imposes a reimbursable state mandate.

Counties often find it is most cost-effective to contract with private vendors for a host of public services. Depending on its unique situation, a county may find it fiscally or operationally challenging (if not impossible) to hire county employees to provide certain services. Despite the fact that it may

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Governor's Office:	By:	Date:	Position Approved _____ Position Disapproved _____
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be extremely difficult for a county to provide a service using its own employees, this bill requires the county to nevertheless perform the required contract cost analysis. Furthermore, if the county chooses to renew a contract that costs over \$100,000, it must pay for an audit to ascertain whether the contract actually resulted in county savings.

The practical compulsion implicit in requiring counties to perform the contract cost analysis and the contract cost audit may form the basis for state mandate claims.

The California Supreme Court has ruled that while local agencies may not be legally compelled to perform certain functions, it is possible for them to be practically compelled to perform those functions, and to thereby incur state-reimbursable costs. In *Department of Finance v. Commission on State Mandates (Kern High School Dist.)* (2003) 30 Cal.4th 727, the Court did not uphold the claimant's argument that it was practically compelled to perform the activities in question. However, the Court did say that "...we do not foreclose the possibility that a reimbursable state mandate might be found in circumstances short of legal compulsion - for example, if the state were to impose a substantial penalty (independent of the program funds at issue) upon any local entity that declined to participate in a given program..." As that ruling pertains to this bill, a local agency that contracts for services could make a compelling case that it has no choice but to perform the required contract cost analysis, because it is cost-prohibitive or operationally impractical to pay county staff to perform the contracted services.

- The bill makes it difficult for counties to provide public services in the most cost-efficient manner, and in a way that best meets their unique needs.

This bill places significant hurdles before counties that have determined the optimum way to provide essential public services is via contracts with non-profit organizations or private firms. The bill makes it extremely difficult for counties to contract for a host of public services including health care services, mental health services, substance use services, social services, transportation projects, and security and maintenance services. Of particular concern are the following issues:

- This bill may disproportionately affect small or rural counties that already experience higher vacancy rates and have difficulty recruiting employees for hard-to-fill or technical assignments.
- The required contract cost analysis places private contractors at a disadvantage, thus making it likely counties will incur added costs to hire new staff to perform services that it would otherwise be more cost-effective and practical to contract out.

The bill requires counties to exclude indirect overhead costs when calculating the cost of having county employees perform a service, unless the cost is solely attributable to the service in question and would not otherwise exist. The rationale for excluding the county's indirect costs from the contract cost analysis is unclear, particularly because most contracts include the vendors' indirect overhead costs.

The bill also precludes counties from contracting with vendors—including non-profit organizations—whose pay rates "significantly undercut" county pay rates. Because the bill does not define "significantly undercut," this provision will likely result in costly litigation for counties that perform the contract cost analysis in good faith, and whose decision to contract is subsequently challenged by parties who believe the contractor's pay rates "significantly undercut" county pay rates. Because non-profits are likely to offer lower wages, this bill may effectively block counties from contracting with non-profit organizations to perform vital

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services.

- The bill does not define the phrase "customarily performed by," as the phrase relates to county employees' duties.

Per subdivision (g) of Section 31000.10, the required contract cost analysis applies whenever a county seeks to execute a new contract, or to renew an existing contract, for personnel services "...currently or customarily performed by the employees of a county." Based on both a plain reading, and on previous court rulings in cases dealing with duties "customarily" performed by civil service employees, this provision likely means a county cannot avoid the required contract cost analysis simply because it has customarily contracted for a certain activity. Instead, if a court determines that counties in general use county employees to perform a certain activity, the court may rule that a county that has customarily contracted for that same activity for years or decades must perform the required contract cost analysis before renewing that contract. The contract cost analysis will likely also apply when a county uses a mix of county employees and contract staff to perform a certain activity.

This provision almost guarantees that counties which choose to contract, despite this bill's many roadblocks, will be embroiled in costly litigation concerning the definition of "customarily performed by."

- The bill is ambiguously drafted and may lead to significant litigation.

In addition to the aforementioned legal ambiguity concerning the definition of "customarily performed by" and "significantly undercut," we note the following ambiguities that may result in litigation if this bill is enacted:

- Whether the contract "adversely affects" any of the county's nondiscrimination, affirmative action efforts.
- Whether savings from contracting are "large enough to ensure" they will not be eliminated by contractor or county cost fluctuations "that could normally be expected" during the contract period.
- Whether the savings "clearly justifies" the contract size and duration.
- Whether the "potential for future economic risk to the county from potential contractor rate increases is minimal."
- Whether "the potential economic advantage of contracting is not outweighed by the public's interest in having a particular function performed directly by county government."
- Whether "the services contracted cannot be performed satisfactorily by county employees, or are of such a highly specialized or technical nature that the necessary expert knowledge, experience, and ability are not available among county employees."
- It is an open question whether the bill will force counties to reduce services under the 2011 realignment.

In 2011, the state realigned responsibility for administering several public safety and human

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services programs to the counties. Counties frequently rely on contracts to provide services in support of these programs.

Under Proposition 30 of 2012, counties are not required to implement any future state laws that increase the overall local costs to administer the respective program responsibilities transferred in 2011, unless the state provides additional money to pay for the increased costs. Under the Proposition the state also is not required to provide reimbursement for these costs. Counties will either not provide the increased service, or will provide it and correspondingly reduce other services.

Because this bill applies to county contracts for the provision of realigned services, and results in increased costs to administer those contracts, it is an open question whether counties will claim exemption from compliance with this bill under Proposition 30 for those particular contracts. However, to the extent that they cannot or do not self-exempt, and without an ability to obtain reimbursement from the state, counties will be forced to absorb these costs within existing funding, resulting in diminished service levels.

- The contracting restrictions in this bill are generally modeled on standards that apply to state government. However, the restrictions in this bill are more comprehensive. Of particular note is the requirement that counties arrange for independent audits to determine whether they achieved the anticipated cost savings by contracting.

We understand some proponents of this bill argue that it merely applies to counties the same contracting standards that apply to the state. This argument fails to acknowledge that the state, with a workforce of more than 229,000 employees (excluding the University of California and the California State University), has less need to contract for personal services. Furthermore, with the fiscal resources at its command, the state is better able than counties to bear the salary, overhead, and pension costs of hiring new employees.

Generally speaking, the state has a somewhat collaborative relationship with its labor organizations on this issue and has an ongoing dialogue with public employee unions about the need to contract for certain services of a complex or time-sensitive nature. The extent to which counties enjoy similar relationships their labor organizations is unclear.

- This bill applies much more broadly than does other legislation pertaining to local agency contracting authority.

In 2011 the Governor signed AB 438 (Chapter 611, Statutes of 2011). While AB 438 imposed contracting restrictions very similar to those imposed by this bill, AB 438 applies only to very specific instances when a city or library district seeks to achieve cost savings by turning their library operations over to private companies. As is discussed in this analysis, this legislation applies much more broadly than does AB 438.

- This bill does not apply uniformly to all counties.

San Francisco is fully exempt from this bill's provisions, and we understand it will soon be amended to also exclude Santa Clara County's health services. This indicates that at least some of the bill's supporters recognize the bill places unnecessary and burdensome new requirements on counties. Were this not so, there would be willingness to apply the bill to all

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counties.

ANALYSIS

1. Programmatic Analysis

Existing law authorizes a county board of supervisors to contract for services on behalf of the county, county officers or departments, and district courts in the county, and requires that the contract be with persons specially trained, experienced, and with expertise and competence to perform the services, among other provisions.

This bill prohibits a county, other than the City and County of San Francisco, from executing new contracts or renewing existing contracts for personal services currently or customarily performed by that county's employees, unless the county demonstrates the contract will result in actual overall cost savings, and the county makes numerous findings, the most significant of which are as follows:

- In comparing costs, the county's indirect overhead costs for providing the service itself shall not be included unless those costs can be attributed solely to the function in question, and would not exist if that function was not performed in county service. Indirect overhead costs are defined as the pro rata share of existing administrative salaries and benefits, rent, equipment costs, utilities, and materials.
- In comparing costs, the county must include costs directly associated with the contracted function. These costs include, but are not limited to, those for inspection, supervision, and contract monitoring.
- Contracting out shall not be approved solely on the basis that savings will result from lower contractor pay rates or benefits. However, proposals to contract out shall be eligible for approval if the contractor's wages are at the industry's level and do not significantly undercut county pay rates.
- The contract does not cause vacant positions in county employment to remain unfilled.
- The contract does not cause the displacement of county employees, including layoffs, demotion, involuntary transfers to a new class, involuntary transfers to a new location requiring a change of residence, or time base reductions.
- The savings shall be large enough to ensure that they will not be eliminated by private sector and county cost fluctuations that can normally be expected.

The cost comparison criteria appears weighted towards favoring county employees over contracted services, especially as it relates to the exclusion of indirect costs from the county calculation. The requirement that counties contract with vendors who pay industry-level wages could make it difficult for small counties and those located in rural areas to contract for services that they cannot afford to hire classified staff to perform.

For contracts over \$100,000, the bill also requires that the contractor must provide:

- A description of all civil and criminal charges, claims, and complaints against them.

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- A description of any debarments by public agencies.
- Information on the total compensation provided to workers under contract.
- The names and compensation of individual employees, should the county request it, which information shall be subject to the California Public Records Act.
- An independent audit to determine whether, and to what extent, the anticipated costs savings were actually realized.

These requirements may be onerous for small firms or non-profit organizations that do not have staff to provide the information readily, potentially resulting in the best qualified providers not bidding for the work and forcing counties to hire county staff without sufficient expertise.

The bill provides several exemptions from its requirements. These include the following:

- When the contract is for a new function for which the Legislature has mandated or authorized the use of private contractors.
- When the contract is for services to be performed by another government entity.
- When the contracted services cannot be performed satisfactorily by county employees, or are of a highly specialized or technical nature.
- When the contracted services are incidental to the purchase or lease of real or personal property.
- When legislative, administrative, or legal goals and purposes cannot be achieved by county employees. A specific example provided by the bill is contracts for expert witnesses in litigation.
- When the work is such that the standards for emergency appointments apply.
- Contracts for private counsel, when the county counsel has a conflict of interest.
- Contracts for legal services, solely on a contingency or fee basis.
- Contracts for equipment, materials, facilities, or support services that the county cannot feasibly provide at the required location.
- Training contracts for which county trainers are not available.
- Contracts for services of such an urgent, temporary, or occasional nature that delays would result from using county employees, and thereby frustrate the desired goals.

The bill also exempts contracts for the following services from its provisions:

- Architecture, engineering, land surveying, and construction project management.
- Construction, alteration, demolition, installation, or repair work related to public works as defined in the Labor Code.
- Public transit and paratransit services, if fully funded by Federal Transit Administration

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assistance.

- Street sweeping.
- Solid waste hauling.

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2. Fiscal Analysis

Many counties contract for a variety of services that it is cost-prohibitive or impractical to hire county employees to perform. In these cases, counties will have little choice but to comply with this bill's requirements if they want to maintain the contracted services.

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Code/Department Agency or Revenue Type	SO	(Fiscal Impact by Fiscal Year)					Fund Code	
	LA	(Dollars in Thousands)						
	CO	PROP						
	RV	98	FC	2017-2018	FC	2018-2019	FC	2019-2020
0001/Major Rev	LA	No	C	1,000-10,000	C	1,000-10,000	C	1,000-10,000 0001