

# **PRIVATIZATION IN HAWAII**

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## FOREWORD

This report was prepared in response to a joint request from the President of the Senate and the Speaker of the House of Representatives of the Hawaii State Legislature, that the Legislative Reference Bureau review the Hawaii Supreme Court's 1997 decision in Konno v. County of Hawaii and propose legislative responses to that decision; discuss privatization, civil service and merit principles, and related legal issues; and review relevant experiences of other states and the federal government.

While the decision to privatize state or county functions or utilize other alternatives to privatization is ultimately one of policy for the Legislature and affected government entities, this report generally views privatization as one of a number of different possible management tools that may or may not be useful in increasing the efficiency and cost-effectiveness of government, depending on the existence of a number of factors. Whether or not the State or counties decide to privatize certain government functions, the report argues that the Konno decision effectively removes that tool as an option in improving both government service delivery and the State's economy as a whole. This report recommends that the Konno decision should be reviewed in the context of a number of related issues, including appropriate reasons for contracting out, contract monitoring, assistance to displaced government workers, managed competition, and other alternatives to privatization.

The Bureau wishes to extend its sincere appreciation to each of the county corporation counsel's offices for their assistance in providing general background information on county privatization issues. The Bureau hopes that the information contained in this report will be useful to the Legislature in its analysis of proposed solutions to the problems raised by the Konno decision and in its continuing review of the merits of privatization.

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## EXECUTIVE SUMMARY

**Findings.** In the 1997 decision of Konno v. County of Hawaii, the Hawaii Supreme Court voided a contract between the County of Hawaii and a private contractor for the operation of a county landfill as a violation of civil service laws and merit principles. The Court adopted the “nature of the services” test in that case, holding that the civil service, as defined by state law, encompasses those services that have been “customarily and historically” provided by civil servants. In addition to increasing the potential for litigation by calling into question many existing state and county privatization contracts, the Court’s decision removed a valuable tool to aid the State and counties in pursuing meaningful economic recovery. Whether or not the State or counties ultimately use privatization or some other form of service delivery, there is a need to remove the legal cloud created by Konno to allow for increased competition between the public and private sectors. In particular, the Court’s decision requires an appropriate legislative response to give the State and counties greater flexibility in finding ways to make government more efficient and cost-effective. The intent of this advisory memorandum, which was drafted in response to a joint request from the President of the Senate and the Speaker of the House of Representatives of the State of Hawaii, is to provide a broader understanding of privatization and related issues in light of Konno. The Bureau has drafted legislation to address the issues raised in Konno and makes the following recommendations based on a review of relevant literature and the experiences of other jurisdictions:

### ***Recommendations***

1. Establish a privatization task force to identify public services that are appropriate for privatization.
2. Implement managed (public-private) competition to allow government agencies to compete with the private sector.
3. Ensure that contracting out is implemented through an open, public, and well-designed contract bidding system.
4. Institute a well-designed contract monitoring and oversight system.
5. Ensure that contracts with private vendors specify performance measures and desired outcomes to ensure accountability, and provide contingency plans in the event of contractor default.
6. Develop comprehensive guidelines to address appropriate reasons for contracting out to the private sector.
7. Develop comprehensive guidelines to provide for detailed cost comparison methods.
8. Develop comprehensive guidelines to provide for a planned workforce transition after contracting out, including assistance to displaced government workers.
9. Develop comprehensive guidelines for the use of alternative approaches to service delivery in addition to contracting out.
10. Work in partnership with the private sector to achieve mutually desirable goals.
11. Consolidate and reform state civil service laws.
12. Consider providing greater clarity with respect to managerial rights in the public sector collective bargaining law.
13. Consider granting the counties broader home rule powers.
14. Replace *Konno*’s “nature of the services” test with a balancing test, and address existing statutory authority to contract out government functions or services.

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## PART I. INTRODUCTION

This advisory memorandum reviews issues relating to privatization in light of the Hawaii Supreme Court's decision in Konno v. County of Hawaii,<sup>1</sup> in response to a joint letter from the President of the Senate and Speaker of the House of Representatives of the State of Hawaii, dated June 3, 1997. That letter, a copy of which is attached as Appendix A, requested the Bureau to:

- (1) Identify the specifics that the Legislature will be required to amend to ensure the validity of government-private provider contracts, while at the same time preserve the integrity of merit principles and civil service, and protect the rights of present government workers;
- (2) Provide a clear explanation of other legal considerations affecting privatization, merit principles, civil service, and collective bargaining, including alternatives for the Legislature to consider;
- (3) Describe some of the experiences of other states, as well as the federal government dealing with the contending policies underlying privatization and the civil service; and
- (4) Suggest proposed legislation for the Legislature to consider.

This memorandum is organized into nine parts as follows: Part I introduces this memorandum and the general subject area. Part II reviews the Konno decision. Parts III to VII discuss relevant legal issues involved. In particular, part III discusses issues relating to privatization; part IV reviews the responses of the counties to Konno and the issue of home rule; part V reviews issues relating to the civil service and merit principles; part VI discusses collective bargaining issues; and part VII reviews other legal issues, including issues relating to tort and civil liability and antitrust law. Part VIII reviews the experiences of other states and the federal government, primarily relating to privatization and civil service issues. Finally, part IX makes findings and recommendations, discussing various legislative options and identifying areas that will require amendment depending on the policy choices made by the Legislature.

Sample bills have been included as appendices to this memorandum, and are presented as examples of the types of legislative responses that may be made to the issues. As such, they do not necessarily reflect the recommendations of the Legislative Reference Bureau on these issues, but are rather intended as examples of possible legislative measures that address each such issue.

### Endnotes

1. Except where otherwise stated, all references in this memorandum to the *Konno* decision are to the Hawaii Supreme Court's opinion in Konno v. County of Hawaii, 85 Haw. 61, 937 P.2d 397, *order modifying decision on reconsideration*, 85 Haw. 79, 937 P.2d 415 (1997). A copy of the slip opinion in that case is attached as Appendix B.

## **PART II. KONNO v. COUNTY OF HAWAII**

Is there a need for a legislative response to Konno? And, if so, what type of response is appropriate? The Hawaii Supreme Court has suggested that direction from the Legislature in this matter is both appropriate and necessary in order to resolve the tension between the principles underlying the civil service system and the decision to privatize: “[P]rivatization involves two important, but potentially conflicting policy concerns. 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. Given the importance of these policy concerns and the potential conflict between them, clear guidance from the legislature is indispensable.”<sup>1</sup>

An understanding of the Konno case is critical to the type of legislative response to be selected, if any is deemed necessary. This part reviews relevant portions of that decision, first discussing Konno itself and the approach used by the Hawaii Supreme Court, the scope of that decision, and finally reviewing the limitations of that decision and the need for legislative action. The Bureau believes that there is a compelling need for a legislative response to Konno for the reasons outlined in this part. The type of response, of course, is entirely within the policy discretion of the Legislature. Various policy options and corresponding sample legislation are included in appendices to this memorandum and explained in part IX.

### **A. Relevant Facts and Procedure**

The Hawaii Supreme Court began its decision in Konno with the following pronouncement: “The central issue addressed in these cases is the privatization of public services.”<sup>2</sup> The Court, however, subsequently changed its position as to the nature of that issue. In rejecting an argument based on the concept of “home rule”, the Court maintained that “the present dispute involves civil service matters ...”, while ignoring the privatization and contractual issues involved.<sup>3</sup> The Court later acknowledged in its discussion of collective bargaining issues that the central issue in Konno was the violation of civil service laws and merit principles: “As noted above, the central issue in this appeal is our holding in No. 18203 that the County violated civil service laws and merit principles; our holding in No. 18236 is in fact dictated by our prior holding in No. 18203.”<sup>4</sup>

The Court’s inconsistency in describing the *central* issue in Konno reflects its ambivalent resolution of that issue, which may be characterized as the scope and applicability of the civil service laws to county privatization contracts. In brief, the Court believed that it was compelled to resolve Konno in the manner it did because it was constrained by existing statutory law:

In the absence of clear legislative support for privatization, we must interpret the laws as they currently exist. Our statutes, and indeed our constitution, reflect strong support for the policies underlying the civil service. As a court, our decisions relating to disputes governed by the application of statutory law (and not otherwise implicating constitutional principles) must be based on that statutory law as it currently exists, and not on statutory law as it could

be or even as it should be. The determination of what that law could be or should be is one that is properly left to the people, through their elected legislative representatives.<sup>5</sup>

While it is clearly within the province of the Legislature to amend the law to provide the support for privatization that the Court believed to be missing, however, existing statutory law — in the form of an express statutory authorization for county contracting out for solid waste disposal — already existed but was inexplicably rejected by the Court. Before discussing that statute, it is necessary to discuss the relevant facts of the case itself.

Konno revolves around two related civil actions. In one action (No. 18203), the United Public Workers and its officers (UPW) argued that the County of Hawaii (County) violated civil service laws and merit principles by entering into a contract with Waste Management of Hawaii, Inc. (WMI), to privatize the operation of a landfill at Puʻuanahulu on the Big Island — specifically, by privatizing certain landfill worker positions. In the second action (No. 18236), UPW maintained that the County violated collective bargaining laws by entering into such a contract without participating in mandatory negotiations with that union. The Court held that the County violated civil service laws and merit principles but did not violate collective bargaining laws. In addition, the Court also found the contract between WMI and the County to be void as a violation of public policy to the extent that it provided for the private operation of the Puʻuanahulu landfill.

The Court originally instructed the circuit court to grant the UPW a declaratory judgment “and an injunction barring private operation of the landfill to determine whether additional relief is appropriate.”<sup>6</sup> On motion for reconsideration, WMI and the County raised several practical concerns — that the transition from private operation to County operation would take time and could result in detrimental public health and environmental effects. While the Court had an insufficient basis to determine the validity of these arguments since the material supporting the County’s motion was not part of the record on appeal, the Court found that the practical impact of the transition from private to County operation was a matter more appropriate for the circuit court to address on remand. Accordingly, the Court modified its decision by deleting the above-quoted language to allow the circuit court to consider the practical and public interest concerns of the parties.<sup>7</sup>

The Court noted that the County had originally owned and operated two landfills on the Big Island — one in Kealakehe, Kona, and the other in Hilo. These landfills were operated by various equipment operators, landfill attendants, and transfer station attendants, all of whom were represented by the UPW and “traditionally recruited and employed through the merit system pursuant to civil service laws.” In 1991, Mayor Lorraine Inouye proposed the possibility of having a private contractor construct and operate a new landfill at Puʻuanahulu to replace the Kealakehe landfill, which had reached capacity and had subterranean fires. In 1992, Mayor Inouye agreed not to privatize the operation of the proposed landfill in response to union opposition.

In 1993, new Big Island Mayor Stephen Yamashiro decided to put both the construction and operation of the Puʻuanahulu landfill out to bid to private contractors. The contract was subsequently awarded to WMI. The Court found that county officials failed to seek certification from the county personnel director or the civil service commission that the landfill workers positions were unique or could not be filled through the normal civil service procedures, and that the Mayor did not consider

the decision to privatize the operations of the landfill to be subject to mandatory bargaining.<sup>8</sup> WMI subsequently assumed responsibility for the construction, operation, and closure of the landfill.

The Court noted that ten workers at the Kealakehe landfill were directly affected by the County's contract with WMI. These workers were given the choice of relinquishment of their civil service status and working for WMI at Pu'uana'hulu or reassignment to other civil service positions. The Court noted that the actual work performed by workers at the new landfill is "virtually identical" to the work performed at the old landfill, and that the only difference was that equipment operators who previously spent half of their time trucking and half bulldozing now spent their entire time trucking waste.

In action no. 18203, the UPW filed a complaint in Hawaii's third circuit court, claiming, among other things, that the County of Hawaii had violated constitutionally mandated merit principles and civil service statutes. The circuit court granted the County's motion for summary judgment, noting that section 46-85, *Hawaii Revised Statutes* ("contracts for solid waste disposal"), authorized such a contract.<sup>9</sup> The circuit court further noted that there would be "no elimination of jobs currently held by civil servants, and thus there is no violation of Civil Service laws."<sup>10</sup> In addition, the circuit court found that the contract was legally executed in accordance with sections 13-13 and 10-11 of the Hawaii County Charter. The court noted that its decision represented a ruling on the sole issue of the legality of the contract between the County and WMI.<sup>11</sup>

In action no. 18236, the UPW filed a prohibited practices complaint with the Hawaii Labor Relations Board against the Mayor and other County officials. The Board ruled that all of UPW's claims were meritless except Count IV — that the County violated section 89-13(a), *Hawaii Revised Statutes*, in refusing to bargain with the UPW. On that count, the Board ruled that the decision to privatize the Pu'uana'hulu landfill was a valid exercise of management rights, and therefore non-negotiable under section 89-9(d), *Hawaii Revised Statutes* ("scope of negotiations"),<sup>12</sup> and not subject to mandatory bargaining. The Board noted, however, that the secondary impact of managerial decisions on conditions of employment must be negotiated before the decision may be implemented, and that the County was obligated to negotiate over the effects of the decision to privatize. On subsequent appeal by both parties to the third circuit court, the court affirmed the Board's decision with respect to those claims found meritless by the Board, but reversed the Board's ruling on Count IV, noting that the County acknowledged that the effects of contracting out required consultation with the union, but that the evidence showed that the County's efforts to negotiate effects were rebuffed by the UPW.

The UPW appealed both actions to the Hawaii Supreme Court. The Court noted that while these cases were not consolidated on appeal, they were considered together since they arose from the same underlying factual events, and because the disposition in no. 18203 directly affects no. 18236.<sup>13</sup>

## B. Discussion

### 1. Civil Service Issues

Most of the Court's discussion of the law in Konno focused on whether the County violated civil service laws and merit principles in contracting out the performance of personal services to a private vendor. The Court began its discussion of this issue by presenting general background information regarding privatization and the policies behind the decision to privatize. The Court contrasted these policies with the policies underlying the civil service system, together with the resulting tension between privatization and the civil service when a position is privatized, and, by definition, removed from the civil service system.<sup>14</sup> The Court went on to discuss the following three approaches taken by other states in dealing with this tension, namely, the "nature of the services", "functional inquiry", and "bad faith" tests:

**Nature of the Services Test.** Under this approach, "services that have been 'customarily and historically provided by civil servants' cannot be privatized, absent a showing that civil servants cannot provide those services."<sup>15</sup> As an example of this approach, the Court cited the 1978 case of Washington Fed'n of State Employees, AFL-CIO v. Spokane Community College, in which a state community college sought to contract out custodial services for a new administration building, although those services had been historically provided by civil service employees of the college. The Washington Supreme Court held the contract to be void in that it violated state civil service laws, despite the fact that the contract would have substantially reduced the cost of custodial services, noting that privatization contravenes the basic policy and purpose of the civil service statutes.<sup>16</sup>

**Functional Inquiry Test.** Under this approach, the focus is on the particular state program or function involved, rather than the type of services to be performed: "New state programs performing new functions are not constrained by civil service laws. Thus, new programs may contract out services even if those services are of a type that can be performed by civil servants."<sup>17</sup>

**Bad Faith Test.** Under this test, contracting out government services violates civil service laws only if the employer has acted in "bad faith" or with the intent to circumvent those laws: "Under this approach, a public employer whose motive is economic efficiency is generally considered to act in 'good faith.' However, efficiency is almost always the justification given for privatization. Therefore, civil service laws are effective against privatization only in the rare instances in which there is actual proof of improper intent/motive."<sup>18</sup>

In its analysis, the Court first rejected the idea that Hawaii's Constitution establishes an independently enforceable right to the protection of merit principles. Article XVI, section 1 of the Hawaii Constitution ("Civil Service") states: "The employment of persons in the civil service, as defined by law, of or under the State, shall be governed by the merit principle." This section does not define the precise scope of the civil service, i.e., the particular job descriptions within the civil service, but instead simply specifies that the civil service, however defined by law, is to be governed by the merit principle. Because that section referred to other sources for a definition of "civil service", the Court concluded that it must examine statutory and case law to determine the scope of that term.<sup>19</sup>

The Court selected section 76-77, *Hawaii Revised Statutes*, as most relevant in defining “civil service”.<sup>20</sup> That section provides that the civil service comprises “all positions in the public service of each county, now existing or hereafter established, and embraces all personal services performed for each county...”. The Court found that the word “all” preceding the words “positions in the public service” and “personal services” indicated that the term “civil service” was to be read broadly, but must not be read so broadly as to lead to absurdity. However, “civil services” could not be read as only including employees who are paid regular government salaries, which would allow state or county employees to avoid coverage under the civil service simply by reducing their official payroll, thereby rendering section 76-77 a nullity.

Because of difficulties in interpreting that statute, the Court looked to the three approaches used by other states for guidance, and determined that the “nature of the services” test was the most consistent with the language of section 76-77. The Court found that this test was the broadest of the three tests and was consistent with the broad coverage suggested by section 76-77. Moreover, by limiting coverage to those types of services that are customarily and historically performed by civil servants, it did not risk being applied too broadly, so as to lead to absurdity. Finally, “and most importantly,” the Court found that this test focused “on the types of services performed rather than the particular programs or governmental functions involved or the intent or motive underlying the decision” and was consistent with the statutory language “all personal services performed in [*sic*] each county.”<sup>21</sup> Accordingly, the Court deemed the “nature of the services” test to be “most consistent” with the language of section 76-77, and held that the civil service, as defined by that section, “encompasses those services that have been customarily and historically provided by civil servants.”<sup>22</sup>

In addition, the Court reasoned that because: (a) the landfill worker positions at the Pu’uanahulu landfill in Konno were basically the same as those at the Kealakehe landfill (except for a minor change in duties); (b) the positions were civil service positions; and (c) Pu’uanahulu was a replacement landfill for Kealakehe, the landfill workers at Pu’uanahulu were therefore “performing a service that has been customarily and historically provided by civil servants” and were therefore within the civil service unless exempted by one of the exceptions enumerated in section 76-77, *Hawaii Revised Statutes*.<sup>23</sup>

The Court stated that only two of the exceptions in section 76-77 “even remotely” applied to the facts in Konno, namely, section 76-77(7) and (10).<sup>24</sup> Under paragraph (7), the civil service does not include positions filled by persons employed by contract where the director has certified, and where the certification has received the approval of the civil service commission, that the service is special or unique, is essential to the public interest, and that personnel to perform the service cannot be recruited through normal procedures because of circumstances surrounding its fulfillment. The Court found that the County of Hawaii in fact made no effort to seek certification, and section 76-77(7) therefore did not apply.

The other exception, section 76-77(10), exempts from the civil service positions that are specifically exempted by other state statutes. The Court examined section 46-85, *Hawaii Revised Statutes*, as one possible exception.<sup>25</sup> In finding that this section did not apply, the Court reasoned that while section 46-85 “clearly authorizes the County to enter into contracts relating to disposal of solid waste[,] ... it mentions nothing about the civil service.”<sup>26</sup> Since section 76-77(10) required that positions be *specifically* exempted by another statute in order to avoid civil service coverage, and

since that section failed to include a specific exemption, according to the Court, the landfill positions were still included within the civil service. Even assuming that section 46-85 was ambiguous as to whether it exempted civil service coverage, the Court argued that the legislative history indicated that the authority to contract was intended to be used for garbage-to-energy plants, not landfills. Moreover, the Court noted that nothing in the legislative history indicated that the statute was intended to allow for the privatization of landfills or the exemption of landfill workers from the civil service laws. The Court therefore concluded that section 76-77(10) did not apply.<sup>27</sup>

In summary, the Court concluded that since the landfill worker positions at Pu'uanahulu were within the civil service under section 76-77, contracting out the operation of that landfill to a private contractor violated constitutionally mandated merit principles and civil service statutes by depriving those civil servants of the protections guaranteed by Article XVI, Section 1 of the Hawaii Constitution and chapters 76 (civil service law) and 77 (compensation law), *Hawaii Revised Statutes*. The County of Hawaii therefore violated civil service laws and the Hawaii Constitution when it privatized the landfill operation, and accordingly, the Court granted summary judgment in favor of UPW as a matter of law. The Court also voided the contract between the County and WMI as a violation of public policy to the extent that it provided for the private operation of the Pu'uanahulu landfill.<sup>28</sup>

The Court was quick to point out that its opinion should not be read “as passing judgment, one way or the other, on the wisdom of privatization”, which was a policy decision for the Legislature: “Whether or not, as a policy matter, private entities should be allowed to provide public services entails a judgment ordinarily consigned to the legislature.”<sup>29</sup> The Court noted that the Legislature had already expressly excluded many positions from the civil service in the past, such as positions held by prisoners under section 76-16(13), *Hawaii Revised Statutes*, but that “privatization does not have an express exclusion, and we believe that it would be improper for this court to usurp the legislature’s role by making our own policy decision in favor of privatization.”<sup>30</sup> Finally, the Court concluded that “[p]rivatization may, or may not, be a worthy idea; we do not, and indeed should not, express an opinion in this regard. But if privatization is attempted by the government, it must be done in accordance with the laws of this state. The privatization effort of the County of Hawai’i simply did not comply with our laws.”<sup>31</sup>

## 2. Collective Bargaining Issues

The Court in Konno also considered UPW’s contention that the County of Hawaii violated state collective bargaining laws. However, the questions before the Court — whether the County was obligated to negotiate with the union over the effects of privatization and whether the County in fact refused to bargain — were not addressed because the dispute was decided on other grounds. In particular, the court noted that under section 89-9(d), *Hawaii Revised Statutes*, parties are barred from negotiating upon and agreeing to proposals that would be inconsistent with merit principles. Because the County’s contract with WMI violated civil service laws and merit principles, the County and UPW were therefore prohibited from bargaining over either the decision to privatize the operation of the landfill or the effects of the privatization. The Court noted: “It would be absurd for us to hold that the County violated collective bargaining laws by refusing to negotiate with the UPW when both parties were expressly barred from negotiating by statute.”<sup>32</sup> The Court therefore



concluded that the County did not violate collective bargaining laws by refusing to bargain over the effects of its privatization effort. However, the Court left the door open as to whether privatization is subject to mandatory collective bargaining.<sup>33</sup>

### C. Scope of Konno

How broadly should the Konno decision be read and to what types of contracts does it apply? Depending on one's interpretation of that case, the decision may alternatively apply to the following contracts in which civil service employees are affected:

- (1) All county contracts seeking to privatize only county landfill operations;
- (2) All county contracts seeking to privatize any county government functions; or
- (3) All state or county contracts seeking to privatize any government functions.

One may look for guidance to the doctrine of *stare decisis*. Under that doctrine, “when a court has laid down a principle of law as applying to a certain set of facts, it will adhere to that principle and apply it to all future cases where the facts are substantially the same.”<sup>34</sup> Courts generally look for an identity of facts and issues between the prior and subsequent cases in determining the *stare decisis* effect:

A decision has a *stare decisis* effect with regard to a later case only if the legal point on which the decision in both cases rests is the same, or substantially the same. To determine whether the questions are identical or substantially so, the court must consider the prior decision in the context of the facts and issues in existence at the time the decision was rendered. Generally, where the facts between the present case and that to be applied as *stare decisis* are essentially different, *stare decisis* does not apply. However, there is also authority for the view that in the consideration of precedents, courts do not look so much for identity of facts as for statements of applicable principles, and that a conclusion of the court may be supported by earlier cases, although the fact situations may not be the same.<sup>35</sup>

The Hawaii Supreme Court earlier noted in Lee v. Insurance Co. of North America that “[w]hen a court has once laid down a principle of law as applicable to a certain state of facts, it will adhere to that principle. Where the facts are essentially different, however, *stare decisis* does not apply, for a perfectly sound principle as applied to one set of facts might be entirely inappropriate when a factual variance is introduced.”<sup>36</sup>

It is difficult to guess how the Hawaii Supreme Court would decide a subsequent case involving a county contract for the privatization of a county government function other than the operation of a landfill, given facts that are otherwise substantially similar to Konno. For example, the Court may find that a contract to privatize the operation of a wastewater treatment facility is similar enough to Konno to extend the principles of Konno to the new facts. On the other hand, the Court may consider the operation of a county correctional facility, for example, as involving substantially different liability issues that render Konno inapposite. It is even harder to speculate whether the Court would apply Konno principles to a case involving a state privatization contract.

There is some rationale for reading Konno narrowly. The case itself affects only a county contract to privatize landfill operations, not state contracts. The Hawaii Attorney General has been quoted as saying that the Court's decision in Konno did not require a blanket cancellation of all contracts with private vendors, but rather that the ruling should be interpreted narrowly.<sup>37</sup> In addition, the Hawaii Supreme Court in Konno stated: "Our decision today merely applies the civil service laws of this state to the example of privatization at issue in the present appeal."<sup>38</sup> This statement appears to imply that the Court intended Konno to have a fairly narrow scope or application. However, in the context of the opinion itself, the Court's statement immediately followed language to the effect that the Court was not passing judgment on the wisdom of privatization, and that it was ultimately the responsibility of the Legislature, as a policy matter, to determine whether private entities should be permitted to provide public services. In this context, the above statement appears more as a disclaimer than a statement of limited scope, i.e., one intended to deflect anticipated criticism that the Court was overstepping its role by judicially legislating its preference for civil service and merit principles over privatization.

The Bureau believes that the better position for the Legislature to take is one of caution — namely, that the Court will look broadly at both county and state privatization contracts in light of its decision in Konno. Even assuming that the Konno decision applies only to county privatization contracts and not state contracts, it is a realistic assumption that state privatization contracts will also be challenged on the same or similar grounds as the county privatization contract in Konno. This is, in fact, already happening. The United Public Workers filed a lawsuit on May 22, 1997, seeking to end the State's contract with a pharmaceutical service provider at the Hawaii State Hospital. In particular, that lawsuit maintained that the State's 1995 contract with Interstate Pharmacy Corporation resulted in the termination or transfer of three UPW members who were civil service employees at that hospital.<sup>39</sup> Other state contracts being questioned include child and adolescent mental health service on the Big Island provided by the State through various contractors, as well as services provided by audio-visual and automated systems electronic technicians in the state library system.<sup>40</sup>

The potential number of state (and county) privatization contracts that may be affected is immense. Examples of state government services being contracted out to the private sector range from the state library's attempt at "outsourcing" — the recently terminated five-year, \$11,000,000 outsourcing contract with wholesaler Baker & Taylor — to Hawaii Health QUEST, under which the State privatized coverage for certain participants enrolled in Medicaid, state general assistance, and the state health insurance program.<sup>41</sup> During the 1997 Regular Session, the Legislature also passed legislation to create a task force to evaluate the feasibility of establishing a community-based management pilot program for one or more state small boat harbors — in effect, setting in motion the privatization of those harbors.<sup>42</sup> Also in the 1997 session, the State amended its purchase of service procedures by establishing separate processes to be used by state agencies to expend appropriations of state funds for grants and subsidies for public purposes, and to pay for and provide health and human services to state citizens on behalf of those state agencies.<sup>43</sup>

State privatization contracts have received mixed reviews by the state Auditor in recent years, ranging from the Auditor's study of the Department of Health's administration of contracts for purchases of service for persons with developmental disabilities (under the former purchase of services process), to audits of the administration of personal services contracts in the state

Department of Education and state contracting for professional and technical services in the Airports Division of the Department of Transportation, the Child and Adolescent Mental Health Division of the Department of Health, and the High Technology Development Corporation, administratively attached to the Department of Business, Economic Development, and Tourism.<sup>44</sup> The state judiciary itself has approximately eight hundred private contracts for equipment, space leases, and various services ranging from landscape maintenance to drug testing, costing about \$20,000,000 per year.<sup>45</sup>

Moreover, the Hawaii Supreme Court itself has implicitly raised the question as to whether Konno applies to state contracts to private vendors affecting state civil servants, while taking no position on that issue. In CARL Corporation v. State of Hawai'i Department of Education,<sup>46</sup> a case decided after Konno involving the awarding of a contract to a private vendor to provide automation and other services to the Hawaii State Public Library System, the Court allowed the Hearings Officer to consider on remand whether the contract satisfied the standard delineated in Konno, although noting that the Konno issue was not before the Court and that the Court was expressing no opinion on that issue.<sup>47</sup>

The Bureau therefore recommends that the Legislature treat the Konno decision as if the scope of the Court's opinion applied to both county and state privatization contracts, and amend state statutes accordingly.

#### **D. Limitations of Konno**

The Konno decision is problematic for several reasons, and, in the opinion of the Bureau, requires a legislative response to address these limitations.

##### **1. Statutory Interpretation**

First, it may be argued, the resolution of the civil service issue in Konno was simply one of faulty statutory interpretation. The problems include the Court's failure to review the two statutes at issue *in pari materia*, as well as the Court's failure to adequately address the express language of one of those statutes — section 46-85, *Hawaii Revised Statutes*,<sup>48</sup> specifically, the first seven words of that section: "Any other law to the contrary notwithstanding...". In essence, the effect of the Court's interpretation is to render the application of section 46-85 a nullity. Given the Court's interpretation of that section, a county can no longer contract out to the private sector for solid waste disposal under the specific language of that section.

The two statutes in question — sections 46-85 and 76-77, *Hawaii Revised Statutes* — should be read *in pari materia*, that is, as relating to the same subject matter. While these statutes do not appear to be related on their face, in that the former relates to county contracts for solid waste disposal, while the latter relates to county civil service exemptions, even a casual analysis shows that both relate generically to county hiring. The more specific statute, section 46-85, provides the mechanism for the county to hire, by contract, private contractors for solid waste disposal. The more general statute, section 76-77, exempts certain county hires from the civil service.

The following three general statutory principles enunciated earlier by the Hawaii Supreme Court in a different case also apply in this statutory analysis:

First, legislative enactments are presumptively valid and “should be interpreted [in such a manner as] to give them effect.” ... Second, “[l]aws in pari materia, or upon the same subject matter, shall be construed with reference to each other. What is clear in one statute may be called in aid to explain what is doubtful in another.” ... Third, “where there is a ‘plainly irreconcilable’ conflict between a general and specific statute concerning the same subject matter, the specific will be favored. However, where the statutes simply overlap in their application, effect will be given to both if possible, as repeal by implication is disfavored.”<sup>49</sup>

Applying these principles to the two statutes at issue in Konno, it is clear that the Court failed to give appropriate deference to the Legislature's statutory authorization for the counties to contract out for the disposal of solid waste.

Section 46-85 specifically authorizes the counties to contract with private contractors for the disposal of solid waste. In language regarding the exclusivity of certain contract terms, that statute provides that “[t]he contract may include provisions for arbitration and reasonable restrictions against other disposal by the county or by other public or private entities or persons over which the county shall have jurisdiction of the substances covered by the contract while the contract is in force and disposal under the contract is practicable.”<sup>50</sup> Since the hiring of private entities under section 46-85 impliedly impacts on existing county civil service positions, the Legislature is presumed to have had knowledge of that fact: “It is assumed that whenever the Legislature enacts a provision it has in mind previous statutes relating to the same subject matter.”<sup>51</sup> Moreover, since section 46-85 was enacted subsequently to section 76-77(10),<sup>52</sup> the Legislature is presumed to have had knowledge of the existence of section 76-77(10). In other words, the Legislature was presumed to be aware that a contract entered into pursuant to section 46-85 could conceivably impact on county civil servants who were then providing solid waste disposal services.

While acknowledging that section 46-85 clearly authorized the County of Hawaii to enter into contracts for the disposal of solid waste, the Court in Konno argued that section 46-85 failed to include a specific civil service exemption, as required by section 76-77(10). However, the Court failed to take into consideration the fact that while there is no specific civil service exemption in section 46-85, there is an even broader blanket exemption of any other law to the contrary, including but not limited to section 76-77(10). It may therefore be argued that the Court's reasoning is flawed to the extent it disregards the express language of section 46-85.<sup>53</sup> Moreover, the Court's failure to give effect to the express statutory language “[a]ny other law to the contrary notwithstanding” legitimately calls into question the effectiveness of that phrase, or similar language, in countless other state statutes. Do similarly worded statutes need to be amended to add specific statutory references that were intended to be encompassed by that phrase, however redundant, in order to avoid having the Hawaii Supreme Court second guess the Legislature as to the meaning of that language? For example, the language in section 46-85 could be redundantly amended to read: “Any other law to the contrary notwithstanding, including but not limited to chapters 76 and 77, ...”. This should obviously be unnecessary, but the Court's interpretation at least begs the question.

In addition, the Court argued that even assuming that section 46-85 was ambiguous as to whether it exempted civil service coverage, the legislative history of that section indicated that the authority to contract was intended to be used for garbage-to-energy plants, not landfills. The state Attorney General has posited that “[i]n our view, the court rejected the County’s section 76-77(10) argument not because section 46-85 made no reference to the civil service laws but because the court was not convinced that section 46-85’s authorization to contract applied to both garbage-to-energy plants and landfills.”<sup>54</sup> The express language of section 46-85, however, authorizes counties to contract with users or operators of a project “for the abatement, control, reduction, treatment, elimination, or disposal of solid waste...”. This language is certainly broad enough to include both “landfills” and “garbage-to-energy plants”, although neither of those terms is actually included in the language of the section itself.

Section 46-85 should also take precedence over section 76-77(10) pursuant to the principle that a specific statute will be favored where there is a ‘plainly irreconcilable’ conflict between a general and specific statute concerning the same subject matter. In addition, “[w]here two statutes are involved each of which by its terms applies to the facts before the court, the statute which is the more recent of the two irreconcilably conflicting statutes prevails”.<sup>55</sup> Since section 46-85 is the more recently enacted of the two statutes, that section should prevail.

Finally, and perhaps most importantly, the Court’s interpretation of section 46-85 in Konno renders that section a nullity — and repeals that section by implication — with respect to any county landfill that has been “customarily and historically” operated by civil servants. Under the Court’s interpretation, a county may not contract out the operation of any such landfill to private entities, despite the express language in that section to the contrary. As such, the Court’s opinion fails to give effect to the principle that legislative enactments are presumptively valid and should be interpreted in such a manner as to give them effect.

In summary, the fact that the Legislature was silent on the specific issue of civil service when it enacted section 46-85 cannot be held as a presumption that the Legislature intended that statute to be superseded by section 76-77(10) for the following reasons:

- (1) The language “[a]ny law to the contrary notwithstanding” in section 46-85 serves as a blanket exemption that allows county contracting for solid waste disposal over any other statute to the contrary, including section 76-77(10). To hold otherwise renders that language inoperative, not only in section 46-85, but in countless other statutes;
- (2) Section 46-85, as the more specific statute, controls over section 76-77, the more general one;
- (3) Section 46-85, as the more recently enacted statute, prevails over section 76-77, the prior enacted statute;
- (4) While the legislative history of that section refers to garbage-to-energy plants, the express language of that section is broad enough to include both those plants and landfills, while neither term is actually included in the text of that section; and

- (5) The Court’s interpretation of section 46-85 renders the counties functionally unable to contract out for the operation of county landfills to private contractors, contrary to the express language of that section, violating the principle that legislative enactments are presumptively valid and should be interpreted in such a manner as to give them effect.

The Court in Konno maintained that “.. privatization does not have an express exclusion, and we believe that it would be improper for this court to usurp the legislature’s role by making our own policy decision in favor of privatization.”<sup>56</sup> Yet privatization — in this case the privatization of the operation of county landfills — does in fact have an express general exclusion (all other laws to the contrary) in 46-85. That section allowed the counties to contract out with private vendors for solid waste disposal. The Court inappropriately voided the express statutory preference for allowing counties to contract out landfill operations to private vendors by effectively preventing the counties from contracting out those functions to private entities. The Bureau therefore agrees with the circuit court’s order that the County of Hawaii’s contract with Waste Management Inc. for the operation of the landfill in question was authorized by section 46-85, *Hawaii Revised Statutes*.

## 2. “Nature of the Services” Test

Since the civil service law at issue in Konno could have been resolved by the reconciliation of sections 46-85 and 76-77(10), *Hawaii Revised Statutes*, there was therefore no need for the Court to fashion a test to resolve the tensions between privatization and the civil service. As will be recalled, under the “nature of the services” test as adopted by the Court, services that have been “customarily and historically” provided by civil servants cannot be privatized without a showing that civil servants cannot provide those services. However, given the fact that this test is now the controlling law in Hawaii, there is a need to determine if the test is broad enough to provide the counties — and the State, if Konno is read broadly — with sufficient flexibility to engage in privatization decisions for the benefit of the citizens of the counties or State, as appropriate. The Bureau believes that the nature of the services test as adopted by the Court is problematic, both theoretically and practically, and that a legislative response is needed to address these limitations.

In his seminal article on privatization, Professor Ronald Cass discussed the problems inherent in a test articulating how government functions are deemed to be historical or traditional. With respect to *historical* government functions, Professor Cass noted the following:

The historical approach asks what government *does* or *has done*, declaring the positive evidence descriptive of essentially governmental functions. Apart from its conflation of positive and normative issues, the historical approach is either nonsensical or unworkable. One sort of historical approach begins with the government as it is today. This approach, by labeling anything the government does as *necessarily* a *governmental* function, would in effect prohibit the government from reducing the scope of its undertaking; the government can never do less or spend less than it does now. This is the most administratively tenable, historical government-function test, but it makes no sense. Why demand a one-way ratchet in government? Even the most ardent advocates of expansive government authority surely would not want a constitutional mandate of this sort.<sup>57</sup>

Professor Cass further noted the practical difficulties inherent in determining reductions in government undertakings: “One can, of course, imagine the sort of difficulties this test would produce in deciding what constituted a reduction in the scope of government undertaking, difficulties present even at the base level of deciding the measure for government spending: nominal dollars? inflation-adjusted dollars? government-budget dollars relative to gross national product?”<sup>58</sup>

Although not as facially nonsensical as the historical approach, practical problems are also inherent in assessing government functions based on a *customary*, or *traditional*, basis:

An alternative historical approach asks what government *traditionally* has done. This alternative cannot be dismissed out of hand as senseless. One might at least imagine plausible bases for seeking to keep some rough constancy over time in the minimum functions performed by government, but this test poses enormous administrative problems. There is virtually no discrete function that one can identify as historically committed to government, rather than to private parties. To take just one example, private security forces both antedate public police forces and continue alongside public forces. Further complicating the relation, deputizing private citizens as temporary public law enforcement officers was once common and private actors generally are privileged from tort liability for certain acts in aid of law enforcement. Tradition can provide information on the roles played by government at various times, but it cannot of itself divide governmental from private actions. The roles have not divided simply enough for description, unaided by theoretical interpolation, to suffice.<sup>59</sup>

Commenting on Cass, Professor Clayton Gillette further outlined the interweaving of public and private functions, the difficulties involved in labeling those functions based on an historical or traditional test, and the need to allow public-private relationships to continue:

Certainly, if we are concerned about optimal resource allocation, there seems little reason to assign one sector a monopoly based on formalistic conceptions of “public” and “private” that bear little relationship to fulfillment of that objective. As Cass indicates, there is little principled basis on which to salvage any immutable dividing line between activities that must be retained within the governmental sphere and those susceptible to privatization. ... Far from being linear, the “tradition” of American government has been intermittent entwinement with private enterprise, not simply through regulation, but also through systematic subsidization and operation of commercial enterprises. These relationships should not be viewed as historical anomalies. If we are at all solicitous of the view that state and local governments serve as laboratories for experiment, then one would endorse such a dynamic relationship between public and private enterprise. That the experiment vacillates between governmental intervention into and government isolation from “essentially” private functions may reflect little more than alterations in social perceptions of the entity best capable of efficiently delivering desired services.<sup>60</sup>

The nature of the services test has also been challenged on public policy grounds. A 1980 student law review note argued that the nature of the services test, which was adopted by the Washington Supreme Court in the 1978 case of Washington Federation of State Employees v. Spokane Community College,<sup>61</sup> was “unsound for reasons of public policy, and contrary to the result reached in all but one jurisdiction that has addressed the issue.”<sup>62</sup> In particular, it was argued that the nature of the services test was unnecessary to protect the civil service system from deterioration, and unnecessarily hampered administrative discretion, innovation, and flexibility provided by the ability

to contract out services. A public agency's main function of serving the public would be impaired, and government would be forced to not expand or improve existing services or reduce services, and increase appropriations.<sup>63</sup> In particular, it was noted that privatizing state government functions would not defeat merit principles because of the safeguards built in to the statutory competitive bidding process in Washington State:

The court's view [in Spokane] that contracting out could foster a spoils system is unpersuasive. A merit system is not the sole method for restricting patronage, and empirical evidence strongly suggests competitive bidding is more effective than the state merit system in insulating Washington state government from improper influences. Because state agencies must comply with the rigorous statutory safeguards associated with competitive bidding, contracting out should not undercut the merit system.<sup>64</sup>

Strong safeguards are similarly built into Hawaii's public procurement code (chapter 103D, *Hawaii Revised Statutes*) with respect to competitive bidding. The purposes of Hawaii's procurement code, as outlined in its legislative history, were to:

- (1) Provide for fair and equitable treatment of all persons dealing with the government procurement system;
- (2) Foster broad-based competition among vendors while ensuring accountability, fiscal responsibility, and efficiency in the procurement process; and
- (3) Increase public confidence in the integrity of the system.<sup>65</sup>

In particular, "professional services", defined in section 103D-104 as including such services as architecture, professional engineering, land surveying, real property appraisal, law, medicine, accounting, dentistry, public finance bond underwriting and investment banking, and other practices, must be procured in accordance with that section, which establishes rigorous procedures to ensure fairness and competence. Professional services may be procured by several different means, including competitive bidding or competitive sealed proposals, and are to be "awarded on the basis of demonstrated competence and qualification for the type of services required, and at fair and reasonable prices."<sup>66</sup>

Other public policy reasons for rejecting the nature of the services test include increased government efficiency, potentially substantial cost savings associated with privatization, including the establishment of innovative public-private partnership arrangements and other alternatives to contracting out, and public safety concerns. As argued by the California Department of Transportation in a 1997 California Supreme Court case, as a result of existing California case law affirming the nature of the services test, "Californians have had to forego promising new techniques for providing services, ranging from contracting with private contractors to outright privatization. This has made more expensive by possibly billions of dollars the delivery of services in California. It also puts lives at risk. For example, the inability to use private engineering firms would threaten the timely completion of the seismic retrofit of California bridges and overpasses."<sup>67</sup>



The nature of the services test was criticized by a California appellate court in 1970 as “simplistic and inadequate”: “Whatever may have been the efficacy of the ‘nature of the services’ test when it was conceived in 1937, it is now evident that rigid application of that test would lead to untoward and possibly chaotic results. ... Certainly, the ‘nature of the services’ formula seems simplistic and inadequate when viewed in relation to modern techniques of public administration, which frequently involve the government in indirect rather than direct administrative operations.”<sup>68</sup> While that test is still the law in California based on the California Constitution and precedent established in over sixty years of settled case law in that state,<sup>69</sup> California courts have resorted to new exceptions and tests to meet changed circumstances in that state since the original rule was announced in State Compensation Ins. Fund v. Riley in 1937.<sup>70</sup>

In Hawaii, the nature of the services test has already led to confusion in interpretation. In May 1997, the Hawaii Corporation Counsel conveyed four questions about the appropriate construction of that test and other matters concerning the civil service law to the state Attorney General. The Attorney General responded by letter opinion in September 1997, a copy of which is attached as Appendix C. That opinion noted divergent views between the Attorney General and the Hawaii Corporation Counsel regarding under what circumstances a service has been “customarily and historically” provided by civil servants pursuant to the nature of the services test. For example, the Hawaii Corporation Counsel has taken the position that in applying the phrase “customarily and historically”, one must look to the custom and history of the entire State, including the other counties, as a whole. In contrast, the Attorney General argued that “a jurisdiction only needs to survey its own prior customs and history to determine whether civil servants have ‘customarily and historically’ provided the services sought.”<sup>71</sup> The Attorney General and Hawaii Corporation Counsel also disagreed on whether there is a temporal limit to what is considered customary and historic. The County of Hawaii has filed a suit in circuit court to clarify these issues in order “to avoid lawsuits, should [the County] abide by the state’s less-stringent interpretation and privatize services.”<sup>72</sup>

Finally, the Konno decision has already generated a significant amount of litigation in Hawaii’s counties, and there will likely be more to come in the future. Many of the counties’ and the State’s privatization contracts may be found void for the same or similar reasons as the Court held in Konno. In addition to increased litigation and the large number of contracts that are placed in jeopardy by Konno, there is also a strong possibility that the Hawaii Supreme Court will be forced to carve out more and increasingly contorted exceptions to the nature of the services test, as the courts have done in California. The rule in Konno simply does not allow the counties — or the State, for that matter — sufficient flexibility to allow for the contracting out of government functions or activities to the private sector. A legislative response is necessary if for no other reason than to provide this additional flexibility to the counties and the State in contracting out government functions.

Moreover, should the Legislature fail to legislatively overrule or otherwise limit the Court’s decision in Konno within a reasonable period of time, the nature of the services test will eventually become settled law in Hawaii — for better or worse, and most likely the latter. As the Hawaii Supreme Court has recently reiterated in January, 1997, “[w]here the legislature fails to act in response to our statutory interpretation, the consequence is that the statutory interpretation of the court must be considered to have the tacit approval of the legislature and the effect of legislation.”<sup>73</sup>

The Bureau therefore believes that the “nature of the services” test adopted in Konno should be rejected for the foregoing reasons. Possible legislative responses are discussed in part IX of this memorandum.

## Endnotes

1. Konno v. County of Hawaii, 85 Haw. 61, 74, 937 P.2d 397, 410 (1997) (emphasis added).
2. 85 Haw. at 64, 937 P.2d at 400 (footnote omitted; emphasis added).
3. 85 Haw. at 76, 937 P.2d at 412 (emphasis added).
4. 85 Haw. at 78 n. 18, 937 P.2d at 414 (emphasis added).
5. 85 Haw. at 79, 937 P.2d at 415 (*motion for reconsideration and order of amendment*).
6. Id., slip op. at 3.
7. Specifically, the Court amended its original opinion by adding the following language: “We further instruct the circuit court to fashion injunctive relief requiring the landfill to be transferred from private operation to County operation as rapidly as possible but consistent with practical and public interest concerns. The circuit court shall also monitor the transition and may impose sanctions for non-compliance. Finally, the circuit court is to determine whether the additional relief requested by the UPW is appropriate.” Id., *motion for reconsideration and order of amendment*, slip op. at 4 (May 13, 1997); 85 Haw. at 64, 937 P.2d at 400.
8. The Court noted that while the County refused to bargain with the UPW over the decision to privatize the operation of the new landfill, it did offer to bargain over the effects of privatization. However, there was no indication in the record that the UPW responded to the County’s offer. Id., 85 Haw. at 65, 937 P.2d at 401.
9. Section 46-85, *Hawaii Revised Statutes*, is set forth in full at n. 25, *infra*.
10. 85 Haw. at 66; 937 P.2d at 402.
11. Id.
12. Section 89-9(d), *Hawaii Revised Statutes*, is set forth in relevant part in the text accompanying n. 31 in part VI of this memorandum.
13. 85 Haw. at 64 n. 1, 937 P.2d at 400.
14. Privatization and civil service principles are discussed in greater depth in parts III and V of this memorandum, respectively.
15. Konno, 85 Haw. at 69, 937 P.2d at 405, *quoting Washington Fed’n of State Employees, AFL-CIO v. Spokane Community College*, 90 Wash.2d 698, 585 P.2d 474, 477 (1978) (*en banc*).
16. *See id.* and cases cited therein; *see also* notes 89 to 95 and accompanying text in part VIII of this memorandum for further discussion of Spokane.
17. Id. (citations and footnote omitted).
18. 85 Haw. at 70, 937 P.2d at 406 (citations omitted).

19. Id.

20. Section 76-77, *Hawaii Revised Statutes*, provides in relevant part:

**§76-77 Civil Service and exemptions.** The civil service to which this part applies comprises all positions in the public service of each county, now existing or hereafter established, and embraces all personal services performed for each county, except the following:

\* \* \*

(7) Positions filled by persons employed by contract where the personnel director has certified and where the certification has received the approval of the commission that the service is special or unique, is essential to the public interest, and that because of the circumstances surrounding its fulfillment, personnel to perform the service cannot be recruited through normal civil service procedures; provided that no contract pursuant to this paragraph shall be for any period exceeding one year;

\* \* \*

(10) Positions specifically exempted from this part by any other state statutes[.]

21. Konno, 85 Haw. at 72, 937 P.2d at 408. The Court rejected the “functional inquiry” test as inconsistent with section 76-77, which provided that the civil service included “all positions ... now existing or hereafter established”, which “clearly encompasses new programs as well as old.” Id. (emphasis in original). The Court also rejected the “bad faith” test as too narrow and also inconsistent with the broad statutory language. In addition, that test focused on the intent or motive underlying privatization, while nothing in section 76-77 indicated that intent or motive was relevant to civil service coverage. Id.

22. Id.

23. Id.

24. *See supra* note 20.

25. Section 46-85, *Hawaii Revised Statutes*, provides as follows:

**[§46-85] Contracts for solid waste disposal.** Any other law to the contrary notwithstanding, a county is authorized from time to time to contract with users or operators of a project for the abatement, control, reduction, treatment, elimination, or disposal of solid waste, whether established or to be established under chapter 48E or as a public undertaking, improvement, or system under chapter 47 or 49, or otherwise. The contract may be included in an agreement, may be for such periods as agreed upon by the parties, and, without limiting the generality of the foregoing, may include:

(1) Provisions for the delivery to the project of minimum amounts of solid waste and payments for the use of the project based on the delivery of the minimum amounts (which payments the political subdivision may be obligated to make, whether or not such minimum amounts are actually delivered to the project);

(2) Unit prices, which may be graduated; and

(3) Adjustments of the minimum amounts and the unit prices.

The payments, unit prices, or adjustments need not be specifically stated in the contract but may be determined by formula if set forth in the contract. The contract may include provisions for arbitration and reasonable restrictions against other disposal by the county or by other public or private entities or persons over which the county shall have jurisdiction of the substances covered by the contract while the contract is in force and disposal under the contract is practicable.

26. Konno, 85 Haw. at 73, 937 P.2d at 409.
27. 85 Haw. at 73-74, 937 P.2d at 409-410.
28. 85 Haw. at 74, 79, 937 P.2d at 410, 415. The Court rejected the arguments of the County of Hawaii and WMI that section 76-77, Hawaii Revised Statutes, was not applicable to the dispute in Konno since: (1) the contract was with a corporation (WMI), rather than an individual, and was therefore not one for “personal services”; and (2) the contract was for the construction and operation of a landfill rather than for “positions” as defined under section 76-11(18). The Court maintained that section 76-77 did not require a formal employment contract with an individual, since that interpretation would render that section a nullity by allowing the government to easily circumvent civil service laws by contracting with corporations to provide services rather than directly hiring individual workers. Similarly, while the Court acknowledged that the definition of “positions” under section 76-11(18) was made applicable to the counties pursuant to section 76-78, the Court nevertheless argued that requiring “positions” to be created and funded by the government, as argued by WMI, would allow the government to avoid civil service coverage simply by reducing the size of their official payroll, which would similarly render section 76-77 a nullity. Id., 85 Haw. at 75 and n. 13, 937 P.2d at 411.
29. 85 Haw. at 74, 937 P.2d at 410.
30. 85 Haw. at 75, 937 P.2d at 411.
31. 85 Haw. at 77, 937 P.2d at 413.
32. 85 Haw. at 78, 937 P.2d at 414. The Court further noted that under State of Hawai’i Organization of Police Officers (SHOPO) v. Society of Professional Journalists, 83 Haw. 378, 927 P.2d 386 (1996), collective bargaining statutes do not require negotiation over topics that are contrary to duly enacted laws. Because the Court had already held in Konno that the County of Hawaii’s privatization effort was contrary to state civil service laws, that effort was outside the scope of negotiable topics, and the County was therefore not required to bargain over privatization. Id.
33. See part VI of this memorandum for a more in-depth discussion of this issue.
34. 20 Am.Jur.2d, Courts §147 (1995) (footnote omitted). Unless there are strong countervailing reasons, the doctrine provides that like cases should be decided alike as a matter of judicial policy to preserve continuity and stability in the law. While stare decisis is not a binding legal rule to be followed blindly, courts are especially reluctant to deviate from that policy where one or more precedents have been treated as authoritative for a long period of time. Id., §§149, 150; see also State v. Magoon, 75 Haw. 164, 186, 858 P.2d 712, reconsideration denied, 75 Haw. 580, 861 P.2d 735 (1993) (“Stare decisis relates to ‘the effect of legal propositions announced in prior adjudications upon subsequent actions which involve similar questions between strangers to the proceedings in which the adjudications were made.’”) (quoting State v. Hawaiian Dredging Co., 48 Haw. 152, 397 P.2d 593 (1964); emphasis in original); Robinson v. Ariyoshi, 65 Haw. 641, 653 n. 10, 658 P.2d 287 (1982), reconsideration denied, 66 Haw. 528, 861 P.2d 735 (1983).
35. 20 Am.Jur.2d, Courts §155 (1995) (footnotes omitted).
36. 70 Haw. 120, 122-123, 763 P.2d 567 (1988) (citation omitted).
37. Edwin Tanji and Hugh Clark, “Hawaii County Sues to Protect Contracts,” The Honolulu Advertiser, May 20, 1997, pp. A1, A5.
38. Konno, 85 Haw. at 74, 937 P.2d at 410.
39. “Hospital Contract Prompts Union Suit,” The Honolulu Advertiser, May 23, 1997, pp. B1, B4.

40. William Kresnak, “Mayors, Union Duel Over Policy,” The Honolulu Advertiser, June 1, 1997, pp. A1, A20.
41. *See, e.g.*, Karen Peterson, “Librarian Halts Plan to Buy New Books,” The Honolulu Advertiser, Sept. 8, 1997, pp. B1, B4; “Hawaii Embarks on Health Care QUEST,” State Legislatures, vol. 19, no. 10 (Oct. 1993), p. 6.
42. *See* Part I of Act 160, Session Laws of Hawaii 1997, approved by the Governor on June 16, 1997.
43. *See* Act 190, Session Laws of Hawaii 1997, approved by the Governor on June 16, 1997. Section 2 of that Act, codified as chapter 103F, *Hawaii Revised Statutes*, now provides for purchases of health and human services, while section 3, codified as chapter 42F, provides for grants and subsidies, replacing chapter 42D, *Hawaii Revised Statutes* (grants, subsidies, and purchases of services).
44. *See, e.g.*, the following studies and audits by the Hawaii Auditor:
- A Study of the Department of Health’s Administration of Contracts for Purchases of Service for Persons with Developmental Disabilities (Honolulu: Report No. 92-32, December 1992);
  - Audit of the Administration of Personal Services Contracts in the Department of Education (Honolulu: Report No. 94-27, December 1994);
  - Audit of State Contracting for Professional and Technical Services (Honolulu: Report No. 95-29, November 1995);
  - Audit of the Administration of the Purchase of Service System (Honolulu: Report No. 96-1, January 1996); and
  - Follow-Up Audit of the Administration of Personal Services Contracts of the Department of Education (Honolulu: Report No. 96-15, October 1996).
45. Kresnak, *supra* note 40, at A20.
46. 85 Haw. 431, 946 P.2d 1 (1997).
47. *Id.*, 85 Haw. at 456 n. 23; *see also* Ken Kobayashi, “Librarian Faulted on Computer Contract,” The Honolulu Advertiser, August 23, 1997, pp. A1, A5.
48. *See* note 25, *supra*, for the text of this section.
49. Richardson v. City and County of Honolulu, 76 Haw. 46, 54-55, 868 P.2d 1193, *reconsideration denied*, 76 Haw. 247, 871 P.2d 795 (1994), *quoting* State v. Spencer, 68 Haw. 622, 624, 725 P.2d 799, 800 (1986); *see also* International Savings and Loan Assn. v. Wiig, 82 Haw. 197, 200, 921 P.2d 117 (1996); *accord*, Sutherland Stat. Const. §51.02 (5<sup>th</sup> ed.) (1992 rev.) at 121 (“Where a conflict exists the more specific statute controls over the more general one.”) (footnote omitted).
50. Section 46-85, *Hawaii Revised Statutes* (emphasis added).
51. Sutherland Stat. Const. §51.02 (5<sup>th</sup> ed.) (1992 revision) at 121.
52. Section 46-85 was enacted by Act 237, Session Laws of Hawaii 1983, which became effective on June 9, 1983. While section 76-77 has been amended numerous times, the latest in 1992, the particular provision of that section at issue, subsection (10) of section 76-77, was originally enacted by section 93(j) of Act 274, Session Laws of Hawaii 1954, effective July 1, 1955 (Laws of the Territory of Hawaii).
53. The Court’s failure to give effect to the phrase “[a]ny other law to the contrary notwithstanding” in section 46-85 is at odds with its previous broad interpretation of similar statutory language, albeit in the context of a criminal case. *See* State v. Dannenberg, 74 Haw. 75, 837 P.2d 776, *reconsideration denied*, \_\_\_ Haw. \_\_\_,

- 843 P.2d 144 (1992) (phrase “[n]otwithstanding any other law to the contrary” in section 712-1200, *Hawaii Revised Statutes*, held to remove trial court’s power to grant deferred acceptance of guilty pleas in prostitution cases, following *State v. Rice*, 66 Haw. 101, 657 P.2d 1026 (1983), since exercising that power to avoid conviction would allow trial court to avoid sentencing scheme created by Legislature specifically for prostitution cases).
54. Attorney General Opinion No. 97-06, Sept. 2, 1997, at 16 - 17.
55. Sutherland Stat. Const., *supra* note 51, at 121 (footnote omitted); “[i]t has been held where two statutes deal with the same subject matter, the more recent enactment prevails as the latest expression of legislative will. If there is an irreconcilable conflict between the new provision and the prior statutes, the new provision will control as it is the later expression of the legislature.” *Id.* at 122 (footnotes omitted).
56. *Konno*, 85 Haw. at 75, 937 P.2d at 411.
57. Ronald A. Cass, “Privatization: Politics, Law, and Theory,” 71 *Marquette L. Rev.* 449, 499 (footnotes omitted; emphasis in original).
58. *Id.*, 71 *Marquette L. Rev.* at 499 n. 227.
59. *Id.*, 71 *Marquette L. Rev.* at 499 - 500 (footnotes omitted; emphasis in original). *See also* Jack M. Sabatino, “Privatization and Punitives: Should Government Contractors Share the Sovereign’s Immunities from Exemplary Damages?”, 58 *Ohio State L.J.* 175, 184 (1997) (“Given the longstanding role that American government undeniably plays in so many subject areas today, it is difficult to draw clear or useful distinctions between so-called ‘traditional’ or ‘core’ governmental functions and ‘nontraditional’ or ‘peripheral’ ones.”) (citing in part *Garcia v. San Antonio Metro. Transit Authority*, 479 U.S. 528, 539 - 547 (1985) (repudiating analysis that would attempt, for purposes of defining the scope of residual state powers under the Tenth Amendment, to distinguish “integral” or “traditional” state governmental functions from “nonintegral” or “nontraditional” ones)).
60. Clayton P. Gillette, “Who Puts the Public in the Public Good?: A Comment on Cass,” 71 *Marquette L. Rev.* 534, 535 - 536 (1988) (footnotes omitted). Professor Gillette further argued that the selection of one sector — whether public or private — over the other to perform a particular function may simply reflect the level of satisfaction of the performance of the last sector assigned to perform that function:
- Indeed, the swings between privatization and intervention may constitute on a more global scale what Albert Hirschman has described as the “shifting involvements” of individuals between public and private activity as they find disappointment with their current state. In the late nineteenth century, social shifts away from public funding of new enterprises, such as railroads, followed periods in which unkept promises of those who benefited from government largesse generated substantial tax burdens for the taxpaying public. The subsequent *laissez faire* period gave way to renewed calls for government intervention when private markets appeared incapable of self-regulation and staving off economic depression. Current calls for privatization emerge from concern that public regulation has unduly catered to the interests of the regulated and interfered with market incentives. These ideological shifts suggest that there is little sacrosanct in the allocation of specific functions to the public or private sector. Instead, our selection of one sector rather than another may reflect our level of satisfaction (or dissatisfaction) with the performance of the last actor assigned to the task. *Id.* at 536 (footnotes omitted).
61. 90 Wash.2d 698, 585 P.2d 474 (1978) (*en banc*), cited in *Konno*, 85 Haw. 61, 69, 937 P.2d at 405.
62. Timothy P. Dowling, “Note: State Civil Service Law — Civil Service Restrictions on Contracting Out by State Agencies,” 55 *Wash. L. Rev.* 419, 422 (1980).

63. See *id.*, 55 Wash. L. Rev. at 424 - 428.
64. 55 Wash. L. Rev. at 424 (footnotes omitted).
65. CARL Corporation v. State of Hawai'i Department of Education, *supra* note 46, 85 Haw. at 456, *citing* Sen. Stand. Comm. Rep. No. S8-93, in 1993 Senate Journal, at 39.
66. Section 103D-304(a), *Hawaii Revised Statutes* (“procurement of professional services”). Subsection (c) of that section also requires the head of the purchasing agency to designate a review committee, consisting of a minimum of three employees from the agency or from another governmental body, having sufficient education, training, and licenses or credentials, to review and evaluate all submissions and prepare a list of qualified persons. Subsection (d) also provides for the establishment of a screening committee to evaluate the statements of qualification and performance data of persons on the list prepared pursuant to subsection (c). Subsection (e) further requires the head of the purchasing agency to evaluate summaries of qualifications of each of the persons provided by the screening committee, conduct additional discussions with them, rank them in order of preference, and negotiate a contract with the first person that is “fair and reasonable, established in writing, and based upon the estimated value, scope, complexity, and nature of the services to be rendered.” See also section 103D-209, *Hawaii Revised Statutes*, allowing any governmental body of the State of Hawaii, except as provided in section 28-8.3 (“employment of attorneys”), to act as a purchasing agency and contract on its own behalf for professional services subject to chapter 103D and rules adopted by the policy office.
67. Professional Engineers v. DOT, 63 Cal.Rptr.2d 467, 480 (Cal. 1997).
68. California State Employees Assn. v. Williams, 7 Cal.App.3d 390, 396 n. 3, 86 Cal.Rptr. 305, 309 n. 3 (1970). It has been argued that the California Supreme Court has found it necessary to “engage in logical contortions to avoid applying the nature of the services test, which perhaps indicates it has recognized *sub silentio* that the test can produce grossly unjust results.” Dowling, 55 Wash. L. Rev. 419, 439 n. 102 (1980).
69. The nature of the services test in California, which, unlike Hawaii law, is predicated on case law interpreting a California constitutional provision, was recently upheld by the California Supreme Court in Professional Engineers v. DOT, *supra* n. 67. See notes 14 to 23 and accompanying text in part VIII of this memorandum for a more in depth review of that case.
70. 9 Cal.2d 126, 69 P.2d 985 (Cal. 1937).
71. Hawaii Attorney General Opinion No. 97-06, Sept. 2, 1997, at 6.
72. “Suit Seeks to Clarify Privatization,” The Honolulu Advertiser, Sept. 30, 1997, p. B2.
73. Gray v. Administrative Director of the Court, 84 Haw. 138, 144 n. 9, 931 P.2d 580 (1997), *quoting* State v. Dannenberg, 74 Haw. 75, 83, 837 P.2d 776, 780, *reconsideration denied*, \_\_\_ Haw. \_\_\_, 843 P.2d 144 (1992).

## PART III. PRIVATIZATION

### A. Generally

In Konno, the Hawaii Supreme Court defined the term “privatization” fairly broadly, noting that only one type of privatization — that of “contracting out” — was at issue in that case:

The term “privatization” is a broad term that has been used to describe a wide range of activity. “Privatization refers to the shift from government provision of functions and services to provision by the private sector.” In countries other than the United States, privatization usually refers to the selling of government owned and operated businesses to private enterprise. However, another type of privatization, which is at issue in the present dispute, is known as “contracting out.” This activity can be defined as “the transfer by governmental entities of responsibility for the performance of desired functions, mostly of a personal service (i.e. administrative) nature, to private institutions” or “the replacement of members of [a] bargaining unit by the employees of an independent contractor performing the same work under similar conditions of employment.”<sup>1</sup>

In addition, the Court outlined the policies underlying privatization as follows:

The purported policy behind privatization is to increase governmental efficiency. Services can often be provided more efficiently by private entities than by civil servants. The productivity of civil servants can be enhanced in that the threat of privatization serves as an incentive to improve performance. Privatization may also give public employers increased leverage in labor negotiations, thus avoiding costly labor disputes.<sup>2</sup>

The idea of privatization — delegating government functions and the fulfillment of public needs to private vendors — is not new; federal, state, and local governments throughout the history of the United States have often hired outside contractors to perform certain public functions. States have long privatized a number of government functions, including human services, employment and job training, transportation, and recreational and correctional facilities. Local governments have also outsourced such functions as public works, building security, health care, and a number of other functions.<sup>3</sup> “As of mid-1987, there were some twenty-eight thousand recorded instances of public services being provided by private firms under contract to local governments. Virtually every function of local government has been delegated to the private sector at some time, in some city.”<sup>4</sup>

Local governments “have probably the widest and best-known range of services under contract, probably because they provide a wide variety of services that directly affect citizens and that are well suited to contracting.”<sup>5</sup> The City and County of Honolulu is no exception. In 1983, the city administration contracted Arthur Young & Company to conduct a feasibility study on privatizing city services.<sup>6</sup> The study reviewed all services performed by city workers and selected five for an in-depth analysis of their functions, costs, and comparative costs provided by private contractors. The study found that in some areas, such as the provision of certain health services and cesspool maintenance and treatment, the city’s costs and fees were lower than private entities bidding on the same services, while the city’s costs were higher than the private sector’s in such areas as certain custodial services and golf course management and operations.<sup>7</sup> The study also noted that contracting out appeared



to be most successful where government agencies had followed a structured approach that consisted of four basic steps:

- Identify all commercial and industrial activities and select potential opportunities;
- Prepare a performance-oriented Statement of Work describing service requirements and work to be performed;
- Perform a comparison study of in-house versus contractor costs; and
- Monitor contract activity.<sup>8</sup>

Moreover, the study noted that it was not enough to simply request bids, award a contract, and assume that service would be provided. Rather, “[c]ontrol and supervision are key elements of the successful contract operation”:

Government administrators need a method for assuring that: 1) contracting out is the most efficient and effective alternative; and 2) they receive the quality and quantity of services desired. The structured approach offers that assurance. It differs from other contracting strategies in that it focuses on the total contracting process and considers all the steps that maximize contract performance and accountability.

Even if a contract is not entered into, the feasibility study provides an important measure of how well the municipality is performing in comparison to private industry and where productivity improvements can be made.<sup>9</sup>

State-level privatization has also “increased dramatically” in recent years, primarily in the areas of mental health, social services, and transportation, and, to a somewhat lesser extent, corrections, administrative and health services, and health care, as determined by a 1993 Council of State Governments survey of all fifty states. Cost savings was the reason most often given for the decision to privatize in most service areas. Other reasons included increased flexibility, less red tape, lack of agency expertise or personnel, speedy implementation, high quality service. Contracting out was “overwhelmingly the privatization technique most often employed by states, accounting for about 78 percent of all state privatization activity.”<sup>10</sup> Privatization has also been accompanied by a growing interest in managerial reform: “Many governments have also embraced the quality revolution that transformed American business during the 1980s, instituting a mission-driven process of continuous improvement. In short, governments are seeking ways to do more with less.”<sup>11</sup>

While privatization is one answer, however, it is not the *only* answer: “Privatization is simply the wrong starting point for a discussion of the role of government. Services can be contracted out or turned over to the private sector. But *governance* cannot. We can privatize discrete steering functions, but not the overall process of governance.”<sup>12</sup> Nor is privatization always appropriate in all markets; rather, it depends on a number of factors to be successful:

Privatization works best where markets are lively, where information is abundant, where decisions are not irretrievable, and where externalities are limited. It works worst where externalities and monopolies are abundant, where competition is limited, and where efficiency

is not the main public interest. Privatization is no magic cure that fits all situations; its advocates rarely have tried to match the solution to the problems it best solves. Finding the right balance between public and private power is deceptively difficult.<sup>13</sup>

Nevertheless, the trend is toward increased state and local government privatization. Over eighty-five percent of the state auditors, budget directors, and comptrollers responding to the Council of State Government's 1993 fifty-state survey predicted increased privatization in the next five years. State privatization case studies, including both successes and failures, produced the following lessons:

- (1) State managers should address employee displacement issues before privatization of state services or programs;
- (2) The existence of competition is probably the most important factor for successful privatization;
- (3) In many if not most cases, private companies can provide services at lower costs without lowering wages; and
- (4) States should establish statewide policies and procedures for regularly examining potential privatization candidates.<sup>14</sup>

The perception of what one considers a "success" or a "failure" may differ depending on one's point of view. For example, some might consider privatization to be a success if it resulted in cost savings, while others might look at the same results and deem it a failure because it resulted in loss of control over the service. Noting these difficulties in characterization, the Colorado State Auditor has identified the following characteristics that contribute to the success or failure of privatization efforts:

- The existence of multiple private providers improves the chances of successful privatization. Competition among providers encourages efficiency and effectiveness.
- A thorough contract monitoring system improves the chances of success.
- The chances for success improve if the agency can specify exactly what it wants from the private sector and anticipates problems. Agencies that can easily measure what they want from the contractor are more likely to succeed with privatization.
- Agencies must accurately estimate the full costs of providing a service. Hidden costs for the agency or provider may result in unrealistic contract bids and contract failure.
- Agency executives must be open to the idea of privatization.
- The less complex the service being privatized, the more likely are its chances for success. For example, privatizing the entire Department of Health would be less likely to succeed due to the Department's large range of activities. In contrast,

privatizing a food service operation in a state building would be less complex and have a greater chance for success.<sup>15</sup>

## B. Pros and Cons

1. **Advantages.** Generally, proponents of privatization argue the following:
  - ***Cost saving measure.*** Private enterprises can deliver certain services more efficiently than government workers. Private sector managers have a stronger incentive to perform. Privatization improves the use of scarce resources by reducing the costs of providing public services, and enables government to meet responsibilities that might otherwise be abandoned because they are too costly.
  - ***Greater flexibility.*** Experimental or temporary programs can be arranged with the private sector. Privatization offers new options for financing expensive construction projects. Privatization may help to meet demands beyond current government capacity, and allows flexibility in adjusting the size of a program in response to changing demand and availability of funds.
  - ***Greater choice of providers.*** Alternative service delivery approaches, such as vouchers and non-exclusive franchises, give citizens a greater choice regarding provider, location, and level of service. Clients usually have fewer options if services are provided only by public facilities.
  - ***Greater efficiency.*** Privatization produces better management of permanent programs by introducing sophisticated cost-cutting techniques to public services. Project completion times may also be reduced. Contracting may permit a quicker response to new needs and facilitate experimentation with new programs.
  - ***Greater productivity.*** Privatization is a positive management and productivity improvement tool. Public administrators are freed from managing day-to-day operations and have more time to plan future programs.
  - ***Lower initial costs.*** Assuming that private vendors have made investments in start-up costs, contracting out often allows rapid initiation of new projects without large initial outlays for equipment, facilities, and personnel training.
  - ***Lower unit costs.*** Large multi-site private firms can take advantage of greater economies of scale, such as central purchasing of supplies and equipment. They can more easily justify new technical equipment and management information systems, and development costs can be divided among jurisdictions served.

- **Greater risk sharing.** Private and public sectors share risks, including cost overruns.
- **Increased services.** Privatization may provide services that are not available from government, since agencies do not always have the resources or technical expertise to provide those services.
- **Specialized skills.** Contracts for professional services may be used to obtain specialized skills that are unavailable within government, or would cost too much to recruit or hire new personnel.
- **Greater quality at lower price.** Taxpayers save money while the private sector pays less for employee benefits, fewer holidays, etc.
- **More jobs.** Privatization provides more jobs in the private sector. Private businesses can expand into areas formerly controlled by government, and may receive tax breaks for providing public services.
- **Less red tape.** Private businesses may not need to follow restrictive government procedures and purchasing regulations. It is easier for private vendors to make quick investments in new technology and improve workforce productivity.
- **Increased tax revenues.** Private businesses are subject to taxes and generate revenues for state and local governments.
- **Competitive pressure.** Having private vendors do a portion of the government's work can exert a beneficial competitive influence on those public agencies that perform the remainder of that work, encouraging public agencies to become more efficient. Competition tends to motivate competing organizations to lower their prices and improve service quality.
- **Ideology.** Privatization reduces the size of "big government". The role of government is changed from that of a primary producer of goods and services to that of governing.

2. **Disadvantages.** Critics of privatization argue the following:

- **Reduced service quality.** Government loses control over service delivery, which affects the quality of services. With high financial stakes, there is a greater temptation for profit-making organizations to do whatever is necessary to maximize profits, including economizing on quality to reduce costs. Contractors may be tempted to "cut corners" by hiring inexperienced staff, providing inadequate supervision, or ignoring contract requirements.

- **Higher costs.** Contracting out is more expensive than government delivery of services due to corruption, unemployment payments to laid off employees, lack of competition, the low marginal cost of expanding government, and no incentive for cost savings in the case of cost-plus-fixed-fee contracts. Government provides services at a lower cost because it does not need to make a profit, pay taxes, or carry as much liability insurance as private vendors. The original bid may be “lowballed” to obtain the contract, while raising prices later.
- **Illusory cost savings.** The financial benefits of privatization are illusory or exaggerated. Hidden costs include contract preparation, administration, and monitoring, which are not usually included in contracting out budgets.
- **Increased service interruptions.** Private vendors are more apt to interrupt services due to declines in profits or labor strikes. Contractors can also go bankrupt or cease operations, unlike government.
- **Loss of flexibility.** Since contracts must be written in very specific terms, contracting out may result in less flexibility to public officials who are unable to respond to unforeseen circumstances, since they may be locked out by contract requirements.
- **Loss of capital.** Government already has a significant capital investment; under privatization, the benefits of owning equipment may be lost.
- **Less accountability** by the government to its citizens. When citizens complain about a contracted service, government is limited in its response and can often do little more than complain to the contractor or enter into costly contract renegotiations or termination proceedings.
- **Less control.** Government may lose a degree of control over the quantity and quality of final products and services due to difficulties in writing and enforcing performance contracts.
- **Dual system.** Privatization creates a dual system of government, one in which workers are subject to strict public personnel regulations and pay and benefit schedules, the other with workers subject only to rules established by their private employers.
- **Potential corruption.** When large sums of money are involved, as in many contracts, there are greater temptations to engage in such illegal activities as bribery, kickbacks, payoffs, and fraud.
- **Potential discrimination.** Certain population groups may be neglected, and private companies may avoid disadvantaged or other clients who are

expensive to serve or for whom securing payment for services is likely to be difficult.

- ***Displaces public employees.*** Government employees may lose their jobs or have their careers disrupted. Declining morale and productivity may result among government workers. Civil service policies and merit principles are weakened.
- ***Necessity for competition.*** Lower costs may be available through contracting only when there is sufficient competition among potential service providers. If only one or very few suppliers are available, the advantage of contracting may be lost.
- ***Weakened policies and values.*** Important values, including safety, quality, and integrity will be compromised when government services are entrusted to profit-maximizing private vendors. While government may enforce public policy objectives, such as equal opportunity advancement, privatization may make some policy objectives more difficult to enforce.<sup>16</sup>

### C. Alternative Approaches to Service Delivery

In addition to contracting out and purchase of service contracts, in which the government contracts with a for-profit or nonprofit private firm to have all, or a portion, of a service or goods to be provided by the firm, other alternative approaches for the delivery of services include the following:

- (1) ***Franchises.*** Government awards either an exclusive or nonexclusive franchise to private firms to provide a service in a certain geographic area; the citizen directly pays the firm for the service;
- (2) ***Grants and subsidies.*** Government makes a financial or in-kind contribution to a private firm or individual to encourage them to provide a service so that the government does not have to provide it;
- (3) ***Vouchers.*** Government provides vouchers to citizens needing a service; citizens may choose the organization from which to purchase goods or services. Citizens give the voucher to the organization, which obtains government reimbursement;
- (4) ***Volunteers.*** Individuals provide free assistance to government agencies. Laws may be necessary to limit volunteers' liability;
- (5) ***Self-help.*** Government encourages individuals or organizations to undertake activities that government has previously undertaken for their own benefit;

- (6) ***Use of regulatory and taxing authority.*** Government uses its authority to encourage the private sector to provide a service, or reduce the need for public services;
- (7) ***Load or service shedding (divestiture).*** Government gives up responsibility for an activity, but works with a private organization who is willing to take over responsibility for the activity;
- (8) ***Demarketing.*** Government seeks to reduce the need and demand for a government service through marketing techniques;
- (9) ***Temporary assistance.*** Private firms loan personnel, facilities, or equipment to government on a temporary basis;
- (10) ***User fees.*** Government imposes a fee or charge on users of a service based on their amount of use of the government-supplied activity, thereby placing the fiscal burden on users of the activity;
- (11) ***Joint public-private ventures.*** Examples of public-private partnerships that allow governments to benefit from leading edge solutions developed by specialized private sector groups; avoid incurring large debts, obtaining needed technical expertise, or carrying project risks; and reduce servicing costs, include the following:<sup>17</sup>
  - ***Strategic sourcing relationships.*** In this type of relationship, government transfers internal business systems, technology applications, or entire business processes to an external resource in order to gain a strategic advantage. Governments benefit through reduced costs and improved efficiencies. Quality is managed through service level agreements, which often include performance targets and penalties if targets are not met.
  - ***Value-based arrangements.*** Governments faced with budgetary constraints may consider building relationships with consulting organizations and developing innovative financial arrangements based on the delivery of a key outcome or identifiable value, helping government achieve objectives without conventional budget demands. Value-based arrangements allow governments and consultants to share project risks and rewards.
  - ***“Build, own, operate” arrangements.*** These arrangements allow governments to avoid substantial capital investments by providing that a private contractor incurs the costs of building or developing an asset, owns the asset, and receives service fees for operating the asset. Alternatively, the asset may be transferred to the government at a future date.<sup>18</sup>
- (12) ***Internal productivity improvements.*** Government takes internal actions to make better use of its existing resources, including the use of new technologies, employee motivation programs, changes in work methods, and organizational changes;

- (13) ***Cooperation, consolidation, or contracting with other government agencies (“intergovernmental contracting” or “service sharing”).*** Brings efficiencies by taking advantage of economies of scale and specialization;
- (14) ***Formation of quasi-governmental agencies.*** E.g., special water and sewer districts, transportation authorities, and park districts;
- (15) ***Reduction of service levels.*** Reduce costs by reducing the amount of service provided, such as reducing the frequency of garbage collection, reducing library hours, etc.; and
- (16) ***Increase revenues.*** Rather than reducing service levels or expenditures, government can seek to increase revenues as taxes, fees, and charges.<sup>19</sup>

#### **D. Contracting Out**

As discussed in the previous section, privatization can appear in many forms, ranging from “load shedding” an existing government operation, in which the means of financing and delivering a service is turned over entirely to the public sector, to the government providing “vouchers” to citizens who need a service, who are then free to select any private or public organization from which to purchase that service, such as a day care provider, which then obtains reimbursement from the government. However, the most common and widely used form of privatization — and the type used by the County of Hawaii in Konno — is that of “contracting out” government functions to the private sector, whether profit or nonprofit firms, to provide goods or deliver services. The government may contract to have all or only a portion of the service provided, and may retain control over the activity contracted out.<sup>20</sup>

There are a number of variations in contracting. For example, governments have attempted to stimulate competition by splitting a jurisdiction into districts and having private vendors compete for each district, thereby allowing a greater number of smaller sized companies to compete. Some governments have divided the work into segments, giving some work to the public agency and some to a private contractor. One benefit of splitting the market is that governments may be able to reduce their vulnerability to job actions by the private entity’s personnel or to the contractor’s financial failure. Retaining some delivery capability in a public agency allows the government to intervene to provide the service if the contractor is no longer able to do so.<sup>21</sup>

In addition, there are a number of variations in the forms of contracts. These include incentives to contractors, such as performance and incentive contracting, in which the contract specifies the performance levels or provides rewards for meeting or exceeding certain performance targets, or penalties for failing to meet those targets. These provisions allow the government to hold the contractor more accountable for performance in such areas as service quality, quantity, and timeliness. Local governments may also use these practices internally by establishing performance targets and by linking compensation of government employees to performance against those targets. While these practices are gaining wider acceptance in government, however, their use is more



widespread in the private sector where performance measurement may be easier and there are fewer legal obstacles, such as civil service rules.<sup>22</sup>

Private contractors generally save money through three techniques. First, they have more flexibility than government agencies because they are not bound by government rules and civil service requirements. They have more freedom to hire and fire employees, use incentive pay systems, employ more part-time workers, have less absenteeism, and use employees for more than one task. Second, they tend to pay lower wages than some government agencies in certain areas. Finally, private vendors pay their employees substantially lower fringe benefits, especially retirement benefits: “The difference in fringe benefits is ‘the largest difference between the government and the private contractor,’ according to the National Commission for Employment Policy.”<sup>23</sup>

Thus, the reduced costs associated with contracting out may not necessarily result from increased efficiency, but rather may come “when private contractors exploit labor and/or provide for few, if any, health and retirement benefits and shift financial responsibility on to society at large.”<sup>24</sup> In deciding whether to contract out government services, moreover, not only cost efficiency but other factors must be considered in determining whether to contract out, such as accountability, distribution, and revenue considerations. In addition, many empirical cost studies compare the cost of private firms under contract with that of government agencies, overlooking the fact that they are using biased samples, namely, that the private firm cost data apply to cases in which the private firm was able to offer the government service at a lower cost than in-house providers; otherwise, they would not have been awarded a contract: “In a sense, the selection process assures that ex post facto cost data show contract costs to be below in-house costs.”<sup>25</sup>

Before government implements privatization by contracting out, the following four conditions should be satisfied:

- The government unit is under serious fiscal stress;
- Significant monetary savings are achievable by contracting, with no reduction in quality or level of service;
- Contracting is politically feasible, in view of the power of the service constituency — the affected employees and other beneficiaries; and
- Some precipitating event makes it impossible to continue with the status quo.<sup>26</sup>

It has been argued that contracting out presents a challenge to the role of government: “Contracting out is basically a challenge to the American way of governing. While the process itself is not innovative, it does reflect a basic shift in the definition of the role of government.”<sup>27</sup> However, this view distorts the role played by private entities performing government functions. Private contractors performing government functions may be relied on for *policy execution* but not *policymaking*: “Relying on contractors to deliver services is one thing; relying on them to make government policy is another”<sup>28</sup>:

It makes sense to put the delivery of many public services in private hands (whether for-profit or nonprofit), if by doing so a government can get more effectiveness, efficiency, equity, or accountability. But we should not mistake this for some grand ideology of privatizing government. When governments contract with private businesses, both conservatives and liberals often talk as if they are shifting a fundamental public responsibility to the private sector. This is nonsense: they are shifting the delivery of services, not the responsibility for services.<sup>29</sup>

In determining whether to contract out government services, the presence or absence of competition is often more important than which entity — government or private — is performing a particular function:

The evidence shows that what matters most is not who performs government services but how they are performed. Policy analyst John D. Donahue observed that “*public versus private* matters, but *competitive versus noncompetitive* usually matters more.” One study, for example, found, that in communities where there was competition to provide electric service, costs were reduced by about 11 percent, regardless of whether the service provider was government or a private concern. Private monopolies are just as subject to inefficiencies as is the government monopoly. It is the presence of competition, not the locus of power, that matters.<sup>30</sup>

However, competition may not always be easy to develop or to promote. Sometimes there are an insufficient number of potential contractors available to create a competitive bidding process. For some services, private entities may not be interested in bidding on jobs in small jurisdictions, where the potential profits and contract size would be small. Many contractors also complain about government bureaucracy and the slow pace with which governments often pay private vendors. For example, the internal checks and balances that have been established to assure that fair value is received in purchases and protect against corruption in contracting may result in a long delay in securing bids, ordering goods or services, and paying bills. After requests for proposals are prepared and sent to approved bidders, sealed bids are received and reviewed, contracts are awarded, purchase orders are prepared and issued, and goods or services are received, various agencies must check for satisfactory delivery or performance of those goods and services, payment is authorized after an invoice is received and cross-checked, and, many months later, a check for payment is “grudgingly” issued: “The result of all this red tape is that many potential vendors refuse to do business with the city, while those who do deal with it have to charge higher prices to make up for their additional costs and trouble. Thus, a strategy intended to increase competition and reduce the cost of goods has precisely the opposite effect of reducing competition and increasing costs.”<sup>31</sup> In addition, competition is costly to create and sustain:

To manage a contract competition, government officials first must define precisely what they want to buy. Contract solicitations must be detailed and specific, for they shape the transaction that is to occur. Government officials must advertise the solicitation and review the bids, resolve technical disputes among bidders and between government officials and potential contractors, and oversee the contract once it is awarded to ensure both the cost and quality of the services provided. Perhaps most important, they must ensure that the winning contractor does not grow into a monopolist, to which the government would find itself captive and from which the promised efficiencies might soon evaporate. Critics argue, for example,

that privately managed mass transit systems are frequently monopolies that share the same limited incentives to control costs as governments.<sup>32</sup>

## E. Managed Competition and Other Issues

***Managed competition.***<sup>33</sup> Some local governments have recently begun to provide direct competition between the government's own agency and private firms, in which the public agency bids on jobs in direct competition with those in private sector bidders.<sup>34</sup> The government may award the contract to either the bidding agency or the private bidder:

Phoenix requires its municipal workers to bid against private contractors for selected local services. In Rochester, New York, city officials decided not to sign a contract with a private garbage collection firm after city employees proposed to reduce their crew size from four to three, which made their costs considerably cheaper than the private contractor's. Workers at a Los Angeles county health clinic formed a private company and bid successfully for a county contract. In Newark, New Jersey, information the city gained from the bidding process for a refuse collection contract helped improve the productivity of city refuse workers. Analysts contend that such competition might produce the biggest benefits of all in local education.<sup>35</sup>

This form of direct competition, known as "*managed competition*", "*competitive contracting*", "*contracting in*", and "*public-private competition*", has helped a number of agencies in various cities to streamline the delivery of government services when faced with the "specter of private competition staring them in the face." Encouraging government agencies to adopt cutting-edge and cost-efficient practices of private contractors helps to foster a competitive climate; "[t]he resulting competition has been successful in producing operating efficiencies and costs that are remarkably low by national standards."<sup>36</sup> While some view the threat of privatization as an underhanded management tool to end labor-management disputes,<sup>37</sup> union leaders "increasingly view managed competition as preferable to the inevitable job losses resulting from outright privatization."<sup>38</sup>

Competitive contracting with the private sector represents a shift in organizational thinking and, as such, is often seen as threatening or disruptive to public employees. Nevertheless, it has been argued that public sector agencies need not assume that they will always lose out to the private sector, which has learned to be competitive and efficient. For example, in cities such as Phoenix, Indianapolis, and Charlotte, North Carolina:

... public service agencies win 30 to 40 percent of the services subjected to competition. the lesson is simple: The private sector can be, but is not necessarily, better. Once public sector managers and employees are granted the freedom to operate in the manner they know to be responsive to demand, using procedures they establish and resources they deem appropriate, they often compete as well as the private sector.

In fact, public sector agencies bring a number of inherent advantages to the competition process.... Among those advantages are existing expertise in the tasks and skills to be performed, thorough knowledge of the client's needs, existing physical plants that are

often ideally situated, exemption from taxes and no requirement to generate a profit since there are no shareholders to please.<sup>39</sup>

Before a public agency can change from its present form to a competitive enterprise, however, there is a need for a “strong, long-term organizational and political commitment to cost-effective, high-quality public services”; making the transition also requires specific training and assistance to affected units, increased employee involvement, and other steps, including:

- Establishment of new group hierarchies and relationships;
- A guarantee that sufficient time will be allotted for development of alternative business methods;
- Management training in aspects like debt borrowing, tax filing and cash flow analysis in those instances when an agency chooses to incorporate outside of the governmental structure;
- Identification of customers and their values;
- Training on how to assess the competition; and
- Exposure to new technologies.<sup>40</sup>

Public employee union leaders in Indianapolis, in which the city and its union recently earned an American Excellence Award from the Ford Foundation for their joint participation in a competition program, identified the following key factors in that program, which resulted in increased communication, better management, worker empowerment, and incentives rather than threats:

- No layoffs;
- Institution of incentive pay;
- Abolishment of a wage freeze;
- Reclassification and upgrading of city jobs;
- Empowerment programs for city workers;
- The release or firing of ineffective supervisors, as well as the retention of the better ones; and
- A system that encourages city workers to communicate directly with city leaders.<sup>41</sup>

While the American Federation of State, County and Municipal Employees (AFSCME) has not officially endorsed managed competition, it provides as official policy that “when the only other alternative is certain job loss, we must ensure that the rules and procedures government competitive

bidding are impartial and fair, that decisions are based on sound statistical analysis, and that public employees are treated as equals in the competition.”<sup>42</sup> AFSCME encourages union leaders and agency managers and to work together in submitting public-sector bids for services.<sup>43</sup>

When in-house units are given the opportunity to bid on contracts, however, “[m]ore often than not, the field tends to be tilted against the private sector in these competitions. When setting up a public-private competition program, public officials need to take great pains to create a level playing field between in-house public units and outside private providers.”<sup>44</sup> The following three major changes are needed to achieve “competitive neutrality”:

- Determining the real in-house costs of delivering the public service. Some mistakes committed by government agencies are failing to determine the true fully allocated costs of in-house service delivery, using unfair cost comparisons (such as comparing the higher level of service from a contractor with the public sector’s expenditures for lower quality services), and failing to include instances of cross-subsidization by units that are not in contract with the private sector.
- Removing all special privileges and tax and regulatory exemptions now enjoyed by public providers that give them an unfair advantage over private firms. Some governments exempt in-house units from submitting sealed, blind bids, while others allow in-house units to prepare bids after being shown the best bids from the private sector.
- Providing public units with much greater flexibility on procurement, personnel, and remuneration so they can effectively compete with the private sector. Government regulations and bureaucracy may decrease an in-house unit’s productivity and competitiveness with private firms: “For instance, a road maintenance crew in Indianapolis complained that it took a week to get supplies from the city’s purchasing department, while private firms can be confident of receiving necessary supplies the next day.”<sup>45</sup>

Another model of competitive contracting provides that the result does not have to be an “all-or-nothing” proposition, but rather one in which public and private entities provide the same services in the same territory, “allowing taxpayers to make the choice one household at a time, rather than giving it to city officials in a single blow.” For example, in St. Paul, Minnesota, homeowners may choose from among several private contractors for their curbside garbage pickup. This form of “simultaneous competition” may in theory also be applied to other government activities and services, in which citizens choose which provider — whether public or private — they wish to provide a particular service.<sup>46</sup>

**Monitoring.** As noted earlier, contract monitoring is also a critical element of contracting out, which may require additional staff: “The public authority’s involvement with the contractor does not cease once the contract has been let. Indeed, the most arduous and expensive part of the process may now be at hand.... The auditing of the contracting-out process requires professional staff, whatever the outsourced service. Technical monitoring may or may not require professionals, depending on the type of service contracted.”<sup>47</sup> Monitoring private contractors may reveal instances

of corruption, or may reveal a need to “monitor the monitors and then devote resources for this purpose”; however, the public nature of the contracts themselves may discourage illegal relationships: “[T]he media is more likely to focus on public sector corruption than private sector bribery. Also, citizens are more likely to be incensed by abuse of public power and thus be more likely to report it to the authorities. Finally, the penalties for violating public trust are apt to be heavier than for private sector abuse.”<sup>48</sup>

Also called “quality assurance” plans, monitoring plans must be reviewed before issuing a request for proposals or signing a contract; they define what a government must do to guarantee that the private contractor is performing in accordance with contract standards. Therefore, the better the contract performance standards, the easier it will be to monitor the contract. However, “the best performance standards in the world are useless unless they are accompanied by a system to track whether the standards are being met. In the private sector, Intel, Hewlett Packard, and other computer companies have developed elaborate software systems to monitor, track, and record the performance of their outsourcing. Another possibility is to link the evaluation system with a citizen complaint hotline.”<sup>49</sup> The City of Indianapolis has initiated “initiative management” reviews, composed of teams (of third parties) that determine the adequacy of contract resources, personnel, procedures, and monitoring systems, as well as performance measures. One of the city’s top priorities for reviews are internal sourcing agreements — those services for which in-house government units have won a bidding competition — which carry a greater difficulty in establishing accountability for outcomes since the organization is essentially monitoring itself, and which therefore carries a greater risk of performance failure.<sup>50</sup>

***Deprivatization.*** Increased competition from the public sector, or failure of a private entity to adequately deliver government services, has prompted some local governments to engage in “*deprivatization*”, i.e., discontinuing the use of a private entity to deliver a program or service: “[T]he result of privatization is sometimes a decision to leave functions in the hands of public employees. In fact, both [Indianapolis and Phoenix] provide examples of functions that have been shifted to the private sector and then moved back to the public sector as a result of competition.”<sup>51</sup> Public officials have begun to examine ways to increase competition to lower costs, whether a particular service is performed by the public *or* private sector, as determined by measurable outputs: “The examples ... of cities which have had long experience in moving functions to and from contractors ... suggests *competition, but not necessarily private sector contracting, yields efficiency when outputs can be measured.*”<sup>52</sup>

***Pseudo-privatization.*** Nevertheless, there continue to be instances of corruption and “cozy politics” in contracting out with the private sector at all levels of government: “Corruption does indeed exist in a number of contractual relationships. It seems to stem as much or more from the actions of politicians and political executives than from those of civil servants. Privatization is involved because the corruption would not be possible without the cooperation of both partners and because privatization as a political movement has weakened public bureaucracies.”<sup>53</sup> Moreover, when the amount of money involved in the project is large enough, so-called “pork-barrel” politics often work to the detriment of program efficiency, leading to what one commentator has dubbed “*pseudo-privatization*”, namely, “the pretense of drawing on the efficiency and effectiveness of the private sector when in actuality, the rationale of privatization serves merely as ideological camouflage for dramatic cases of pervasive corruption.”<sup>54</sup>

**Purchaser/provider split.** Also known as “uncoupling”, the goal of this “cutting edge public policy trend” is to separate policy and regulatory functions from service-delivery and compliance functions, and to transform them into separate and distinct organizations. The purpose of this reform, which has been implemented in both the United Kingdom and New Zealand, is “to free policy advisors to advance policy options that are in the public’s best interest but may be contrary to the self-interests of the departments”, thereby reducing conflicting objectives that arise when the same agency is involved in service delivery, regulation, and compliance:

For example, a central problem with government organizations is ‘agency capture.’ This refers to the tendency of service departments to capture the policy advice process from policy makers and top managers, using this power to recommend themselves as service providers and to bias policy advice toward increasing the size of their budgets. One example: a housing authority recommending staff and budget increases in order to build and manage more government housing. Splitting policy functions from service delivery creates incentives for governments to become more discriminating consumers by looking beyond government monopoly providers to a wide range of public and private providers.<sup>55</sup>

While no state or local government in the United States has formally separated purchasers, providers, and regulators into separate organizations, the City of Indianapolis has come close to this model by providing for one department that regulates business, another that eliminates unnecessary regulation, and an enterprise development group that seeks to inject competition into government and monitor public and private providers. On the federal level, the reform efforts of the National Performance Review are focused on converting selected government bodies into performance-based organizations (PBOs), to be run by chief executives on fixed-term performance contracts, and which are to receive a large degree of flexibility in procurement and control over personnel and financial management.<sup>56</sup>

## **F. Legislative Responses**

The Legislature may choose to enact legislation that provides for the following:

1. Establish a privatization task force as provided in recommendation no. 1 in part IX of this memorandum. The task force could be assigned the following responsibilities:
  - Identify and assess the present extent of contracting out government services to the private sector;
  - Identify and assess other governmental services which may be privatized at a cost savings without decreasing the quality of existing services, and which will not displace government employees;
  - Review state laws and rules which might inhibit privatization as well as to ensure that public interests are protected if privatization is expanded; and

- Review other privatization options such as franchise agreements and divestiture of government responsibility for a service or services; and
2. Establish a government competition program, either in an existing state agency, such as the Department of Budget and Finance, or in a newly created agency, to develop comprehensive guidelines to address appropriate reasons for contracting out to the private sector, cost comparison methods, and employee union relations, and to establish statewide policies and procedures for regularly examining potential privatization candidates. As discussed in recommendation no. 2 in part IX of this memorandum, the Legislature may wish to consider legislation based on the following four establishing competitive government programs:
- The Virginia Commonwealth Competition Council, which promotes both privatization and managed competition, as appropriate (Appendix K);
  - The Arizona Competitive Government Program, allowing agencies to choose the programs they wish to consider for public-private competition (Appendix L);
  - The Florida State Council on Competitive Government, which promotes competition with private sources or other state agency service providers (Appendix M); and
  - The Utah Privatization Policy Board, while focusing on privatization, also provides for reviews of agency competition with the private sector (Appendix N).



## Endnotes

1. Konno v. County of Hawaii, 85 Haw. 61, 68, 937 P.2d 397, 404 (1997) (internal references and citations omitted).
2. Id. (internal citations omitted).
3. Jack M. Sabatino, "Privatization and Punitives: Should Government Contractors Share the Sovereign's Immunities from Exemplary Damages?", 58 Ohio State L.J. 175, 179 - 185 (1997) (footnote omitted). *See, e.g.*, Joan W. Allen, et al., The Private Sector in State Service Delivery: Examples of Innovative Practices (Washington, DC: The Urban Institute Press, 1989); Harry P. Hatry, A Review of Private Approaches for Delivery of Public Services (Washington, DC: The Urban Institute Press, 1983); Marvin J. Levine, Privatization of Government: The Delivery of Public Goods and Services by Private Means (Alexandria, VA: International Personnel Mgmt. Assn., 1990); E. S. Savas, Privatization: The Key to Better Government (Chatham, NJ: Chatham House Publishers, Inc., 1987); Paul Starr, "The Meaning of Privatization," 6 Yale Law & Policy Rev. 6 (1988).
4. John D. Donahue, The Privatization Decision: Public Ends, Private Means (NY: Basic Books, Inc., 1989) at 135 (footnote omitted).
5. John A. Rehfuss, Contracting Out in Government: A Guide to Working with Outside Contractors to Supply Public Services (San Francisco: Jossey-Bass Publishers, 1989) at 10.
6. Other privatization studies have focused on specific areas. *See, e.g.*, George Lee, et al., State Operated Ambulance Service Versus Contract Ambulance Service: A Cost Benefit Study (Honolulu: University of Hawaii, Center for Governmental Development, June 1976).
7. Tom Yoneyama, "Private Profits, Public Concerns", Hawaii Business, Vol. 32, No. 7, January 1987, at 42.
8. City and County of Honolulu, Contracting Out Services to Private Concerns, Final Report (Honolulu: Arthur Young, Nov. 1983) at 6-7.
9. Id. at 8 (emphasis in original).
10. Privatization 1994, ed. John O'Leary (Los Angeles: Reason Foundation, 1994) at 7. The Council of State Governments has recently completed a new survey of state privatization activities, which is scheduled for publication in January 1998. *See* Keon S. Chi and Cindy Jasper, Private Practices: A Review of Privatization in State Government (Lexington, KY: The Council of State Governments, 1998).
11. Id. at 5.
12. David Osborne and Ted Gaebler, Reinventing Government: How the Entrepreneurial Spirit is Transforming the Public Sector (Reading, MA: Addison-Wesley Publ. Co., Inc., 1992) at 45 (emphasis in original).
13. Donald F. Kettl, Sharing Power: Public Governance and Private Markets (Washington, DC: The Brookings Institution, 1993), pp. 39 - 40 (footnote omitted). Several factors are important in determining the feasibility of using various privatization methods, including the following:
  - The "private good" characteristic of the service;
  - The level of government expenditures for the service;
  - The availability of private suppliers;
  - The ability to specify outputs and monitor performance;
  - The degree of dissatisfaction with the public service;
  - The degree of employee acceptance;

- The extent of political support; and
- The legal authority to privatize.

Kenneth W. Clarkson, "Privatization at the State and Local Level," in Privatization and State-Owned Enterprises: Lessons from the United States, Great Britain and Canada, ed. MacAvoy, Paul W., et al. (Boston, MA: Kluwer Academic Publishers, 1989) at 151.

14. Privatization 1994, *supra* note 10, at 7-8.
15. Colorado State Auditor, Privatization in Colorado State Government: Performance Audit (Denver: March, 1989) at 17-18; *see also* Privatization 1997, (Los Angeles: Reason Public Policy Institute, 1997) at 21-22, discussing general principles and criteria associated with successful competition/privatization projects in Indianapolis.
16. *See* Joan W. Allen, et al. (1989), *supra* note 3, at 2 - 6; Colorado State Auditor (1989) at 13 - 16; Government for Sale: An Examination of the Contracting Out of State and Local Government Services (Washington, DC: American Federation of State, County and Municipal Employees, [1987]) at 8 - 9; Sabatino, 58 Ohio State L.J. at 181 - 182 (footnotes omitted); Passing the Bucks: The Contracting Out of Public Services (Washington, DC: American Federation of State, County and Municipal Employees, 1983) at 13 - 16; Ronald C. Moe, "Exploring the Limits of Privatization," in Classics of Public Administration, ed. Jay M. Shafritz and Albert C. Hyde (Belmont, CA: Wadsworth Publishing Co., 1992) at 545 - 547; Randall Fitzgerald, When Government Goes Private: Successful Alternatives to Public Services, A Pacific Research Institute for Public Policy Book (NY: Universe Books, 1988) at 80 - 92; Donald Fisk, Herbert Kiesling, and Thomas Muller, Private Provision of Public Services: An Overview (Washington, DC: The Urban Institute, May 1978) at 6 - 9; *see also* Michael H. Schill, "Privatizing Federal Low Income Housing Assistance: The Case of Public Housing," 75 Cornell L.Rev. 878, 881-888 (1990).
17. *See* Judy L. Flanigan, "Private/Public Partnership: A Balancing Act," Public Works, Sept. 1997, at 52 (citing David R. Hunter, "Strategic Advances: Creating the New Public Enterprise").
18. An example of this type of public-private arrangement was proposed in House Bill No. 667, H.D. 2 (1997), which provided for the development of a "people mover" system in Honolulu to be built, owned, and operated by a private developer, with the exclusive use and ownership reverting to the State of Hawaii upon a specified period of time.
19. *See* Harry P. Hatry (1983), *supra* note 3, at 5-7; *see also* Joan W. Allen, et al. (1989), *supra* note 3; William G. Colman, State and Local Government and Public-Private Partnerships: A Policy Issues Handbook (New York, NY: Greenwood Press, 1989) at 153 - 173; Kenneth W. Clarkson (1989), *supra* note 13; Savas (1987), *supra* note 3; Lydia Manchester, "Alternative Service Delivery Approaches and City Service Planning" in Public Sector Privatization: Alternative Approaches to Service Delivery, ed. Lawrence K. Finley (NY: Quorum Books, 1989) at 13 - 23; New York, Legislative Commission on State-Local Relations, State-Local Issue Brief, Vol. 1, No. 1 (Albany: 1988); Osborne and Gaebler (1992), *supra* note 12, Appendix A at 332 - 348.
20. No attempt has been made to ascertain the extent of contracting out in Hawaii state or county governments, which is beyond the scope of this memorandum.
21. Harry P. Hatry (1983), *supra* note 3, at 14.
22. Id. at 14-15.
23. Kettl (1993), *supra* note 13, at 161 (footnote omitted).

24. Werner Z. Hirsch, "Contracting Out by Urban Governments: A Review," Urban Affairs Review, vol. 30, no. 3 (Jan. 1995) at 470.
25. Id.
26. Savas (1987) at 256; *see also* Robert W. Bailey, "Uses and Misuses of Privatization," in Prospects for Privatization, Proceedings of the Academy of Political Science, Vol. 36, No. 3, ed. Steve H. Hanke (New York: 1987) at 148 - 151 (discussing issues to be addressed before policymakers and public managers make a commitment to privatize). It has also been argued that it is appropriate for governments to contract out for such reasons as reducing costs, when complex or technical services are needed, to establish benchmark costs, and to avoid management and policy constraints, but only if they are willing to effectively monitor those contracts. Agencies should be wary of contracting out, however, if they expect strong employee resistance, are considering contracting out emergency services, or are trying to save money by disguising service cuts as cost savings. *See* Rehfuss (1989), *supra* note 5, at 43-60.
27. Robert D. Tyre, Issues in the Decision to Contract for Services, Government Briefing (Washington, DC: Arthur Young, 1985) at 2.
28. John J. DiIulio, Jr., Gerald Garvey, and Donald F. Kettl, Improving Government Performance: An Owner's Manual (Washington, DC: The Brookings Institution, 1993) at 34.
29. Osborne and Gaebler (1992) at 47 (emphasis added).
30. Kettl (1993), *supra* note 13, at 162; *see also* State Policy Reports, Vol. 14, Issue 6, March 1996 (2<sup>nd</sup> of 2 March issues) at 8: "For elected officials, ... the basic criterion is not private or public sector performance. Instead it is the presence or absence of competition..."; Savas (1987) at 262: "The most important single attribute of contracting is that when properly done, it creates and institutionalizes competition, which is the underlying factor that encourages better performance."
31. Savas (1987) at 263.
32. Kettl (1993) at 163 - 164 (footnote omitted).
33. As used in this memorandum, "managed competition" is distinguished from its use in health care reform: "Managed competition is an economic theory gaining popularity as a cost-containment mechanism and as an alternative to single-payer reform systems...", and has been defined as "a purchase strategy based on informed, cost-conscious consumer choice designed to reward health care organizations that do the best job of improving quality and cutting costs with more subscribers." Shelda L. Harden, What Legislatures Need to Know About Managed Care (Denver, CO: National Conference of State Legislatures, April 1994), p. 15 (footnote omitted); *see also* U. S. Congressional Budget Office (C.B.O.), Managed Competition and Its Potential to Reduce Health Spending (Washington, DC: May 1993); U.S.C.B.O., An Analysis of the Managed Competition Act (Washington, DC: April, 1994); Thomas L. Greaney, "Managed Competition, Integrated Delivery Systems and Antitrust," 94 Cornell L.Rev. 1507 (1994); Helen Halpin Schaffler and Jessica Wolin, "Community Health Clinics Under Managed Competition: Navigating Uncharted Waters, 21 Journal of Health Politics, Policy and Law 461 (Fall 1996).
34. Hatry (1983) at 14; *see also* Gary Enos, "Four Words that Can Wake a Sleeping Bureaucracy: 'We May Go Private,'" Governing, Nov. 1996 at 40 - 41; "Bidding on Service Delivery: Public-Private Competition," Management Information Service Reports, vol. 25, no. 11 (Nov. 1993) (entire issue); "Selecting Services for Public-Private Competition," Management Information Service Reports, vol. 28, no. 3 (Nov. 1993) (entire issue); Lawrence Martin, "How to Compare Costs Between In-House and Contracted Services," in Issues & Options: Practical Ideas for Local Government Leaders, vol. 1, no. 8 (National League of Cities, Sept. 1993),

- at 2-12; Rich Lowry, "Competition's Coming to Town," Reader's Digest, May 1997. The federal government has also introduced competition in its operations through the A-76 process, described in part VIII of this memorandum.
35. Kettl (1993) at 162 - 163 (footnotes omitted).
  36. Savas (1987) at 264.
  37. *See, e.g.*, Craig Becker, "With Whose Hands: Privatization, Public Employment, and Democracy," 6 Yale Law & Policy Rev. 88, 91-92 (1988).
  38. Enos (1996), *supra* note 34, at 40.
  39. Brian Foster, "Playing to Win the Competition Game," American City & County, Feb. 1997, at PS20 (privatization supplement).
  40. Id. at PS21.
  41. Id.; *see also* notes 84 to 86 and accompanying text in part IX of this memorandum discussing the need for increased public-private cooperation.
  42. Enos (1996) at 41.
  43. Id.
  44. Privatization 1997, *supra* note 15, at 15.
  45. Id. at 16. One way to prevent the sharing of inside information on the preparation of in-house bids is to maintain "fire walls" between the department that prepares a request for proposals and the department that develops a proposal in response. *See, e.g.*, Diane Kittower, "Serving the Public With Private Partners," Governing, vol. 10, no. 8 (May 1997) at 70 (regarding San Diego's city-wide managed competition program).
  46. Enos (1996) at 41. At least six different models of private-sector delivery exist for collection services: single district, winner-take-all competitive contracting; multiple-district competitive contracting; noncompetitive negotiated contracting; free-for-all competition; nonexclusive franchising; and competitive exclusive franchising. Privatization 1997 at 36.
  47. Jonas Prager, "Contracting Out Government Services: Lessons From the Private Sector," Public Administration Review, Vol. 54, No. 2 (March/April 1994), at 181.
  48. Id. at 181.
  49. Privatization 1997 at 19.
  50. Id. at 20.
  51. State Policy Reports, Vol. 14, Issue 6, March 1996 (2<sup>nd</sup> of 2 March issues) at 8.
  52. Id. at 9. Many state and local government officials, realizing that "efficiency gains are associated with competition, not necessarily with either private or public workers in non-competitive environments," have therefore become increasingly pragmatic in their support of privatization, promoting privatization efforts only competition and other cost-saving factors are present. Id. at 10.

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53. Peter Kobrak, "Privatization and Cozy Politics," in Public Integrity Annual, ed. James S. Bowman (Lexington, KY: Council of State Governments and American Society for Public Administration, 1996) at 16. For example, the head of Hawaii's United Public Workers union maintained that an examination of privatization contracts has revealed examples of waste, conflicts of interest, and possible corruption. See William Kresnak, "Rodrigues Sees Corruption," The Honolulu Advertiser, Oct. 15, 1997, pp. A1, A8.
54. Id. at 17.
55. Privatization 1997 at 17.
56. Id.

## PART IV. THE COUNTIES AND HOME RULE

### A. County Responses to *Konno*

Soon after the Court's decision in Konno and subsequent re-affirmation of that ruling upon reconsideration, the counties were described as being in a state of "chaos" and debating whether to cancel contracts that were jeopardized by that decision: "County officials at every level say the confused privatization issue is getting thornier by the day, and that there's only one solution: The Legislature needs to meet and take action, as the Supreme Court suggested in the Konno case, to clear up where privatization is appropriate and where it's not."<sup>1</sup> Hawaii County, for example, was prepared to cancel 1,300 contracts. Maui County voided approximately fifty contracts for the maintenance of county parks and facilities, and Maui County attorneys believed that one hundred of 350 additional private contracts were void under Konno. In Kauai, Circuit Judge Masuoka ruled that the Kekaha Landfill in Kauai County could not remain privatized, and that the court would oversee the transition to public operation.<sup>2</sup> However, in a November, 1997 ruling, Judge Masuoka upheld the state Department of Health's privatization of day care and training services for retarded adults, believed to be the first validation of a privatization contract for government services since the Konno ruling.<sup>3</sup>

As described below, the situation in the City and County of Honolulu has not been as tense as in the other counties; the City and County has taken the position that the Konno decision does not directly apply to the City and County. The City is also apparently seeking to work out more out-of-court compromises rather than litigate disputed contracts.<sup>4</sup> Nevertheless, a lawsuit has been threatened regarding the privately run Waimanalo Gulch landfill on the Leeward Coast which has allegedly been "improperly privatized", and that workers displaced by the closure of the City's Kapa'a landfill in Kailua had been denied opportunities for promotion because of its reduced operation and contracting out at the Waimanalo Gulch.<sup>5</sup>

Since Konno has a direct impact on many county privatization efforts, it is necessary to review county responses to that decision and to determine if legislative changes are necessary. The following is a brief description of recent county developments in response to Konno, including county court settlements, as well as relevant charter provisions and ordinances affecting privatization.

#### 1. Hawaii County

Following the Hawaii Supreme Court's remand of Konno to the circuit court, the County of Hawaii and the other parties to that suit agreed to a settlement and dismissal of the case, which was filed on July 1, 1997.<sup>6</sup> In Exhibit A of that settlement, the court established a process for reviewing Hawaii County contracts under the Konno decision. Defendant State of Hawaii Organization of Police Officers (SHOPO) entered into a separate agreement with the County that addressed Konno concerns relating to SHOPO as Exhibit B. The text of the court's dismissal of that case and Exhibits A and B are attached to this memorandum as Appendix D.

The process for reviewing county contracts in Exhibit A requires the county to review “each and every one of its existing contracts including those covered by the subject cases, except those which have been challenged via privatization litigation” as of the date of that agreement. The review is to determine whether, under Konno, the services that have been contracted out are those that have been “customarily *and* historically” performed by civil servants. The county is to make preliminary and final determinations on this issue, including whether the services qualify under any civil service exemptions or exceptions or other special circumstances apply, within certain time limits. The contractor and union may submit objections to the preliminary findings within thirty days; if there are no objections, those determinations become final. If there are objections, the county must make a final determination within thirty days regarding whether the services are to be terminated.

Exhibit A further provides that if the union and contractor object to a final determination within thirty days, the county is to submit a request within two weeks to the Attorney General for a review and opinion. The county may seek declaratory relief if it agrees with the Attorney General’s opinion. If services are to be terminated, the contractor and union are to mutually agree to a transition period to allow the county to make the transition from services performed by a contractor to services performed by civil servants. In addition, for “all services entered into in the future,” the county must certify that it conducted a review of the terms and conditions of the services provided, and that the review met all legal requirements, including those set forth in the state civil service laws and Konno decision with respect to any new contracts. The agreement also allows a contractor or union that disagrees with any determinations of the county or Attorney General to bring an action for declaratory relief, or may seek other legal or equitable relief in any court alleging that a contract is contrary to public policy.

In September, 1997, Judge Amano ruled that county workers were to perform refuse disposal operations at the Pu’uanahulu landfill that the County sought to privatize in Konno, and gave the county until September 16, 1997, to transfer the jobs to those workers. However, the private contractor (Waste Management Inc.) was permitted to continue bulldozing and developing new sections of the landfill. The court rejected the union’s position that the contract should be voided completely, but noted that a number of issues remained to be worked out, including reaching agreements with the union on transfers and temporary hires to replace the private workers.<sup>7</sup> A subsequent union suit asking certain Hawaii County officials to personally repay millions of dollars to the county treasury for authorizing the privatization contract for the landfill operation was rejected in November, 1997.<sup>8</sup>

The Hawaii County Charter provides that the county department of finance is responsible for the procurement of all services, and provides for the appointment of a “standardization committee” composed of five members who prepare and adopt standards and specifications for materials, supplies, and equipment. Purchases and contracts for services are to be made by advertising and competitive bidding.<sup>9</sup> The charter also allows the county to enter into contracts with private parties “for the performance of any function or activity which the county is authorized to perform.”<sup>10</sup> The County of Hawaii Managing Director and Department of Civil Service have recently issued guidelines and procedures for reviewing county contracts under Konno, which are attached to this memorandum as Appendix E.

## 2. Maui County

Almost immediately following the settlement reached by the County of Hawaii, the County of Maui subsequently settled its Konno-related privatization issues under terms similar to those agreed upon in the Hawaii County settlement.<sup>11</sup> Under that agreement, Maui County agreed to a process for the review of Maui County contracts under the Konno decision, attached to the Court's agreement as Exhibit A, and set forth in this memorandum as Appendix F.

As in the Hawaii County agreement, Maui County agreed to review "each and every" affected contract, except those that had not been challenged via privatization litigation as of the date of the agreement (not including cases referenced in that settlement), to determine whether pursuant to Konno, the services contracted out are those that have been customarily and historically performed by civil servants. However, the Maui County agreement contains an additional clause not found in the Hawaii County agreement, namely, that the procedure for contract review does not apply to "contracts which the County has canceled prior to the date of this agreement by reason of the Konno decision...". As a result, unlike Hawaii County, certain other contracts in Maui County that may be affected by the Konno decision that were not included in that case are not bound by that settlement.<sup>12</sup>

The Maui County Charter allows the mayor, at the mayor's discretion, to establish procedures for the purchase of services required by the any county department through the department of finance or other department designated by the county.<sup>13</sup> All written contracts are to be approved by the corporation counsel as to form and legality and signed by the mayor, except that personal services, public works, and other contracts are to be signed by the director of finance.<sup>14</sup> The Maui Charter also provides for a "cost of government commission" to "promote economy, efficiency and improved service in the transaction of the public business in the legislative and executive branches of the county...".<sup>15</sup>

## 3. Kauai County

The Kauai County Attorney also filed an action seeking declaratory relief in circuit court, seeking to establish a process for reviewing Kauai County contracts under Konno similar to that of Hawaii and Maui Counties. However, the court dismissed that suit without prejudice for lack of a justiciable controversy.<sup>16</sup> (See Appendix G.) Each county contract that may be affected by the Konno decision must now be reviewed on a case-by-case basis to determine whether there are any violations.<sup>17</sup>

The Kauai County Charter provides for centralized purchasing similar to that of Hawaii County. The county department of finance is responsible for the procurement of all materials, supplies, equipment, and services. A standardization committee of three members, similar to that of Hawaii County, classifies all materials, supplies, and equipment commonly used by the various departments, and purchases and contracts for services are made by advertising and competitive bidding.<sup>18</sup> All written contracts are to be approved by the county attorney as to form and legality and signed by the mayor, except that personal services and other contracts are to be signed by the director of finance.<sup>19</sup> The County's operating budget ordinance was also recently amended to specify that all contracts were to be in compliance with Konno.<sup>20</sup> (See Appendix G.)



#### 4. City and County of Honolulu

The City and County of Honolulu has had a somewhat different experience than the other counties, primarily because of the structure of the state civil service law. While that law, codified as chapter 76, *Hawaii Revised Statutes*, applies not only to the State but to “each of the counties” as well,<sup>21</sup> civil service provisions relating to the City and County of Honolulu are not specifically included in that chapter.

Civil service provisions for the Territory of Hawaii were enacted in 1955 by Act 274. That Act specifically included a separate part comprised of civil service provisions applying only to the City and County of Honolulu, and another part applying only to the counties of Hawaii, Maui, and Kauai.<sup>22</sup> However, the provisions relating to the City and County of Honolulu were deleted from the 1955 edition of the *Revised Statutes of Hawaii* in the changeover to the *Hawaii Revised Statutes* by the Advisory Committee on Statutory Revision in 1968 as being “superseded by the Honolulu Charter”.<sup>23</sup> In 1970, a new section was added to chapter 46 of the *Hawaii Revised Statutes* (relating to the counties) to provide civil service exemptions to “any county with a population of 500,000 or more...”, namely, the City and County of Honolulu.<sup>24</sup>

The absence of Honolulu from chapter 76, *Hawaii Revised Statutes*, raises questions as to the applicability of Konno to the City and County and the future of its privatization decisions. According to the Honolulu Department of the Corporation Counsel, the City and County of Honolulu was not included in chapter 76 because the City and County apparently argued successfully before the Legislature that the city charter had the same commitment to merit principles as provided under state law, and therefore, under principles of home rule, there was no need to include the City and County under that chapter. A 1986 Hawaii Supreme Court case has also established some basis for asserting that the City and County is not subject to that chapter.<sup>25</sup>

The City and County has taken the position that since the Konno decision was decided under chapter 76, *part III*, relating to the civil service for the counties of Hawaii, Maui, and Kauai only, that decision does not apply directly to the City and County. Instead, the City and County’s civil service system is covered by its charter. However, the City and County acknowledged that the Konno decision does apply at least indirectly to them, because: (1) the language in chapter 76, part III, is very similar to the civil service language contained in the City and County Charter; and (2) chapter 76 provides for a uniform civil service system statewide. Honolulu therefore cannot unilaterally change its charter substantially from state law provisions.

The City and County Charter provisions establishing a department of personnel and county civil service commission are fairly comprehensive. Those provisions mirror the provisions in the *Hawaii Revised Statutes* regarding the establishment of a county civil service system based on merit principles, establish civil service exemptions for the legislative and executive branches of county government, and provide for appointments and promotions, the adoption of civil service regulation, and prohibit discriminatory practices.<sup>26</sup> The civil service provisions in the other counties are more abbreviated. They generally establish a personnel or civil service department and civil service commission, and establish powers, duties, and functions of the personnel director.<sup>27</sup> The City and County Charter also provides for centralized purchasing, similar to that of Hawaii and Kauai

Counties, and allows for the county to enter into contracts upon obtaining the approval of the corporation counsel as to form and legality.<sup>28</sup>

City and County ordinances also provide for the contracting out of services to private contractors in specified areas. For example, ordinances provide for the awarding of consultant contracts “at fair, competitive and reasonable compensation to provide ... professional services to the city”<sup>29</sup> and the employment of private attorneys as special counsel to represent the city, its agencies, officers, and employees.<sup>30</sup> Ordinances also require the establishment of standards for the appropriation of funds to private organizations that provide programs and services that the City and County has determined to be in the public interest.<sup>31</sup>

In addition, in September, 1997, the Honolulu City Council overrode the Mayor’s veto of an ordinance placing stricter controls on the awarding of personal service contracts to help to guard against favoritism.<sup>32</sup> The Council’s action followed an October, 1996 Council audit of the procurement of personal services in the City and County, which found several weaknesses in City and County policies relating to personal services contracts, including the lack of public notice, record keeping, and public reporting requirements for employer-employee personal services contracts; lack of review to ensure that those contracts were not used to evade a competitive procurement process; and no time restrictions on certain employer-employee contracts.<sup>33</sup>

## **B. Home Rule**

In Konno, the Hawaii Supreme Court rejected the arguments of Hawaii County and WMI (the private contractor) that invalidating the privatization contract to operate the county landfill in question would violate the “home rule”<sup>34</sup> provisions of the Hawaii Constitution. Those provisions are contained in Article VIII, Section 2 of the Hawaii Constitution, which provides in relevant part as follows:

Charter provisions with respect to a political subdivision’s executive, legislative and administrative structure and organization shall be superior to statutory provisions, subject to the authority of the legislature to enact general laws allocating and reallocating powers and functions.<sup>35</sup>

That section further provides that “[a] law may qualify as a general law even though it is inapplicable to one or more counties by reason of the provisions of this section.” In addition, Section 6 of that article provides that Article VIII “shall not limit the power of the legislature to enact laws of statewide concern.”

Hawaii County and WMI argued in Konno that invalidating the privatization contract based on state law would infringe on the county’s home rule powers, since the Hawaii County Charter authorized the county to enter into contracts with private parties, and was therefore superior to state law.<sup>36</sup> The Court rejected this argument, citing its 1984 decision in City & County of Honolulu v. Ariyoshi,<sup>37</sup> and its earlier 1978 decision in Hawaii Gov’t Employees’ Ass’n v. County of Maui (HGEA),<sup>38</sup> for the proposition that personnel matters, including civil service and compensation matters, still remain subject to the control of the legislature. The Court concluded as follows: “As

discussed above, the present dispute involves civil service matters. We have held that the landfill worker positions in question are civil service positions. Therefore, state civil service statutes still govern the present dispute and article VIII, section 2 of the Hawai'i Constitution does not affect our decision.”<sup>39</sup>

While a review of the relevant constitutional and statutory provisions regarding home rule shows that civil service matters are clearly subject to control by the state Legislature, the Court failed to adequately address competing local concerns regarding contracting out by the counties, in particular, county privatization contracts that affect the county's “executive, legislative and administrative structure and organization”. The present form of Article VIII, Section 2 of the Constitution (formerly Article VII, Section 2) was recommended to the people by the Constitutional Convention of 1968. Standing Committee Report No. 53 (majority) noted that the area within which the charter was to be superior to statutory law was based on the model provision recommended by the American Municipal Association, but that this superiority of authority was limited in scope:

As presented by your Committee, ... the area which the proposal places beyond legislative control is limited to charter provisions as to the executive, legislative and administrative structure and organization of the political subdivision. For example, the legislature could not change the composition of the legislative body of a county. However, the proposal specifically preserves the authority of the legislature to enact general laws allocating and reallocating powers and functions. This means that the legislature could transfer a function from the county to the state level even if the result would be to eliminate a department of the county government provided for in its charter.<sup>40</sup>

The Committee further rejected granting residual powers to local governments, i.e., all powers not denied by statute, charter, or constitution, noting that “Hawaii's experience in having the legislature confer powers to the counties has worked well in the recent past; that the legislature has been sympathetic and responsive to county problems; and that there is no demonstrated need for the constitutional grant of residual powers to the counties.”<sup>41</sup>

The 1978 Constitutional Convention retained the language that was recommended and subsequently ratified following the 1968 Convention, finding that the “allocation” method, rather than the “residual powers” method, was in line with other states' home rule provisions:

Your Committee finds that Section 2 of the Constitution provides for the adoption of charters by each political subdivision and specifically provides that the charter provisions regarding structure and organization shall be superior to statutory provisions, subject to the allocation of powers and functions through the enactment of general laws.

Thus the Constitution permits local government powers by the allocation method, rather than by the shared residual powers method. Under the allocated powers method, powers are granted by the State to local governments. Under the residual powers method, all powers not granted to the State by Constitution, charter or other law belong to the local governments.

Representatives from the counties felt that powers allocated by the state legislature to local government usually have been narrowly construed by the courts, thus preventing the localities from assuming their proper responsibilities.

With shared residual powers, local government would have full legislative authority, subject to control by the state legislature through enactments which restrict local legislative actions or which deny power to act in certain areas. The local government would possess all power not denied by statute, charter or Constitution.

Your Committee finds that the existing allocation of powers method has not given rise to any major problems. Moreover, Hawaii's approach to the allocation of power to local governments appears to be in line with that of a majority of states. In addition, it is clear that charter provisions on governmental structure and organization are superior to conflicting statutory provisions<sup>42</sup>

Convention delegates further maintained that the record showed that the legislature had been responsive to the counties' needs, and that there was no need to grant them residual powers:

By requiring the state legislature to distribute power among the different governmental levels, function can be shifted without invoking constitutional amendment procedures. Your Committee believes that the record demonstrates the legislature's responsiveness to the need of the counties. Although your Committee recognizes that there are some merits in providing "home rule" to the counties, this issue raises many complicated questions. The committee felt that proceeding without knowing all the facts and ramifications might adversely affect the public's welfare.<sup>43</sup>

In HGEA, several provisions of the revised Maui Charter were challenged by the Hawaii Government Employees' Association as being in conflict with the Hawaii Constitution and Hawaii Revised Statutes. The Hawaii Supreme Court held that the challenged provisions of the revised charter regulating the administration, structure, and organization of the departments of water supply, police, and liquor control were directly related to the organization and government of Maui County, and were therefore of local, rather than statewide, concern.<sup>44</sup> On the other hand, the Court noted that the constitutional amendments made to Article VII (now Article VIII) "did not grant to the political subdivisions complete home rule" but rather "gave the local governments limited freedom from legislative control."<sup>45</sup> Accordingly, the challenged charter provisions relating to staff of the corporate counsel and prosecuting attorney, and mayoral control of the county director of personnel, were invalid under Article VII and section 50-15, Hawaii Revised Statutes.<sup>46</sup> In reaching this conclusion, the Court stated its belief that the framers of the 1968 constitutional provision "intended the final authority on all civil service and compensation matters to remain with the legislature."<sup>47</sup>

In Ariyoshi, the counties and local public executives challenged the constitutionality of a state law that barred certain classes of county employees from receiving salary increases. The Court noted that a conflict between charter provisions and the state statute required the court to determine if this area was "one of statewide concern and therefore a permissible area of control reserved for the legislature or if the area is one of local self-government and therefore granted to the counties through the home rule provision in the constitution."<sup>48</sup> The Court also cited HGEA for the proposition that "a political subdivision could not adopt provisions in its charter which are repugnant to existing or

future laws in the area of personnel.”<sup>49</sup> Personnel matters, including civil service and compensation matters, therefore remained under legislative control. The Court concluded that the state statutes in question superseded conflicting charter provisions and county ordinances, noting that “the area of compensation of county officials is a matter of statewide concern where a salary structure integrated with that of the state structure will provide for more efficient and effective government for the people of Hawaii. It is a matter within the powers of the legislature and does not intrude upon the executive, legislative or administrative structure or organization of the counties.”<sup>50</sup>

The general rule is that statutes relating to state affairs govern and prevail over inconsistent charter provisions or ordinances: “Using the term ‘state affairs’ as pertaining to those matters not of purely local concern, and not made ‘municipal affairs’ by constitutional provision, the power of the legislature to control, and by its statutes to supersede the acts of municipal corporations within the sphere of state affairs ordinarily is not questioned.”<sup>51</sup> However, while the state “remains supreme in all matters not purely local”, questions often arise as to what constitutes a “state affair” as opposed to a “municipal affair”. Courts frequently refuse to define these terms, so that each case is often decided on its own facts and circumstances; however, “[o]ne factor that courts consider when determining whether a matter is of primarily local or state concern is whether uniform regulation throughout the state is necessary or desirable.”<sup>52</sup> Courts often devise a “mixed” category where the facts of the case do not clearly demonstrate favoring either state or local affairs, but rather a merging of the two. In the final analysis, however, where a concern is both statewide and local, some courts will determine which interest is paramount.<sup>53</sup>

While the Hawaii Supreme Court has already ruled (in HGEA and Ariyoshi) that the merit principles underlying the civil service system are a matter of statewide concern, it did not make a similar ruling in Konno with respect to county privatization contracts. It would appear, however, that contracting out county government functions is in a “mixed” category, that is, one involving equally pressing state and local concerns: local, because of the county’s need to administer its functions efficiently (in Konno, the operation of a landfill), and statewide, because of the State’s concurrent interest in protecting the ability of the counties to contract for those services and to ensure that they conform to acceptable standards and procurement protections, such as encouraging the use of competitive bidding and limiting sole source contracts or “parceling”.

In Konno, while the Court recognized the statewide concern of the civil service laws, it failed to adequately balance the competing concerns regarding the ability of the counties to contract for their needs in general, and to contract for landfill operations in particular. Both of these contractual provisions are embodied in state statutes. The more general contracting statute, section 46-1.5(4), *Hawaii Revised Statutes*, provides that “[e]ach county shall have the power to make contracts and to do all things necessary and proper to carry into execution all powers vested in the county or any county officer.” The more specific statute, already reviewed in part II of this memorandum, is section 46-85, *Hawaii Revised Statutes*, which authorizes the counties “to contract with users or operators of a project for the abatement, control, reduction, treatment, elimination, or disposal of solid waste...”. Both the state and the counties also have an interest in ensuring a safe environment regarding county landfills pursuant to laws relating to solid waste disposal, integrated solid waste management, solid waste pollution.<sup>54</sup>

The question not adequately addressed by the court in Konno is whether these competing local concerns regarding county privatization contracts impacted on the county's "executive, legislative and administrative structure and organization", and are therefore superior to statutory provisions, or whether they are subject to the legislature's authority to enact general laws allocating and reallocating powers and functions. The court, however, maintained that "the present dispute involves civil service matters", ignoring its earlier pronouncement that "the central issue" in Konno "is the privatization of public services",<sup>55</sup> and did not reach this issue. Nevertheless, the resolution of this issue is important with respect to the ability of the counties to contract out public functions to the private sector under their "home rule" powers.

In construing the terms "structure and organization" in Article VIII, Section 2, the Hawaii Supreme Court in HGEA cited with approval the Louisiana Supreme Court's interpretation of those terms as meaning "supervision, control and internal arrangement of the component parts of the mechanism or instrumentality through which the power (ability) conferred is exercised in obedience to the function (duty) imposed."<sup>56</sup> Under this definition, it is questionable whether Hawaii County's privatization contract for the operation of the landfill in Konno was within that county's executive, legislative and administrative structure and organization that would remove it from state legislative intervention. The contract in that case was for the operation of one particular landfill, rather than for landfill operations generally in that county. In the event that Konno involved an ordinance relating to the privatization of landfill operations generally, however, it is still unclear whether state environmental, safety, and health concerns would supersede that ordinance.

### C. Legislative Responses

As discussed in part IX of this memorandum, legislative options include the following:

- (1) Amend the State Constitution by giving counties broad residual home rule powers. One example is Article X, Section 11 of the Alaska Constitution, which provides as follows: "A home rule borough or city may exercise all legislative powers not prohibited by law or by charter";
- (2) Amend the State Constitution by giving counties powers over specified areas, such as landfill operations, to insulate county government from legislative intervention in those areas. The counties could also be given control over such areas as water works, police, and liquor control; and
- (3) Add statutory language to allow the counties greater flexibility in contracting out. For example, New Jersey law gives municipalities in that state the authority to contract with the private sector to render services on behalf of the municipality.

### Endnotes

1. Jan TenBruggencate, "Privatization 'Thorny' on Kauai," The Honolulu Advertiser, May 21, 1997, p. B4.

2. For a discussion of these and related recent developments, *see, e.g.*, Sandi M. Skousen, “Privatization War: Labor vs. Small Business; Supreme Court Decision Has Put Government and Private Contractors in a Quandary,” Pacific Business News, Week of April 28, 1997, pp. 1, 6; Ken Kobayashi and William Kresnak, “Chaos Feared Over Ruling,” The Honolulu Advertiser, May 10, 1997, pp. A1, A2; Jan TenBruggencate, Hugh Clark, and Edwin Tanji, “Big Island, Maui Ready to Cancel; Kauai Undecided,” The Honolulu Advertiser, May 14, 1997, p. A9; Hugh Clark, “Big Island Ready to Cut Contracts,” The Honolulu Advertiser, May 15, 1997, pp. A1, A9; Jan TenBruggencate and Edwin Tanji, “Clarification Sought in Courts,” The Honolulu Advertiser, May 15, 1997, pp. A1, A8; Jan TenBruggencate, Edwin Tanji, and Hugh Clark, “Counties Back in Court on Privatization,” The Honolulu Advertiser, May 16, 1997, pp. A1, A5; Edwin Tanji and Hugh Clark, “Hawaii County Sues to Protect Contracts,” The Honolulu Advertiser, May 20, 1997, p. A1; Jan TenBruggencate, “Privatization ‘Thorny’ on Kauai,” The Honolulu Advertiser, May 21, 1997, p. B4; Jan TenBruggencate, “Kauai Calls on Legislature to Convene on Privatization,” The Honolulu Advertiser, May 29, 1997, p. B1; William Kresnak, “Mayors, Union Duel Over Policy,” The Honolulu Advertiser, June 1, 1997, p. A1; Hugh Clark, “Big Island Sorting Out Contracts,” The Honolulu Advertiser, June 15, 1997, p. A23; “Privatization,” (Honolulu: Damon Key Bocken Leong Kupchak, A Law Corp., June 17, 1997) at <http://www.hawaiilawyer.com/private.htm>; Andrew Gomes, “Privatization Dispute Puts Hold on Hawaii County Foreclosures,” Pacific Business News, Week of Aug. 4, 1997, pp. 1, 48; Edwin Tanji, “Program Is Privatization, Union Says in Maui Suit,” The Honolulu Advertiser, Oct. 21, 1997, p. B1; Linda Lingle, “We Need Privatization,” The Honolulu Advertiser, Oct. 28, 1997, p. A8. In addition, a recent poll indicated that 67% of Hawaii residents disapproved of the Court’s decision in Konno, *see* Gary T. Kubota, “67% Disapprove of Ruling,” Honolulu Star-Bulletin, July 15, 1997, pp. A-1, A-9, while 80% of residents believed that the issue of privatization would have a “somewhat or very important bearing” on the 1998 gubernatorial race. Gary T. Kubota, “Handling of Privatization Could Affect ‘98 Gov Race,” Honolulu Star-Bulletin, July 15, 1997, p., A-9.
3. Jan TenBruggencate, “Kauai Judge Validates Privatized Hiring,” The Honolulu Advertiser, Nov. 5, 1997, p. B1; Editorial, “Ruling Further Calms Privatization ‘Crisis’,” The Honolulu Advertiser, Nov. 10, 1997, p. A8.
4. Interview with First Deputy Corporation Counsel Chris Parsons on August 4, 1997.
5. *See* Robbie Dingeman, “Labor Lawyer Targets Leeward Landfill,” The Honolulu Advertiser, July 31, 1997, p. B1; Editorial, “Privatization Should Be Handled With Caution,” The Honolulu Advertiser, Aug. 2, 1997, p. A8.
6. County of Hawaii v. Hawaii Island Humane Society, Civil No. 97-244, Court Order Re: Dismissal of Case; Exhibit A, July 1, 1997 (Amano J., Third Circuit Court); conversation with Assistant Corporation Counsel Ted Hong on August 7, 1997. *See also* Rod Thompson, “Hawaii County Begins Reviewing Private Contracts,” Honolulu Star-Bulletin, June 27, 1997, p. A-3.
7. *See* Hugh Clark, “Landfill Disposal Defined as County Job,” The Honolulu Advertiser, Sept. 6, 1997, p. B1. Later that month, the union reportedly maintained that the county was violating a Hawaii Supreme Court order by not returning the Kona landfill to the control of county workers. While the mayor has the authority to make temporary hires of county workers to bring the landfill back under county control, the mayor stated that he was waiting for the county council to free up money for those positions. An official for the private contractor stated that it “uses 1 ½ workers to perform the same functions done by seven county workers.” [Associated Press], “Union Accuses County of Violating Landfill Order,” The Honolulu Advertiser, Sept. 21, 1997, p. A32. By October, the Hawaii County Council had approved a new contract with Waste Management Inc. that reduced payments to that company by approximately \$300,000 out of a total of about \$4,000,000 per year, and authorized the creation of seven new county jobs and equipment purchase totaling approximately \$300,000 per year. Rod Thompson, “Costs of Landfill Operations Even Out,” Honolulu Star-Bulletin, Oct. 22, 1997, p. A-3.
8. Rod Thompson, “UPW Asks Judge to Order Public-Funds Restitution,” Honolulu Star-Bulletin, Oct. 11, 1997, pp. A-1, A-8; “Judge Says Officials Aren’t Liable,” The Honolulu Advertiser, Nov. 11, 1997, p. B3.

9. Section 10-14, Hawaii County Charter (1991).
10. Hawaii County Charter §13-13 (1991), cited in Konno v. County of Hawaii, 85 Haw. 61, 76, 937 P.2d 397, 412 (1997).
11. County of Maui v. Maui Economic Opportunity, Inc., Civil No. 97-0359(3), Order Re: Dismissal of Case; Exhibit A; Certificate of Service (July 3, 1997) (Mossman, J., Second Circuit Court).
12. Conversation with Joseph Wolsztyniak, Esq., Department of the Maui Corporation Counsel, on August 4, 1997.
13. Maui County Charter §9-15 (1993).
14. Maui County Charter §9-18 (1993).
15. Maui County Charter, article 8, chapter 14 (1993). Section 8-14.1 of that charter provides that county policies are to be carried out by:
  1. Limiting expenditures to the lowest amount consistent with the efficient performance of essential services, activities, and functions.
  2. Eliminating duplication and overlapping of services, activities, and functions.
  3. Consolidating services, activities, and functions of a similar nature.
  4. Abolishing services, activities, and functions not necessary to the efficient conduct of government.
16. County of Kauai v. Akita Enterprises, Ltd., Civil No. 97-0160 (Order Dismissing Complaint) (July 2, 1997) (Masuoka, J., Fifth Circuit Court).
17. Conversation with Galen Nakamura, Esq., Office of the Kauai County Attorney, on August 7, 1997.
18. Kauai County Charter §19.19 (1988).
19. Kauai County Charter §19.18 (1988).
20. County of Kauai Operating Budget Ordinance, Ordinance No. B-518-97 (Bill No. 1830, Draft 2), section 32, p. 180, effective July 1, 1997.
21. Section 76-1, *Hawaii Revised Statutes*. The state civil service system is discussed in greater detail in part V of this memorandum.
22. Act 274, *Session Laws of Hawaii* 1955, pt. of §1 (Laws of the Territory of Hawaii, Regular Session of 1955). That Act amended chapter 2, Revised Laws of Hawaii 1945, by adding separate civil service provisions for the Territory in Part I (sections 67 to 88), the City and County of Honolulu in Part II (sections 89 and 90), and the Counties of Hawaii, Maui, and Kauai in Part III (sections 92 to 95).
23. See Hawaii, Advisory Committee on Statutory Revision, Hawaii Revised Statutes [as prepared for submission to the Fourth Legislature of the State of Hawaii], Vol. I (Honolulu: Revisor of Statutes, February 1968), deleting part III of chapter 3 (sections 3-50 to 3-52), *Revised Laws of Hawaii* 1955.
24. Section 46-33, *Hawaii Revised Statutes*. This type of classification by population act has generally been upheld by the courts as a necessary, constitutional means of legislation, especially in states where there is great diversity in the populations of local government units. The general rule is that “[a]cts classifying local political subdivisions by population are valid as general laws if the act operates uniformly on all members of the class, and if the classification is reasonably related to the subject matter and purpose of the statute.”



*Sutherland Stat. Const.* §40.09 (5<sup>th</sup> ed.) at 235; *see also* Proceedings of the Constitutional Convention of Hawaii of 1978, Vol. II (Honolulu: 1980) at 249 - 251 (Committee of the Whole Debates on Local Government); Miriam P. Beams, Hawaii Constitutional Convention Studies 1978, Article VII: Local Government (Honolulu: Legislative Reference Bureau, May 1978) at 27 - 30.

Legislative history regarding section 46-33 noted that the purpose of that section was “to give effect to certain of the policies arrived at by the Civil Service directors of the State and the several Counties at their conference in Hilo relating to the elimination or correction of certain inequities and inconsistencies with respect to certain county positions exempt from civil service.” *See* House Stand. Comm. Rep. No. 469-70 (Majority), Government Efficiency and Public Employment on H.B. No. 1817-70 (reprinted in 1970 House Journal at 1008); and Senate Stand. Comm. Reps. 922-70 (Federal-State-County Relations and Judiciary) and 972-70 (Oahu Select and Federal-State-County Relations and Government Efficiency) on H.B. No. 1817-70, H.D. 1 (reprinted in Senate Journal at 1423 and 1445 - 1446).

25. Interview with First Deputy Corporation Counsel Chris Parsons on August 4, 1997. Section 6-302 of the Revised Charter of the City & County of Honolulu 1973 (1994 ed.) is apparently based on, and is similar in wording to, section 76-1, *Hawaii Revised Statutes*, which outlines the merit principles underlying the civil service system. Mr. Parsons noted that the Hawaii Supreme Court case of Gibb v. Spiker, 68 Haw. 432, 718 P.2d 1076 (1986), has been cited for the proposition that chapter 76, part II, applies only to the State of Hawaii. In particular, that case noted that “[t]hrough the Civil Service Law Part III (HRS §§ 76-71 to 76-81) specifically applies to Hawaii, Maui, and Kauai Counties, the City and County of Honolulu does not appear subject to HRS Chapter 76.” 68 Haw. at 436.
26. Revised Charter of the City and County of Honolulu, 1973, §§6-301 to 6-312 (1994 ed.).
27. *See* Hawaii County Charter, Article VII, Chapter 1 (Department of Civil Service) (1991); Maui County Charter, Article VIII, Chapter 9 (Department of Personnel Services) (1993); and Kauai County Charter, Article XV (Department of Personnel Services) (1988).
28. Revised Charter of the City and County of Honolulu, 1973, §§9-301 and 9-305 (1994 ed.).
29. Revised Ordinances of Honolulu 1990, §§2-19.1 to 2-19.9 (1997).
30. Id., §§2-26.1 to 2-26.7 (1997).
31. Id., §§6-29.1 to 6-29.4 (1997).
32. City and County of Honolulu Ordinance No. 97-54 (Bill No. 102 - 1996); vetoed on Aug. 22, 1997 by Mayor Jeremy Harris; approved by the Honolulu City Council over the Mayor’s veto on Sept. 17, 1997. *See also* William Kresnak, “Council Overrides Veto on Contracts,” The Honolulu Advertiser, Sept. 18, 1997, pp. B1, B4; William Kresnak, “Mayor, Council Square Off Over Contracted Staff,” The Honolulu Advertiser, Sept. 21, 1997, pp. A1, A2. It has been argued that the contracts of certain temporary city employees are routinely renewed each year, despite provisions in the Honolulu Charter allowing for the hiring of people under personal service contracts for one year or less. The Mayor has declared his intention to ignore the new ordinance, which places restrictions on personal service contracts. Id.
33. City and County of Honolulu, Office of Council Services, Audit Section, Issue Profile: Procurement of Personal Services in the City and County of Honolulu (Honolulu: Oct. 1996).
34. Home rule began in the United States in the nineteenth century when state legislators were mostly rural, and urban citizens opposed state legislative interference in drafting municipal charters; it was urged that municipal affairs be settled at the city hall level, rather than at state capitals. *See* Beams (1978), *supra* note 24, at 18.

35. Hawaii Constitution, Article VIII, Section 2 (emphasis added).
36. Section 13-13 of the Hawaii County Charter provides in pertinent part:
- Contracts.** The county may enter into contracts with private parties, other counties, the state or the United States for the performance of any function or activity which the county is authorized to perform.
37. 67 Haw. 412, 689 P.2d 757, *reconsideration denied*, 67 Haw. 682, 744 P.2d 779 (1984).
38. 59 Haw. 65, 576 P.2d 1029 (1978).
39. Konno, 85 Haw. at 76, 937 P.2d at 412 (footnote omitted; emphasis added).
40. Proceedings of the Constitutional Convention of Hawaii of 1968 (Honolulu: 1973), Vol. I, p. 229; *see also id.*, Vol. II, Committee of the Whole Debates on Local Government, at 422-426; HGEA, 59 Haw. at 75.
41. Id., Vol. I, at 230.
42. Proceedings of the Constitutional Convention of Hawaii of 1978, Vol. I, at 593-594 (Standing Committee Report No. 42).
43. Id. at 594; *see also id.*, Vol. II, Committee of the Whole Debates on Local Government, at 246-251. In particular, Delegate Sakima noted the following in those debates:

Our examination of the record shows that the present method of allowing the State to allocate powers to the counties has not presented any major problems. Generally, the record supports the conclusion that the legislature has been very responsive to the needs of the counties. The state allocation of authority to the counties is generally practiced in many states, even those where the counties have more responsibility. \* \* \* Your Committee was not totally convinced that vesting the counties with residual authority would not create undue hardship on the current division of responsibility for lawmaking. \* \* \* There was no consensus among legal counsels available to the committee on the practical effect of granting counties residual authority. In fact, it is possible that a grant of such authority — which offers the counties all powers and responsibilities specifically not denied to them by the Constitution, charter or statute — would serve to inhibit the legislature from passing a state law once a particular county has previously acted. Id., Vol. II, at 247.

44. 59 Haw. at 85.
45. Id.
46. Id., 59 Haw. at 85 - 88. Section 50-15, *Hawaii Revised Statutes*, provides as follows:

**§50-15 Reserved powers.** Notwithstanding the provisions of this chapter [regarding charter commissions], there is expressly reserved to the state legislature the power to enact all laws of general application throughout the State on matters of concern and interest and laws relating to the fiscal powers of the counties, and neither a charter nor ordinances adopted under a charter shall be in conflict therewith.

47. 59 Haw. at 86. In construing the personnel provisions of the revised Maui charter, the Court noted that the delegates to the 1968 Constitutional Convention, in their committee of the whole debates and in their standing committee report on the subject of local government, signaled their intent that personnel matters were intended to be of statewide, rather than local, concern, and that all civil service and compensation matters

should remain with the legislature. In addition, the Court stated: “The merit system has become an established policy of government. This has been a policy of state-wide application. Uniformity in the administration of the law is essential to its success. How well the system works and whether its ultimate objectives are to be achieved depends in relevant part upon the manner in which the laws pertaining to it are administered.” 59 Haw. at 87; *see also* Catherine Carey [student author], “*Marsland v. First Hawaiian Bank: Home Rule and the Scope of the County Prosecutor’s Power*,” 12 U. of H. L.Rev. 261, 273 - 274 (1990).

48. 67 Haw. at 417.

49. 67 Haw. at 420, *citing* HGEA, 59 Haw. at 85, 576 P.2d at 1041.

50. 67 Haw. at 421; *see also* 12 U. of H. L.Rev. 261 at 274 - 275. Writing in dissent, Chief Justice Lum commented that the majority opinion misinterpreted HGEA, “which dealt exclusively with matters dealing with civil service personnel and compensation, which led the court to find statewide concern.” 67 Haw. at 423. In contrast to HGEA, the dissent noted that “this case involves salaries for positions of key officers and employees of the counties. All of these positions are exempt from civil service laws and regulations. I cannot conclude as the majority does that the action of the legislature in ‘freezing’ or regulating such salaries constituted ‘civil service and compensation matters’ or for that matter, constituted a regulation within an ‘area of personnel.’ To do so, I think, is stretching HGEA beyond its boundaries.” Id.

51. McQuillin Mun. Corp. §4.84 (3<sup>rd</sup> ed.) at 196 (footnotes omitted).

52. McQuillin Mun. Corp. §4.85 (3<sup>rd</sup> ed.) at 203 (footnote omitted). Justice Kidwell, writing in a concurring and dissenting opinion in HGEA, *supra*, offered the following test in distinguishing between state and municipal affairs:

In my view, the essential difference between matters which pertain to county self-government and those which are of state-wide concern lies in whether the choices which a county makes are of significance only to the people of the county or are also of significance to the people of the state who do not reside in the county. Under this test, a county charter has constitutional superiority over state law with respect to the administrative structure and organization which deals with those matters which are not of significance to the rest of the state. 59 Haw. at 89 - 90 (Kidwell, J., concurring and dissenting).

53. *See* McQuillin Mun. Corp. §4.85 (3<sup>rd</sup> ed.) at 204 - 205 (footnotes omitted):

Conceding the inability to clearly define what are state affairs and what are municipal affairs, or their equivalents, it is nevertheless true that all of those public affairs which alone concern the inhabitants of the locality as an organized community apart from the people of the state at large, as supplying purely municipal needs and conveniences and the enforcement of by laws and ordinances of a strict local character limited to the interests of the city residents, are essentially local matters. If the matter is of general concern to the inhabitants of the state outside of the municipality, it is a state affair. But many if not most public matters are of interest in some degree both to the municipal corporation and to the state at large, and as to such affairs, as subsequently is observed, the paramount interest must be determined before they can be said to be ‘municipal’ or ‘state’ affairs, with respect to the legislative control of municipal corporations. Accordingly, where the concern is both general and local, some courts will determine which interest is paramount. In some states, the constitution confines special and local legislation by listing particular subjects.

54. *See, e.g.*, chapter 340A (solid waste), *Hawaii Revised Statutes*, providing that the county agency responsible for the collection and disposal of solid waste may require that all solid waste transported by that agency, collectors, businesses, or individuals be disposed of at facilities or in areas designated by the county agency

if found to be in the best public interest (section 340A-3), and chapter 342G (Hawaii integrated solid waste management act), requiring the state department of health and each county to consider various solid waste management practices and processing methods, including landfilling. In particular, section 342G-2 (solid waste management priorities), specifically provides that “[t]he respective roles of landfilling and incineration shall be left to each county’s discretion”, while section 342G-25(b)(8) (county integrated solid waste management plans), requires each county plan and subsequent revision to include, as part of its program element, a landfill and incineration component. *See also* chapter 342H (solid waste pollution), regarding county ordinances relating to solid waste management (section 342H-19); and section 46-19.1 (facilities for solid waste processing and disposal and electric generation), allowing counties to issue general obligation bonds to finance a facility for the processing and disposal of solid waste.

55. Konno, 85 Haw. at 64, 76, 937 P.2d at 400, 412.
56. 59 Haw. at 77, *quoting* La Fleur v. City of Baton Rouge, 124 So.2d 374, 378 (La. App. 1960); *see also* Letellier v. Jefferson Parish, 254 La. 1067, 229 So.2d 101 (1969). The Hawaii Supreme Court further noted that “power” meant the “ability or capacity ... synonymous with inherent or basic authority to indulge in a particular undertaking or provide or perform a certain service,” while “function” was defined as “duty in the sense that it is complementary of the power (ability) conferred, and, as such, is taken to mean onus or obligation to execute the power granted.” Id.

## PART V. CIVIL SERVICE

### A. Generally

As noted in Konno, Hawaii's civil service laws have a constitutional foundation. Article XVI, section 1, of the Hawaii Constitution provides that "[t]he employment of persons in the civil service, as defined by law, of or under the State, shall be governed by the merit principle." Hawaii's civil service statutes are found in chapters 76 and 77, *Hawaii Revised Statutes*. Chapter 76 establishes the civil service based on merit principles for the State and the counties,<sup>1</sup> while chapter 77 establishes a statewide system providing for the compensation of civil servants in order to attract and retain competent persons for government service. The purpose of the civil service laws, including the foundation of that law on merit principles, is located in section 76-1, Hawaii Revised Statutes, which provides in relevant part as follows:

It is the purpose of this chapter to establish in this State and each of the counties a system of personnel administration based on merit principles and scientific methods governing the classification of positions and the employment, conduct, movement, and separation of public officers and employees. It is also the purpose of this chapter to build a career service in government which will attract, select, and retain the best of our citizens on merit, free from coercive political influences, with incentives in the form of genuine opportunities for promotions in the service, which will eliminate unnecessary and inefficient employees, and which will provide technically competent and loyal personnel to render impartial service to the public at all times, and to render such service according to the dictates of ethics and morality.<sup>2</sup>

As discussed in part IV of this memorandum, while chapter 76 applies not only to the State but to "each of the counties" as well, and therefore has statewide application, civil service provisions relating to the City and County of Honolulu are not specifically included in that chapter.<sup>3</sup>

The Hawaii Supreme Court in Konno contrasted the purposes underlying privatization with that of the State's civil service system, noting that the purpose of that system was to implement the principles of merit, openness, and independence in personnel hiring and administration, as well as to eliminate the "spoils system":

In contrast to privatization, the purpose of the civil service is not just to foster efficiency but to implement other policies as well. One obvious policy is the elimination of the "spoils system," which awarded jobs based on political loyalty. The civil service also embodies positive principles of public administration such as openness, merit, and independence. Openness is served through public announcement of job vacancies, clear articulation of qualifications, open application to all persons, and selection according to objective criteria. Merit is served through a system of competitive examinations and qualification standards aimed at identifying competent candidates. Independence is served through the job security provided by civil service laws; because civil servants can be terminated only for just cause, they are more likely to speak out against unlawful activities occurring in their agencies.<sup>4</sup>

As the Court in Konno noted, United States Supreme Court Justice William O. Douglas called the civil service system “‘the one great political invention’ of nineteenth century democracy.”<sup>5</sup> The merit system was first introduced into federal law by the Pendleton Act of 1883, followed by New York, Massachusetts, and seven other states by the end of World War I. About 85% of all public employees occupied classified positions by 1970, and the “vast majority” of federal employees are in the classified service today.<sup>6</sup> Until 1996, all of the states had adopted some form of civil service system. In that year, however, Georgia enacted civil service reform legislation providing that all state employees hired after July 1, 1996, were considered “at will” employees and no longer under civil service protection, effectively repealing its civil service system while grandfathering in those civil servants hired before that date.<sup>7</sup>

Today’s civil service laws have two central requirements: “(1) appointment and promotion must be in accord with merit and fitness and (2) discharge may only be for just cause. These restraints not only prohibit the ‘spoils system,’ which awards jobs on the basis of political fealty, but also embody a set of positive principles of public administration.”<sup>8</sup> As noted in Konno, these principles include those of openness, merit, and independence. Because of greater opportunities for advancement based on merit, public employees are generally more representative of both the gender and racial composition of the workforce than are employees in the private sector:

Civil service laws guarantee that vacancies in government are publicly announced, qualifications are clearly articulated, application is open to all, and selection is according to objective criteria. The commitment to openness in the civil service is designed to ensure that it will be representative of the electorate. Although merit is difficult to define and harder to measure, the system of examinations and qualification standards required by civil service laws provide some assurance that the public business is not delegated simply to workers of a particular color, workers who have given something in return, or workers willing to accept the lowest wage. Private contractors are barred from engaging in certain types of discrimination, but they remain relatively free to hire through a closed and private process. It is not surprising, therefore, that government service opened an avenue to secure and well-paying jobs for women and minorities, while the doors to the corporate boardroom remain closed.<sup>9</sup>

In the private sector, most employees may be discharged at the will of the employer (“at will” employment), except for those who are covered by collective bargaining agreements. Civil servants, who may be discharged or disciplined for just cause — misconduct affecting their job performance — in theory promotes independence, which, in turn, promotes fidelity to the law rather than to superiors. For example, “[a] civil servant cannot be discharged for insubordination based on his or her refusal to obey an unlawful order. The civil service system thus fortifies the democratic process, guaranteeing that changes in public policy can be secured solely through legislative action rather than by altering the identity of those who administer the laws.”<sup>10</sup>

Opponents of civil service, however, note that vast changes have taken place in government and society in recent years, and rules that may have been worthwhile at one point in time are now rigid and regressive. Many see a system that has nothing to do with “merit”, but rather a system riddled with shortcomings: “The low productivity of public employees and the malfunctioning of governmental bureaucracies are becoming apparent to an increasing number of frustrated and indignant taxpayers. The problems shows up all over the country in the form of uncivil servants going through pre-programmed motions while awaiting their pensions. Too often the result is mindless

bureaucracies that appear to function for the convenience of their staffs rather than the public whom they are supposed to serve.”<sup>11</sup> Opponents contend, however, that it is the system itself that is at fault, more than its employees; in particular, critics often focus on both the inflexibility of the system in terms of hiring and firing, but also counterproductive policies inherent in the system itself.

The civil service system in New York City is representative in many ways of the problems inherent in such a system. For example, most entry positions are filled on the basis of written examinations, which may be scored to two or three decimal places, although there is no scientifically supportable evidence that these exams are in fact related to subsequent on-the-job performance. Once a ranked list of exam scores is established, management must select one of the top three names regardless of special qualifications, knowledge, experience, aptitude, or training of other applicants on the list. After working on the job for six months, an employee is virtually guaranteed that job for life; after acquiring tenure, an employee can be fired only on grounds of dishonesty or incompetence “of a truly gross nature”, and cannot be moved to a less demanding assignment.<sup>12</sup>

Moreover, it is argued, employees are often “milked” of their ability and dedication, while given little significant opportunity for advanced training, or a more enriched job that engages the employee’s changing interests. Very narrow, specialized jobs often emerge, partly because this makes it easier to produce an examination that is sufficiently specific to give an appearance of fairness and relevance. Promotions are often limited to employees who are in the next lower position in the same division, and prerequisites for advancement may be introduced “with no discernable value except bureaucratic convenience in the subsequent selection process”, resulting in “artificial and nonsensical divisions.” Salary increases may be almost automatic and are often completely unrelated to the employee’s work performance. In addition, supervisors belong to unions, often the same unions as the employees that they supervise; unions often have sufficient political power to influence the appointment of top-level managers or whether or not the chief executive is permitted to stay on. Critics further maintain that civil service systems often operate as an *inverse merit system* in that they discriminate against those applicants who are most qualified according to their own standards.<sup>13</sup>

## **B. Problems in Hawaii’s Civil Service**

Some of the problems inherent in civil service systems generally are also encountered in Hawaii state government. State government is the largest employer in Hawaii, with over sixty thousand full-time employees, accounting for annual state wages in excess of \$1,500,000,000 per year. Approximately half of the total number of state employees are hired pursuant to a staffing process administered by the state Department of Human Resources Development (DHRD), formerly known as the Department of Personnel Services. The remaining half are composed of mostly professional staff of the University of Hawaii and the Department of Education, which were recognized as having unique employment requirements and which were granted authority to recruit employees independently. Of those hired through the state personnel system, over twenty-four thousand, or eighty-five percent, were hired through the civil service process. The remaining employees, numbering over eight thousand, are exempt employees and not subject to civil service requirements.<sup>14</sup>

Recent departmental studies on the state civil service system have included a 1986 report that questioned the practice of hiring individuals on a temporary or non-civil service basis for several years, and then converting those temporary positions into permanent civil service personnel; a 1989 integrated personnel system study that found current personnel processes to be “slow or tedious” at best; a 1990 feasibility study to improve the classification, job evaluation, and compensation system; and a 1991 review of the use of temporary, emergency, and exempt hires by the State.<sup>15</sup> In 1994, the Auditor was asked to audit the process of staffing state programs to assist in answering the question: “Why does it take so long to fill state positions?” The Auditor noted that the issues facing Hawaii’s personnel system were not unique, and that “[a]ll levels of government must create mechanisms that respond to pressing needs, are sufficiently flexible, and can efficiently use scarce personnel and financial resources” in an effort to “create a government that works better and costs less.”<sup>16</sup>

The Auditor in particular noted that Hawaii’s civil service system was “antiquated”: “It was established in 1939 and in the past 50 years has grown seventeenfold to cover over 24,000 employees.... Current methods of classification and auditing may have been suited to a system with less than 1,400 employees. However, these processes are too labor intensive and cumbersome to match the needs of Hawaii’s largest employer.”<sup>17</sup> In addressing the difficulties in filling positions and the problem of classification delays, the Auditor recommended, among other things, that DHRD provide long-term commitment and leadership to the civil service reform effort, a primary focus of which should be to simplify the system of classifying positions; that DHRD establish clearer rules regarding exempt positions; and that the Department of Budget and Finance clarify and expedite the reorganization process. While DHRD has already implemented a series of reforms on developing a state career service and improving services to line agencies, the Auditor noted that the classification system continues to be “a major problem” which will require continual adjustment and rethinking.<sup>18</sup>

The Auditor further noted that civil service reform has been on the agenda of both federal<sup>19</sup> and other state governments, based on the criticism that it is “inefficient, unnecessarily complex, and unresponsive to government’s needs.” These reforms have included the following:

- Decentralizing personnel actions to line agencies;
- Transforming the role of the central personnel agency from controlling to facilitating personnel actions; and
- Simplifying the method of civil service job classifications.<sup>20</sup>

### **C. Abolish Civil Service?**

Should the civil service system be abolished in Hawaii, as was done in Georgia in 1996, relying instead on the collective bargaining system and judicial precedents to protect the rights of public employees? It has been noted that “a strong argument can ... be made for acknowledging reality and abolishing the civil service system, relying instead on the collective bargaining system.”<sup>21</sup> As discussed in part VI of this memorandum, the public sector collective bargaining system has increased in size and strength in recent years, as growing union membership, power, and influence has resulting in increased protections, wages, and benefits for union members. Some argue, however,



that public sector unions have also decreased work productivity and that “[t]he ultimate monopoly of power held by municipal unions raises fundamental and disquieting questions about public employee unionism that are not yet resolved”:

It is an inescapable fact ... that union power has produced a second personnel system overlapping and at times conflicting with and negating the civil service system. Job classifications and duties, recruitment, promotion paths, eligibility for advancement, and grievances all fall within the purview of the civil service system, yet all are in fact negotiated, albeit informally, with the municipal unions.<sup>22</sup>

Some have also questioned the role that merit principles play in a system dominated by unions, particularly in the area of workforce reductions:

Traditionally, the unions take the position that seniority is the only determinant — merit has nothing to do with it. And if you attempt to make a joint issue of merit and seniority, I challenge your ability to do it fairly. I have yet to see a uniform performance evaluation system in any organization. I suggest that you are going to have a very difficult time trying to make that kind of system — one based upon both merit and seniority — work at all. It is much easier to go on the basis of seniority alone. Everyone knows where he stands in that respect.<sup>23</sup>

While some believe that the principles underlying the merit system and the collective bargaining system are compatible<sup>24</sup> and that the negotiation of collective bargaining agreements with unions gaining exclusive recognition can be developed without violating merit principles, others argue that “[t]o destroy merit systems ... is a perfectly logical objective of unions ...”<sup>25</sup>

Abolishing the civil service system may assist in state privatization efforts by removing one of the key impediments to contracting out government services performed by civil servants.<sup>26</sup> A 1975 study on the impact of collective bargaining on the merit system in Hawaii may shed some light on this issue. That study examined the relationship between the two systems and sought to ascertain their compatibility, determine problem areas, and make recommendations for clarifications or changes in the law to protect the merit principle without infringing on the collective bargaining rights of public employees. The study concluded that “although collective bargaining has had some impact on the merit principle in state and local government in Hawaii, it has not destroyed the merit principle, nor is it likely to do so. Collective bargaining limits the merit principle most in the area of filling vacancies, particularly promotions....”<sup>27</sup> Other social goals, the authors pointed out, such as political influence and equal opportunity, modified the merit system much more than collective bargaining had ever done. The authors concluded that while there was some conflict between the two, that conflict was reconcilable:

Although collective bargaining and merit conflict at some points, the conflict is not so great or so irreconcilable [*sic*] that a choice must be made between them.... Collective bargaining is desirable in the public service because it improves morale, prevents arbitrary management action, and gives employees a voice in the determination of working conditions. The merit principle is important to give all applicants opportunity for appointment and to promote efficiency. Thus, ... public policy should seek to preserve some essentials of the merit principle, such as those relating to the examination and appointment process, as desirable goals logically entrusted to management, while permitting unions to negotiate

reasonable security of employment that will raise morale while assuring efficiency in government.<sup>28</sup>

Changes in the civil service and collective bargaining laws since the completion of that study, as well as the growth of union power since 1975, however, may require a re-evaluation of these conclusions.

While the issues underlying many of the problems associated with the civil service system in Hawaii are beyond the scope of this memorandum, the State has several possible options — that may be implemented administratively, legislatively, or both — to achieve reform, particularly in the area of contracting out of government services.

#### **D. Administrative Responses**

Administrative responses should address the increasing demands for additional contract management specialists, assuming that state and county governments will be increasing their privatization efforts in an attempt to provide greater efficiency and cost effectiveness in government. Contracting poses significant challenges for government managers. While “[g]overnment must be adept at identifying what it wants to buy, negotiating tough contracts, ensuring that competitive markets provide low prices, and monitoring the quality of what it buys ...”, most civil servants currently doing this work “joined the government to do something else.”<sup>29</sup> Many government employees have skills and expertise that simply do not match the jobs they will have to do as contract managers.<sup>30</sup>

Moreover, recruiting these managers will be difficult. “Schools of public administration and management do not include such courses in their curricula; raiding other agencies or the private sector would not work because the skills are not there either. Only a few organizations have begun to ‘grow their own’ contract management specialists” through in-house training. In addition, managers have few incentives for effective oversight: “They work within a rule-bound system that poorly matches the competition-based world of contracts. These rules limit their discretion in producing success; the political system quickly blames them for any failures that occur on their watch even if the problems are rooted in the contractors’ behavior or in a system inadequate to the job of overseeing such a complex system.”<sup>31</sup> Several options exist on the administrative level, however, to address these shortcomings:

First, the public service could ‘grow its own’ contract management specialists, much as the [United States] Department of Defense now does. It could hire competent people and train them on the job. Second, the public service could try to identify employment pools where it is possible to buy the necessary skills and expertise, and pursue aggressive recruiting campaigns in those pools. But such pools are rarely more than puddles. Finally, the civil service could buy its former contract managers back from the contractors who have hired them away. The public sector has always served as a training ground for private employment, so the ... government could reverse the roles.<sup>32</sup>

#### **E. Legislative Responses**

Legislative responses to the civil service system should also address the interaction between contracting out by the state and county governments, again assuming that privatization efforts will increase in the future in an attempt to establish greater efficiency in government. Depending on the policy objective taken by the Legislature, the following legislation may be introduced to achieve one or more of the following purposes:

- (a) Although beyond the scope of this memorandum, one possible legislative response is to review and redraft chapter 76, *Hawaii Revised Statutes*, to: (1) merge the statutory provisions relating to the civil service system of the City and County of Honolulu in chapter 46 into chapter 76, so that chapter 76 is in fact applicable to the State and “each of the counties”, as provided in section 76-1; and (2) incorporate the Auditor’s recommendations to liberalize provisions on position classifications and clarify the rationale for and categorization of exempt positions. This type of legislation assumes, of course, that the civil service system under chapter 76 will not be repealed and that the counties will not be given greater home rule powers that include establishing their own civil service systems;
- (b) The *Hawaii Revised Statutes* already includes a number of instances authorizing the state and county governments to contract out government services to the private sector. Some of these provisions already contain exemptions from the civil services and other laws, such as collective bargaining. A bill has been included as Appendix V that seeks to amend each statutory instance of contracting out by the State or counties, giving the Legislature the option of exempting or not exempting each such particular activity from the civil service and other state laws;
- (c) Another option would be to amend the State Constitution to give greater power to the counties by giving local civil service laws (in county charters and ordinances) priority over state civil service laws.<sup>33</sup> Alternatively, the counties could be given the power to adopt their own civil service systems subject to their conformity with certain statutory guidelines, such as ensuring consistency with the merit system. This proposal could be a separate proposal from the proposed “residual powers” home rule amendment suggested in part IV of this memorandum, or it could be incorporated in such a constitutional amendment; and
- (d) As discussed in part VIII of this memorandum, the State of Georgia has recently reformed its civil service system by essentially abolishing that system with respect to new hires. Another option is therefore to introduce legislation to abolish the state civil service system, similar to that of Georgia, for those employees hired after July 1, 1998. See Appendix Q.

## Endnotes

1. The process established under chapter 76, *Hawaii Revised Statutes*, includes a number of requirements to be incorporated into the steps that agencies must take in order to fill civil service positions, including a systematic classification of all positions through adequate job evaluation; development and maintenance of a position classification plan; creation and adjustment of position classes and class specifications, including

- minimum position qualifications; allocation of positions to appropriate classes; competitive examinations; and specific guidelines for filling vacancies. See Hawaii Auditor, Report No. 94-23, at 6 - 16.
2. Section 76-1, *Hawaii Revised Statutes*, further declares as the policy of the State that the personnel system be applied and administered in accordance with the following merit principles:
    - (1) Equal opportunity for all regardless of race, sex, age, religion, color, ancestry, or politics....;
    - (2) Impartial selection of the ablest person for government service by means of competitive tests which are fair, objective, and practical;
    - (3) Just opportunity for competent employees to be promoted within the service;
    - (4) Reasonable job security for the competent employee, including the right of appeal from personnel actions;
    - (5) Systematic classification of all positions through adequate job evaluation; and
    - (6) Proper balance in employer-employee relations between the people as the employer and employees as the individual citizens, to achieve a well trained, productive, and happy working force.
  3. For a discussion of civil service limitations on public sector privatization initiatives in other states, see part VIII of this memorandum.
  4. Konno v. County of Hawaii, 85 Haw. 61, 68, 937 P.2d 397, 404 (1997) (internal references and citations omitted).
  5. 85 Haw. at 69, 937 P.2d at 405, *quoting* United Public Workers v. Mitchell, 330 U.S. 75, 121, 67 S.Ct. 556, 580, 91 L.Ed. 754 (1947) (Douglas, J., dissenting in part) (*quoting* G. Wallas, Human Nature in Politics 263 (2d ed.)).
  6. Craig Becker, "With Whose Hands: Privatization, Public Employment, and Democracy," 6 Yale Law & Policy Review 88, 95 (1988). The implementation of the federal civil service system in 1883 followed the assassination of President Garfield "by a disgruntled job seeker." E. S. Savas and Sigmund G. Ginsburg, "The Civil Service: A Meritless System?" in Classics of Public Personnel Policy (ed. By Frank J. Thompson) (Oak Park, IL: Moore Publishing Co., 1979), at 214.
  7. See notes 35 to 38 and accompanying text in part VIII of this memorandum for a discussion of Georgia's civil service reform law.
  8. Becker (1988), *supra* note 6, at 95. Becker noted that if elimination of the spoils system was the sole purpose of civil service laws, "they would have been rendered largely superfluous by Elrod v. Burns, 427 U.S. 347 (1976), which held that patronage dismissals trespass on the first amendment." Id. at 95 n. 48.
  9. Id. at 96. Becker noted that a recent study on the effect of privatization on women workers suggested that "because of greater subjectivity in hiring and promotion procedures, privatization may contribute to a stabilization or increase in the gender, racial, and ethnic segregation of occupations." Id. at 97 (footnote omitted).
  10. Id. at 98.
  11. Savas and Ginsburg (1979), *supra* note 6, at 215.

12. Id.
13. Id. at 215 - 219. For example, one study found that candidates with low passing grades were actually more likely to be hired than those with high passing grades. Id. at 218. Rigid procedures often prohibit the promotion of the most highly qualified individuals, as described by one frustrated high-level official in New York City: “In an occupational area like computer operations, applying the usual rigid procedures denies us the option of hiring experienced computer programmers, systems analysts, and data processing managers. It would force us to appoint only computer programming trainees and to wait for these to be trained and developed by years of experience. This is patently absurd.” Id. at 219.
14. Hawaii Auditor, Audit of the Process of Staffing State Programs (Honolulu: Report No. 94-23, Dec. 1994) at 1. As of December 31, 1995, 24,547 employees, or 52.17 percent of the workforce, were civil service employees. Hawaii Department of Human Resources Development, Hawaii State Government WorkForce Profile 1995 (Honolulu: Feb. 1996) at 1. A 1994 state demographics analysis showed that of the number of civil service employees, over half were between the ages of 35 and 49, with the median age in the 40 to 44 range; and 16% were over 55 and eligible for retirement. In addition, 61% of the employees were female, 39% male; 63% had less than ten years of service, while 42% had less than five years. Hawaii Department of Personnel Services, State of Hawaii Civil Service Demographics Analysis, prepared by the Social Science Research Institute, University of Hawaii at Manoa (Honolulu: Aug. 1992) at 1-2.
15. *See, respectively*, Hawaii Department of Budget and Finance, Report on Senate Resolution No. 126, Requesting a Study of “Exempt” Employment in the Civil Service (Honolulu: 1986); Hawaii Department of Personnel Services, Integrated Personnel System Study (Honolulu: May 1989 to August 1989); Hawaii Department of Personnel Services, A Feasibility Study to Improve the Classification, Job Evaluation and Compensation System (Philadelphia, PA: The Wyatt Co., 1990); and Hawaii Department of Personnel Services, A Review of the Use of Temporary, Emergency, and Exempt Hires by the State (Honolulu: 1991). The 1990 study found that the job classification system as it had evolved over the years “is viewed by employees and program managers as a problem”, and that if the State was committed to improving that system, it should install an automated system based on quantitative job evaluation concepts. Id., Executive Summary at 1. That study further noted that after holding discussions with agency and union representatives, the State was not ready to move to a true “pay-for-performance” philosophy, although the federal government was expected to consider modifying its salary program to incorporate private sector merit pay concepts in 1990 as part of a pay reform package. Id. at 2.
16. Auditor, Report No. 94-23, at 1.
17. Id. at 21.
18. Id. at 22 - 25.
19. Federal civil service reform has been addressed in several recent works, including Donald F. Kettl, et al., Civil Service Reform: Building a Government That Works (Washington, DC: Brookings Institution Press, 1996); Patricia Wallace Ingraham, The Foundation of Merit: Public Service in American Democracy (Baltimore: The Johns Hopkins University Press, 1995); and John J. DiIulio, Jr., Gerald Garvey, and Donald F. Kettl, Improving Government Performance: An Owner’s Manual (Washington, DC: The Brookings Institution, 1993) at 64-72.
20. Id. at 23.
21. Savas and Ginsburg (1979), *supra* note 6, at 220 (emphasis added).
22. Id. at 221; *see also* David T. Stanley, “What are Unions Doing to Merit Systems?”, *reprinted in* Classics of Public Personnel Policy, ed. Frank J. Thompson (Oak Park, IL: Moore Publishing Co., Inc., 1979) at 264 - 270.

23. Public-Private Collaboration in the Delivery of Local Public Services, California Government Series II, No. 16 (Workshop Proceedings of April 11, 1980) (Davis, CA: Institute of Governmental Affairs and the Univ. Of California at Davis Kellogg Program, Sept. 1980) at 88 (remarks by T. F. Nelson).
24. *See, e.g.*, Robert D. Behn, “Winning Labor’s Cooperation,” Governing, Vol. 10, No. 8, May 1997, at 62 (“both civil service and collective bargaining — by creating a structured system for making decisions about hiring, promotion and discipline — deny the legislature the opportunity to micromanage executive-branch personnel and reinforce each other”).
25. Frederick C. Mosher, “Democracy and the Public Service: The Collective Services,” *reprinted in* Classics of Public Administration, ed. Jay M. Shafritz and Albert C. Hyde (Belmont, CA: Wadsworth Publishing Co., 1992) at 507 (footnote omitted).
26. The argument can be made that Article XVI, section 1, of the Hawaii Constitution, which provides that “[t]he employment of persons in the civil service, as defined by law, of or under the State, shall be governed by the merit principle”, effectively prohibits the abolition of the civil service. While this section *presumes* the existence of a civil service, the provision can nevertheless be read as providing that *if* there is a civil service, *then* that system shall be governed by the merit principle, rather than as necessarily *mandating* the establishment of a civil service system itself.
27. Joyce Najita, Hawaii Constitutional Convention Studies 1978, Article XII: Organization: Collective Bargaining (Honolulu: Legislative Reference Bureau, May 1978) at 63, *citing* Joel Seidman and Joyce Najita, The Merit Principle and Collective Bargaining in Hawaii (Honolulu: State Department of Personnel Services, 1976).
28. Id. at 64.
29. Kettl, et al. (1996), *supra* note 19, at 50.
30. *See, e.g.*, Ingraham (1995), *supra* note 19, at 116, regarding the need for federal civil servants responsible for contract management to update their skills: “Clearly new skills are required. The technical and professional skills needed by a successful engineer, for example, do not necessarily translate into the effective design or management of engineering contracts. In this sense, the recruiting, classification, and training activities of the federal government lag far behind — or worse, fail completely to match — the reality of what many employees do on a daily basis.”
31. Kettl, et al. (1996) at 50.
32. Id. at 51.
33. While state legislatures may generally enact laws providing that appointments to public offices or positions are to be made according to merit principles, the state constitution may provide that the regulation of the civil service of a local government is one of the powers of that government under its home rule powers. In such a case, it has been held that “[w]here the regulation of the civil service of a city is clearly one of the powers of the local self-government, provisions in relation thereto contained in a charter adopted by a city under the ‘home rule’ provisions of the state constitution supersede the general civil service law in the municipality concerned, provided they comply with a state constitutional requirement for making appointments and promotions in the city civil service according to merit and fitness ascertained, so far as practicable, by competitive examinations, and are otherwise constitutional.” 15A Am.Jur.2d Civil Service §9 (1976) at 14-15; *see also id.* at §§2, 3; 63C Am.Jur.2d Public Officers and Employees §§44-47 (1997).

## PART VI. COLLECTIVE BARGAINING

### A. Generally

Like Hawaii's civil service laws, public sector collective bargaining in Hawaii has a constitutional foundation. Article XIII, Section 2, of the Hawaii Constitution provides that "[p]ersons in public employment shall have the right to organize for the purpose of collective bargaining as provided by law."<sup>1</sup> The Legislature enacted implementing legislation in 1970, which was codified as chapter 89, Hawaii Revised Statutes ("collective bargaining in public employment").<sup>2</sup> Chapter 89 establishes thirteen bargaining units, including supervisory and nonsupervisory employees in blue- and white-collar positions, firefighters, and police officers (section 89-6). That chapter also provides for the resolution of disputes and impasses through mediation, fact finding, and arbitration (section 89-11); participation in strikes (section 89-12); prohibited practices (section 89-13); and penalties (section 89-18). An office of collective bargaining was created in 1975, codified as chapter 89A, Hawaii Revised Statutes, to assist the Governor in discharging the duties of the collective bargaining law. The legislative history of that chapter states that the intent was to "clearly specify" the areas and the manner in which bargaining was required in order to avoid or minimize controversies.<sup>3</sup>

The central issue to be resolved regarding collective bargaining is whether, and under what circumstances, privatization is subject to mandatory collective bargaining by public sector employees in Hawaii.<sup>4</sup> The Hawaii Supreme Court did not reach this issue in Konno. The Court held that "privatization of the landfill violates civil service statutes and constitutionally mandated merit principles"; however, Hawaii's public sector collective bargaining laws "expressly state that parties are barred from negotiating upon and agreeing to proposals that violate merit principles."<sup>5</sup> Citing section 89-9(d), Hawaii Revised Statutes ("scope of negotiations"),<sup>6</sup> the Court maintained that since the County's contract with the private contractor violated civil service laws, the County and the union (UPW) were therefore prohibited from bargaining over either the decision to contract out or the effects of that decision. The Court therefore concluded that the County did *not* violate collective bargaining laws by refusing to bargain over the effects of privatization. As noted in part II of this memorandum, the Court left the door open on this issue:

We emphasize that this opinion should not be interpreted as establishing a per se rule that privatization is not subject to mandatory collective bargaining. Our decision on the collective bargaining issue is based on our prior holding that the County's privatization effort violated civil service laws and merit principles. If a future privatization effort does not violate civil service laws and merit principles, either because the County obtains certification under HRS § 76-77(7) or because the legislature enacts a new statute specifically exempting such privatization efforts, then it may indeed come into conflict with our collective bargaining laws. However, such circumstances are not present before us at present.<sup>7</sup>

In addressing the merits of this issue, including how the Hawaii Supreme Court might decide the issue in a future case, it is necessary to review federal and state law in this area.

Many state statutes regulating collective bargaining in the public sector, including Hawaii's, are based in part on the National Labor Relations Act (NLRA).<sup>8</sup> That Act was enacted "to eliminate the causes of certain substantial obstructions to the free flow of commerce and to mitigate and eliminate these obstructions when they have occurred by encouraging the practice and procedure of collective bargaining and by protecting the exercise by workers of full freedom of association, self-organization, and designation of representatives of their own choosing, for the purpose of negotiating the terms and conditions of their employment or other mutual aid or protection."<sup>9</sup> Although that Act applies only to the *private* sector, it has served as a model for a number of state statutes that have established collective bargaining for various state, county, and municipal employees.<sup>10</sup>

In the private sector, an employer's decision to contract out — i.e., allocate or subcontract work to another private company — may reduce the work remaining for the employer's workforce, and may or may not be lawful, depending on the surrounding circumstances. For example, if the employer's decision to contract out is made to prevent its employees from organizing and selecting a collective bargaining representative, that is generally considered an unfair labor practice under the NLRA. However, an employer does not commit an unfair labor practice by contracting out work for business reasons so long as the contracting out was not an attempt to chill unionism. The issue is not whether the employer's business reasons were good or bad, but rather whether those reasons actually motivated the contracting out; the National Labor Relations Board will not substitute its business judgment for that of an employer in determining whether the decision to contract out was illegally motivated.<sup>11</sup> However, the transfer of business to an independent contractor is considered to be an unfair labor practice "if the transfer is a sham to avoid unionization and results merely in the so-called independent contractor conducting business on the employer's behalf."<sup>12</sup>

Public sector labor law generally recognizes two categories of subjects in collective bargaining, namely, mandatory and permissive bargaining. Mandatory subjects are those on which the parties must bargain on demand and in good faith, and that materially or significantly affect the terms and conditions of employment. Permissive subjects are those about which the parties may bargain on a voluntary basis, including those that are remote or incidental to the employment relationship or do not have a direct, significant relationship to the terms or conditions of employment.<sup>13</sup> The resolution of whether a subject is a mandatory or permissive subject of negotiations is a two-step process: "First, it is necessary to determine whether it is legal for a public employer to agree to a given subject. Second, if it is legal, then it is necessary to determine whether the item is a mandatory or permissible subject of negotiations."<sup>14</sup>

## **B. Federal Law**

Most state public sector bargaining laws define the mandatory scope of negotiations in terms similar to that of the National Labor Relations Act, namely, that the parties must negotiate in good faith "with respect to wages, hours, and other terms of employment."<sup>15</sup> The ambiguous and widely litigated phrase "other terms and conditions of employment" has caused the most difficulty in resolving disputes. The question for decision in cases involving whether there is an obligation to bargain is "to what extent does the subject at issue affect working conditions? On this, the United States Supreme Court decision in Fibreboard Paper Products Corp. v. NLRB, is one of the most instructive cases on the subject."<sup>16</sup>



In Fibreboard, an employer unilaterally decided to terminate its own maintenance staff and hire a subcontractor to perform the same work within its plant without bargaining in good faith. The Court held that the contracting out of work performed by bargaining unit employees was a mandatory subject of bargaining under the NLRA when that contracting out involved the replacement of employees in the existing bargaining unit with those of an independent contractor to do the same work under similar conditions of employment.<sup>17</sup> In interpreting the phrase “other terms and conditions of employment”, Chief Justice Warren writing for the majority focused on the discharge of the maintenance employees, arguing that a discharge falls within the literal meaning of that phrase, the contracting out resulted in the loss of employment, and the decision to contract out was therefore a term or condition of employment that was beyond the power of the employer to effectuate unilaterally.<sup>18</sup> The majority opinion further maintained that including “contracting out” as a mandatory subject of collective bargaining helped to effectuate the purposes of the NLRA to “promote the peaceful settlement of industrial disputes by subjecting labor-management controversies to the mediatory influence of negotiation”, and was further reinforced by industrial practices in the country.<sup>19</sup>

The Court acknowledged that the Company was concerned with the high cost of its maintenance operation, and that it was induced to contract out to save money by economies derived from reducing its work force, decreasing fringe benefits, and eliminating overtime payments. However, the Court rejected the Company’s argument that when costs savings can be achieved by contracting work out to an independent contractor, there is no need to try to achieve similar economies through negotiations with existing employees or give them an opportunity to negotiate a mutually acceptable alternative, stating that “[t]he short answer is that, although it is not possible to say whether a satisfactory solution could be reached, national labor policy is founded upon the congressional determination that the chances are good enough to warrant subjecting such issues to the process of collective negotiation.”<sup>20</sup>

While contracting out under the NLRA may be a mandatory subject of collective bargaining, however, it is not necessarily so. The Fibreboard ruling remained in effect without significant change until the United States Supreme Court’s ruling in First National Maintenance Corp. v. NLRB in 1981,<sup>21</sup> which recognized the right of an employer to make management decisions even though they may specifically affect a union. In that case, the Court held that an employer is not obligated to bargain with a union before closing a part of its business and discharging the employees who worked in that part of the operation. The Court noted that “in establishing what issues must be submitted to the process of bargaining, Congress had no expectation that the elected union representative would become an equal partner in the running of the business enterprise in which the union’s members are employed.”<sup>22</sup> The Court also identified three types of management decisions:

- (1) Those with “only an indirect and attenuated impact on the employment relationship”;
- (2) Those that “are almost exclusively ‘an aspect of the relationship’ between employer and employee”, such as “the order of succession of layoffs and recalls, production quotas, and work rules”; and
- (3) Those “that [have] a direct impact on employment, ... but [have] as [their] focus only the economic profitability” of non-employment-related concerns.<sup>23</sup>

The employer's decision to terminate one part of its business in First National fell into the third category of management decisions, since that decision affected employment but was motivated by considerations unrelated to the employment relationship. Whether decisions in that category require mandatory collective bargaining depends upon the extent to which "the subject proposed for discussion is amenable to resolution through the bargaining process. Management must be free from the constraints of the bargaining process to the extent essential for the running of a profitable business. It must also have some degree of certainty beforehand as to when it may proceed to reach decisions without fear of later evaluations labeling its conduct an unfair labor practice."<sup>24</sup>

While Congress did not explicitly state which issues of mutual concern to management and union were to be excluded from mandatory bargaining, the Court nevertheless held that, "in view of an employer's need for unencumbered decision making, bargaining over management decisions that have a substantial impact on the continued availability of employment should be required only if the benefit, for labor-management relations and the collective-bargaining process, outweighs the burden placed on the conduct of the business."<sup>25</sup> The Court noted that the Court in Fibreboard had implicitly engaged in this balancing test. However, the Court in First National reached the opposite result from Fibreboard since the employer's decision to close part of its business was not driven by labor costs. The Court concluded that collective bargaining would have been futile and was not required because the union had no control over the factors motivating the company's decision to close part of its operation: "We conclude that the harm likely to be done to an employer's need to operate freely in deciding whether to shut down part of its business purely for economic reasons outweighs the incremental benefit that might be gained through the union's participation in making the decision..."<sup>26</sup>

### C. State Law

*Hawaii.* It has been noted that "[i]n many ways Hawaii's collective bargaining law resembles the National Labor Relations Act, administered by the National Labor Relations Board (NLRB). Indeed, the Hawaii Supreme Court has found NLRB decisions 'particularly instructive...'.<sup>27</sup> However, the NLRA, which is only applicable to the private sector, contains "significant differences: The duty to bargain is not restricted by a management rights reservation; violation of a contract provision is not per se an unfair labor practice; federal courts are expressly empowered to enforce collective bargaining agreements; and arbitration is strictly voluntary, not imposed by the federal Act."<sup>28</sup> Perhaps the most important difference for purposes of this discussion is Hawaii's management rights clause.<sup>29</sup> Hawaii's management rights provision is contained in section 89-9(d), Hawaii Revised Statutes, which provides in relevant part:

The employer and the exclusive representative shall not agree to any proposal which would be inconsistent with merit principles ... , or which would interfere with the rights of a public employer to (1) direct employees; (2) determine qualifications, standards for work, the nature and contents of examinations, hire, promote, transfer, assign, and retain employees in positions and suspend, demote, discharge, or take other disciplinary action against employees for proper cause; (3) relieve an employee from duties because of lack of work or other legitimate reason; (4) maintain efficiency of government operations; (5) determine methods, means, and personnel by which the employer's operations are to be conducted; and take such actions as may be necessary to carry out the missions of the employer in cases of emergencies

....<sup>30</sup>

The Hawaii Supreme Court has previously held that “[b]earing in mind that the Legislature intended Chapter 89 to be a positive piece of legislation establishing guidelines for joint-decision making over matters of wages, hours and working conditions, we are of the opinion that all matters affecting wages, hours and working conditions are negotiable and bargainable, subject only to the limitations of Section 89-9(d).”<sup>31</sup> However, “the permissible scope of negotiations is not unlimited”: “The legislative history reveals that the intent of the legislature in enacting [Hawaii Revised Statutes] § 89-9 was to allow the public employees and their employers free range in negotiating the terms of their contract as long as those terms ... do not interfere with the rights of a public employer to carry out its public responsibility.”<sup>32</sup>

At the same time, the public employer’s “public responsibilities” necessarily include duties imposed by duly enacted legislation.<sup>33</sup> Nor do the managerial rights specified in section 89-9(d) “give such sweeping power to the ... [public employer] so that all matters mentioned there are sacrosanct and inviolable by collective bargaining.”<sup>34</sup> The Court has also deferred to the Hawaii Labor Relations Board, and its predecessor, the Hawaii Public Employment Relations Board, in their interpretations of the public sector collective bargaining law, noting that “[j]udicial deference to agency expertise has ... been a guiding precept where the interpretation and application of broad or ambiguous statutory language by an administrative tribunal are the subject of review.”<sup>35</sup> In 1975, the Board ruled that the Hawaii Legislature had “completely preempted the *excluded* management rights from the scope of bargaining.”<sup>36</sup>

**Other States.** Other state and county public employment relations boards (“PERBs”) have recognized “[t]hat a given item might be considered a term or condition of employment and at the same time constitute a managerial prerogative thereby creating a problem of overlap/conflict...”<sup>37</sup> While state courts have generally recognized that issues of policy that fall under the category of managerial prerogative are not proper subjects of bargaining or negotiation,<sup>38</sup> state court decisions have established different tests of bargainability or negotiability. These usually follow one of two models — either the balancing test used in First National and Fibreboard, or a “primary” or “significant” relations standard.<sup>39</sup>

Fibreboard/First National “balancing” standard. The other standard used to resolve this conflict is the “balancing” test, used by the United States Supreme Court in First National and implicitly used in Fibreboard, and which was also used beginning in the 1970s by courts in such states as Kansas, Pennsylvania, and Oregon: “A balancing test is rapidly emerging as the proper standard by which to determine whether a subject is mandatory or permissive — a test which openly acknowledges the overlap/conflict problem and involves a consideration of the competing interests at stake.”<sup>40</sup> More recently, courts in Illinois have used the following three-part test to determine if an issue is a mandatory subject of collective bargaining, which incorporates a balancing standard:

The first part of the test requires a determination of whether the matter is one of wages, hours and terms and conditions of employment. This is a question that the [Board] is uniquely qualified to answer, given its experience and understanding of bargaining in ... labor relations. If the answer to this question is no, the inquiry ends and the employer is under no duty to bargain.

If the answer to the first question is yes, then the second question is asked: Is the matter also one of inherent managerial authority? If the answer to the second question is no, then the analysis stops and the matter is a mandatory subject of bargaining. If the answer is yes, then ... the matter is within the inherent managerial authority of the employer and it also affects wages, hours and terms and conditions of employment.

At this point in the analysis, the [Board] should balance the benefits that bargaining will have on the decisionmaking ... process with the burdens that bargaining imposes on the employer's authority. Which issues are mandatory, and which are not, will be very fact-specific questions, which the [Board] is eminently qualified to resolve.<sup>41</sup>

New Jersey has also adopted a balancing standard together with a three-part test. In In re IFPTE Local 195 v. State, the New Jersey Supreme Court held that the issue of contracting out was not a mandatory subject of collective bargaining.<sup>42</sup> While that Court sought to balance the competing interests of the public employer and public employees, the Court recognized that the balancing process was constrained by the policy goals underlying relevant statutes and the state constitution.<sup>43</sup> Accordingly, the Court adopted the following three-part test for scope of negotiations determinations:

A subject is negotiable between public employers and employees when (1) the item intimately and directly affects the work and welfare of public employees; (2) the subject has not been fully or partially preempted by statute or regulation; and (3) a negotiated agreement would not significantly interfere with the determination of government policy. To decide whether a negotiated agreement would significantly interfere with the determination of governmental policy, it is necessary to balance the interests of the public employees and the public employer. When the dominant concern is the government's managerial prerogative to determine policy, a subject may not be included in collective negotiations even though it may intimately affect employees' working conditions.<sup>44</sup>

The Court concluded that the decision to contract out work was a non-negotiable matter of managerial prerogative, and that "[i]mposing a duty on the state to negotiate all proposed instances of subcontracting would transfer the locus of the decision from the political process to the negotiating table, to arbitrators, and ultimately to the courts. The result of such a course would significantly interfere with the determination of government policy and would be inimical to the democratic process."<sup>45</sup>

The balancing test has been praised in helping to resolve scope of bargaining issues on a case-by-case basis: "The balancing test utilized by an increasing number of PERBs and courts to resolve the conflict/overlap problem acknowledges that both parties have significant interests at stake and that these competing interests should be balanced to determine how a proposed subject for negotiations should be classified. Moreover, the balancing approach is well suited to a case by case determination of negotiability." However, "the balancing standard will produce different conclusions as to the same item because of differences in statutes and difference in the criteria utilized by the decision maker to balance the competing interests."<sup>46</sup> The Hawaii Supreme Court is not limited to federal and state court precedents in determining whether contracting out should be a mandatory subject of bargaining; for example, the Court may look for guidance to the history and custom of the industry in Hawaii in resolving this question, as did the United States Supreme Court in Fibreboard.<sup>47</sup>

*“Primary” or “significant” relationship standard.* The Wisconsin Supreme Court in Unified Sch. Dist. v. WERC adopted a “primary relationship” standard, under which the question is “whether a particular decision is primarily related to the wages, hours and conditions of employment of the employees, or whether it is primarily related to the formation or management of public policy.”<sup>48</sup> In that case, a school district’s decision to subcontract out a food services program to the private sector “merely substituted private employees for public employees. The same work will be performed in the same places and in the same manner. The services provided by the district will not be affected.”<sup>49</sup> Accordingly, because the policies and functions of the district were unaffected by the decision to contract out, and the primary impact of that decision was on the “conditions of employment”, the decision was subject to mandatory bargaining.<sup>50</sup>

Other state and county PERBs and state courts have adopted a similar “significant relationship” standard to resolve this conflict: “Several courts have resolved the overlap problem by classifying a given subject as mandatory if it is significantly related to wages, hours and other terms and conditions of employment.”<sup>51</sup> For example, both the Nevada PERB and the Los Angeles County Employee Relations Commission have used this standard in resolving this conflict/overlap problem. This standard has been criticized, however, as producing a “distinct bias towards negotiability”: “This standard is inadequate because it does not properly recognize the competing interests at stake where there is an overlap between conditions of employment on the one hand and management prerogatives on the other. By focusing on only one-half of the overlap problem, the standard gives undue weight to conditions of employment.”<sup>52</sup>

#### **D. Balancing Competing Interests**

As noted earlier, the Court in Konno cited the portion of section 89-9(d) prohibiting an employer and the exclusive representative from agreeing to any proposal that would be inconsistent with merit principles. At the same time, however, paragraph (4) of that subsection specifies the competing managerial right prohibiting the employer and the exclusive representative from agreeing to any proposal that would interfere with the employer’s rights to “maintain efficiency of government operations”. The Court, however, did not address this conflicting managerial right, finding that the collective bargaining law did not require negotiation over topics that were contrary to duly enacted laws.

How would the Hawaii Supreme Court decide the issue of whether contracting out is a mandatory subject of collective bargaining, assuming that the decision to contract out government services is not illegally motivated or otherwise contrary to any duly enacted law? If the Court chooses to weigh the competing issues using a balancing standard, similar to First National and Fibreboard, the Court must determine balance the rights of public sector workers, including a union’s job security and related concerns over the effects of contracting out, on the one hand, with the managerial prerogative of “maintain[ing] efficiency of government operations” on the other. Ultimately, the Court’s decision in determining whether contracting out is a mandatory subject of bargaining will depend on the facts of a particular case, and whether “the benefit, for labor-management relations and the collective-bargaining process, outweighs the burden placed on the conduct of” the efficient business of operating Hawaii state or county government.

What are the competing concerns to be balanced in “contracting out” decisions? For the most part, they center on issues relating to government efficiency versus job security. On the one hand, it is argued that contracting out government activities to the private sector generally increases government effectiveness and efficiency. Arguments in favor of this position are advanced in part III.B.1. of this memorandum. The Court must also review the agency’s decision to contract out — namely, did that decision fall within the managerial prerogative to maintain the efficiency of government operations under section 89-9(d)(4), or was it the decision made for other, impermissible reasons. Agencies may be able to introduce sufficient evidence that a decision was made for reasons of economy and efficiency.<sup>53</sup>

For example, the budgetary problems in Hawaii state and county governments in recent years have forced executive agencies to review all necessary measures to reduce government costs to make government more efficient. In 1993, the Legislature adopted House Concurrent Resolution No. 209, S.D. 1, requesting a study and report on issues relating to the sufficiency of government in Hawaii. That resolution noted that “the size of government in this State is reaching the point where the public payroll is no longer adequately supported by the tax base” and that “concurrently, in light of ever-increasing demands for new and more services, it is vital that an analysis of overall state efficiency be conducted to develop new problem-solving mechanisms to facilitate efforts to reduce and eliminate waste and inefficiency...”<sup>54</sup> Among the solutions presented by the Interim Commission on Government Redesign in response to that resolution was the implementation of the privatization of government services.<sup>55</sup> Legislation enacted in 1994 also required proposed new executive programs to meet cost efficiency standards similar to that of the private sector.<sup>56</sup>

On the other hand, when government employers seek to contract out work that is currently being performed by government employees, whether because the work can be done more cheaply by the private sector or for other administrative or political reasons, public employees and their unions may feel threatened and resist, often bringing pressure to retain government work for government employees.<sup>57</sup> Job security is an extremely important issue for public workers, especially during periods of economic downturns, in which state and county budget cutbacks and other factors make finding other jobs in a worker’s field of expertise either difficult or impossible: “Fear, not inflation, has become the gut issue for many public employees. Terminations for any reason whatsoever are particularly threatening in an economy where alternative job opportunities are severely limited or nonexistent and the unemployment rate remains at an unusually high level.”<sup>58</sup> Although public employees have traditionally enjoyed greater job security than similarly situated private sector workers, this situation is changing in response to governments’ efforts to downsize and become more efficient.

While public employees have traditionally sought greater job security through the Legislature and the Judiciary, collective bargaining has emerged as a new mechanism.<sup>59</sup> Opinions vary, however, as to the appropriateness of this usage, especially in the context of contracting out government services. For example, it has been argued that successful union resistance to contracting out “means that governments have agreed to retain work for employees even though there may be otherwise sound management reasons for having the work done by outsiders. Governments have thus surrendered some of their rights to determine management policies. They are obliged, under these anti-contracting pressures, to do their work in such a way as to protect the jobs of certain groups of citizens.”<sup>60</sup>

Others argue that, all other things being equal, contracting out “is preferable to retaining a function that has been unionized” for several reasons. One reason is to avoid strikes affecting essential public services. Another is that a private employer is better organized to resist demands by unions than are political subdivisions: “The organization of a private business is directed largely to one end: the maximization of profits. While there may be internal conflicts over policy, and policy may be formulated only after a series of internal bargains, the hierarchical structure of a firm permits a final decision binding all those within it.”<sup>61</sup> On the other hand, public employers are organized for completely different purposes:

There is a division of power between state and local levels, and within each level are complex organizational arrangements designed to divide functions and allocate power in a way that creates a system of checks and balances. The principal purpose of these structures seems to be to encourage division and weakness, or at least to prevent omnipotence. As a result, a united front by a public employer in a labor dispute frequently is impossible; each affected group or political unit within the government will have a different perspective on the dispute and will pursue its interest in the matter individually. This fact has not been lost on the unions.<sup>62</sup>

Private employers, it is argued, are therefore in a better position to counter union power than public employers; moreover, “[t]he threat of unemployment as a result of increased benefits ... is greater in private employment. The profit motive creates an incentive to resist wage demands and to place capital elsewhere if the return is too low.”<sup>63</sup>

It may be argued that since chapter 89, *Hawaii Revised Statutes*, resembles the NLRA, and the Hawaii Supreme Court appears to be receptive to the interpretations of that Act by the NLRB and federal courts, the Hawaii Supreme Court would hold, consistent with Fibreboard, that a public employer’s unilateral decision to contract out bargaining unit work and its failure to bargain in good faith about the effects of that decision would be a prohibited practice under section 89-13, Hawaii Revised Statutes. Some states, such as Ohio and Michigan, have already held that an employer’s unilateral decision to contract out bargaining unit work under facts similar to Fibreboard is a proper or mandatory subject of collective bargaining.<sup>64</sup> Other state courts, however, have split on this issue.<sup>65</sup>

A future case in Hawaii may also be distinguished from Fibreboard on its facts. In Fibreboard, the United States Supreme Court stated that its holding was limited to the facts of that case and the particular type of “contracting out” involved. Specifically, the United States Supreme Court noted that it agreed with the Court of Appeals that, “on the facts of this case, the ‘contracting out’ of the work previously performed by members of an existing bargaining unit” was subject to mandatory bargaining under the NLRA.<sup>66</sup>

The facts of the present case illustrate the propriety of submitting the dispute to collective negotiation. The Company’s decision to contract out the maintenance work did not alter the Company’s basic operation. The maintenance work still had to be performed in the plant. No capital investment was contemplated; the Company merely replaced existing employees with those of an independent contractor to do the same work under similar conditions of employment. Therefore, to require the employer to bargain about the matter would not significantly abridge his freedom to manage the business.<sup>67</sup>

The Court further noted that its decision “need not and does not encompass other forms of ‘contracting out’ or ‘subcontracting’ which arise daily in our complex economy.”<sup>68</sup>

Moreover, while the holding in Fibreboard is persuasive, that decision was based on the National Labor Relations Act, which applies only to the *private* sector, unlike Hawaii’s collective bargaining in public employment law. The scope of bargaining in public sector employment is generally more restricted in public, as opposed to private sector employment relations:

While some urge that more subjects of bargaining should be considered mandatory in the public arena because public employees are generally prohibited from striking, in reality the scope of bargaining in public employment relations is generally more limited. These limitations arise because of judicial concerns about the effect of unionization upon the political process, restrictions in the statutory language of public employee relations statutes, and concern for the ‘management rights’ of the public employer in making policy decisions....<sup>69</sup>

The Hawaii Supreme Court has also recently acknowledged that “‘the scope of negotiations in the public sector is more limited than in the private sector’ because ‘the employer in the public sector is government, which has special responsibilities to the public not shared by the private sector’”.<sup>70</sup>

While other state courts’ interpretations on this issue are persuasive, they may nevertheless be distinguished on the basis of different state statutory provisions on the same subject matter. For example, Michigan, which has consistently held that an employer’s unilateral decision to contract out bargaining unit work under facts similar to Fibreboard is a mandatory subject of collective bargaining, is in the minority of courts that have followed the precedents set in federal private labor decisions under the NLRA. Those state courts generally construe public employee collective bargaining rights “as broadly as those under the NLRA because of the similarity of state statutes to the NLRA.”<sup>71</sup> In contrast, Hawaii’s collective bargaining in public employment law, while similar in some respects to the NLRA, includes language modifying the NLRA requirement that parties negotiate in good faith “with respect to wages, hours, and other terms and conditions of employment”.<sup>72</sup> Moreover, the State, unlike the private sector, has the unique responsibility to make and implement public policy. The Court may therefore find that the scope of negotiations in Hawaii’s public sector to be more limited than in the private sector. The resolution of this issue by the Hawaii Supreme Court in a future case, however, may well depend upon the similarity of the facts in that case to Fibreboard, as well as the outcome of balancing the competing interests in a particular dispute.<sup>73</sup>

## **E. Legislative Responses**

The Legislature may wish to consider the following legislative measures:

- (1) As discussed earlier, the legislative intent in enacting Hawaii’s public sector collective bargaining law was to “clearly specify” the areas and manner in which public employees were to bargain collectively in order to avoid or minimize controversies.<sup>74</sup> Rather than wait for the Hawaii Supreme Court to resolve the issue of whether privatization is subject to mandatory collective bargaining under that law, the Legislature may wish to amend existing management rights provisions in section 89-



9(d), Hawaii Revised Statutes, by specifically including the decision to contract out as a managerial right, similar to language provided in the management rights section of the federal Civil Service Reform Act. A bill that incorporates relevant management rights language from that Act is attached as Appendix U.

- (2) As discussed in part IX of this memorandum, there are a number of instances in the *Hawaii Revised Statutes* that authorize the state and county governments to contract out services to the private sector. A bill has been included as Appendix V that seeks to amend each statutory instance of contracting out by the State or counties, giving the Legislature the option of exempting or not exempting each such particular activity from the collective bargaining laws and other state laws.

### Endnotes

1. The Hawaii Constitution was originally amended in 1968 as Article XII, Section 2; the current provision, which was renumbered in 1978 as Article XIII, Section 2, is substantially the same as the 1968 version. See Benjamin C. Sigal, "Public Employee Arbitration in Hawaii: A Study in Erosion," 2 U.H. L.Rev. 477, 481 n. 16 (1980 - 1981).
2. Act 171, Session Laws of Hawaii 1970. Section 1 of that Act stated that its purpose was to implement the constitutional mandate granting public employees the right to organize for collective bargaining purposes. For further information regarding collective bargaining in public employment law in Hawaii, see generally Hawaii Center for Labor Education and Research, A Guide to Hawaii Public Sector Employee Collective Bargaining (Honolulu: University of Hawaii, 1989); Hawaii Office of Collective Bargaining, Executive Office of the Governor, Annual Report (Honolulu: 1995); Hawaii Labor Relations Board, Annual Report (Honolulu: 1995 - 1996); Hawaii Government Organization Commission, Concern in Regards to the Operation of the Collective Bargaining Law, Research Memo No. 11 (Honolulu: April 1976).
3. The conference committee report for S.B. No. 1696-70, later enacted as Act 171 (1970), stated the belief of committee members that "any collective bargaining law enacted should clearly specify the areas and manner in which public employees shall bargain collectively if we are to avoid, or at least to minimize, the controversies which have arisen in other jurisdictions where collective bargaining is permitted and which have often resulted in disruption of public services." Conf. Com. Rep. No. 24 on S.B. No. 1696-70, *reprinted in House Journal, Reg. Sess. of 1970*, at 1262 (emphasis added). Similar language is found in Senate Stand. Comm. Rep. No. 745-707 and House Stand. Comm. Rep. No. 761-70, which were incorporated by reference into the conference committee report. See Senate Journal, Reg. Sess. of 1970, at 1330, 1331; House Journal, Reg. Sess. of 1970, at 1170, respectively.
4. This memorandum does not review the related issue of the extent private contractors and their employees in privatized institutions, such as correctional facilities that have been contracted out to be managed by the private sector, should be allowed collective bargaining rights. For further information on this issue, see generally Keltner W. Locke, "'Privitization' [sic] and Labor Relations: Some Welcome Guidance from the NLRB," Labor Law Journal, Vol. 38, No. 3, March 1987, at 166 - 172. For a discussion of the impact of collective bargaining and the merit principle on equal employment opportunity and affirmative action in Hawaii, see generally Alice H. Cook and Joyce M. Najita, Equal Employment Opportunity, Collective Bargaining and the Merit Principle in Hawaii (Honolulu: State Dept. of Personnel Services, Oct. 1979); Symposium Proceedings, Equal Employment Opportunity, Collective Bargaining and the Merit Principle in Hawaii, ed. Helene S. Tanimoto (Honolulu: State Dept. of Personnel Services, July 1980).
5. Konno v. County of Hawaii, 85 Haw. 61, 78, 937 P.2d 397, 414 (1997).

6. Section 89-9(d), *Hawaii Revised Statutes*, provides in relevant part: “The employer and the exclusive representative shall not agree to any proposal which would be inconsistent with merit principles...”.
7. 85 Haw. at 79, 937 P.2d at 415 (emphasis in original).
8. 29 U.S.C. §§151 *et seq.*, also known as the Wagner Act of 1935.
9. 29 U.S.C. §151.
10. *See generally* Benjamin Aaron, “Unfair Labor Practices and the Right to Strike in the Public Sector: Has the National Labor Relations Act Been a Good Model?”, 38 Stanford L.Rev. 1097 - 1122 (April, 1986). One commentator divides state statutes concerned with public sector bargaining into two broad categories: those providing for “*collective negotiations*” and those providing for “*meet and confer negotiations*”. In the former approach, the statutory definition of the duty to bargain is often very similar to that found in the National Labor Relations Act; these statutes may have been intentionally designed to incorporate by reference private sector precedents. The latter approach is defined as the “process of negotiating terms and conditions of employment intended to emphasize the differences between public and private employment conditions...”; legislation based on these types of negotiations “usually imply discussions leading to unilateral adoption of policy by legislative body rather than written contract, and take place with multiple employee representatives rather than an exclusive bargaining agent.” *See* Edwards, “The Emerging Duty to Bargain in the Public Sector,” 71 Mich. L. Rev. 885, 895 - 896 (1973) (footnote omitted); Joseph R. Grodin, et al., Collective Bargaining in Public Employment (Washington, DC: The Bureau of National Affairs, 1979) (3<sup>rd</sup> ed.) at 96 - 97.
11. 48 Am.Jur.2d, Labor and Labor Relations §§ 2031, 2032 (1994) at 1086.
12. Id., § 2033 (1994) at 1087 (footnote omitted).
13. 48A Am.Jur.2d, Labor and Labor Relations §§3018, 3019 (1994) at 373-374; *see also* NLRB v. Borg-Warner Corp., 356 U.S. 342, 78 S.Ct. 718, 2 L.Ed.2d 823 (1958).
14. R. Theodore Clark, Jr., “The Scope of the Duty to Bargain in Public Employment,” in Labor Relations Law in the Public Sector, ed. Andria S. Knapp (Chicago: American Bar Assn., 1977) at 82 - 83 (footnote omitted); *see also* Isidore Silver, Public Employee Discharge and Discipline (New York: John Wiley & Sons, 1989), §2.2 (“Scope of Bargaining”) at 2-4 to 2-13. In addition, several important legal consequences follow from a determination that a given subject of bargaining is mandatory or permissive:
 

*First*, and most obvious, if it is determined that a subject is permissive, it is usually an unfair labor practice for either party to insist upon such a permissive subject to the point of impasse. *Second*, in several states the determination of whether a given subject is mandatory or permissive has implications in terms of the statutory impasse procedure.... [I]mpasse procedures ... are usually limited to mandatory subjects of bargaining unless both parties agree to submit certain permissive subjects of bargaining. *Third*, even though the parties have agreed to include the permissive subject of bargaining in a collective bargaining agreement, upon its expiration neither party is under any obligation to include such provision in a successor agreement.... *Fourth*, if it is determined that a given subject is permissive rather than mandatory, an employer can act unilaterally without bargaining as to such permissive subject. *Fifth*, if a given item is held to be mandatory, an employer is prohibited from acting unilaterally on such item and is required to give the union prior notice and an opportunity to negotiate over said item prior to taking action. Clark (1977) at 85 - 86 (footnotes omitted).
15. 29 U.S.C. §158(d) provides in relevant part: “For the purposes of this section, to bargain collectively is the performance of the mutual obligations of the employer and the representative of the employees to meet at

- reasonable times and confer in good faith with respect to wages, hours, and other terms and conditions of employment, or the negotiation of an agreement, or any question arising thereunder, and the execution of a written contract incorporating any agreement reached if requested by either party, but such obligation does not compel either party to agree to a proposal or require the making of a concession ....” (Emphasis added.)
16. Reginald Alleyne, “Statutory Restraints on the Bargaining Obligation in Public Employment,” in Labor Relations Law in the Public Sector, ed. Andria S. Knapp (Chicago: American Bar Assn., 1977) at 102 - 103, *citing* 379 U.S. 203, 85 S.Ct. 398, 13 L.Ed.2d 233 (1964).
  17. 379 U.S. at 215.
  18. 379 U.S. at 210.
  19. 379 U.S. at 203 (footnote omitted). In a concurring opinion, Justice Stewart noted that while industrial experience may be useful in determining the proper scope of the duty to bargain, data showing that many labor contracts referred to subcontracting, or that subcontracting grievances were often referred to arbitrators under collective bargaining agreements, “while not wholly irrelevant, do not have much real bearing, for such data may indicate no more than that the parties have often considered it mutually advantageous to bargain over these issues on a permissive basis.” 379 U.S. at 220 (Stewart, J., concurring). In construing the scope of the duty to bargain, Justice Stewart further noted that “the words of the statute are words of limitation”, and that the NLRA did not say that the employer and employees were bound to confer on any subject that interested either of them, but rather that “the specification of wages, hours, and other terms and conditions defines a limited category of issues subject to compulsory bargaining.” *Id.* The concurring opinion further maintained that the ambiguity of the phrase “conditions of employment” was “susceptible of diverse interpretation”, and that only a narrow reading of that phrase would “serve the statutory purpose of delineating a limited category of issues which are subject to the duty to bargain collectively. Seeking to effect this purpose, at least seven circuits have interpreted this statutory language to exclude various kinds of management decisions from the scope of the duty to bargain.” 379 U.S. at 221 - 222 (footnote omitted).
  20. 379 U.S. at 214.
  21. 462 U.S. 666, 101 S.Ct. 2573, 69 L.Ed.2d 318 (1981).
  22. 452 U.S. at 676.
  23. 452 U.S. at 677 (citations omitted).
  24. 452 U.S. at 678 - 679 (footnote omitted).
  25. 452 U.S. at 679 (emphasis added).
  26. 452 U.S. at 686 (footnote omitted). The Court accordingly held that the employer’s decision itself was not part of the “terms and conditions” over which Congress had mandated bargaining under the NLRA. Looking to current labor practices in collective bargaining, the Court earlier noted that provisions giving unions a right to participate in “effects” bargaining were more prevalent than those giving unions a right to participate in the decision making process concerning alterations of the scope of an enterprise, that latter appearing to be “relatively rare.” 452 U.S. at 684.
  27. Sigal, *supra* note 1, 2 U.H. L.Rev. at 487 (footnotes omitted) (*citing* Hawaii State Teachers Ass’n v. Hawaii Pub. Employment Relations Bd., 60 Haw. 361, 365, 590 P.2d 993, 996 (1979)).
  28. Sigal, 2 U.H. L.Rev. at 487 (footnotes omitted).

29. *See, e.g.*, Sigal, 2 U.H. L.Rev. at 481 (footnote omitted) (“[T]he [Hawaii] Collective Bargaining Act limited the scope of bargaining with a management rights restriction that survives virtually unchanged.”) It has been noted that “[t]he singularly critical difference between the NLRA and the public sector labor laws on the scope-of-bargaining issue is the absence of a statutory management rights provision in the NLRA and the existence of those provisions in so many public sector enactments.” Alleyne (1977), *supra* n. 17, at 105. In 1981, the Industrial Relations Center of the University of Hawaii noted that a number of other states and municipalities had enacted management rights provisions in their public sector collective bargaining laws: “Traditional management rights clauses reserving for management those aspects of the employer’s operations which do not require discussion with or concurrence by the union are found in 36 laws and regulations. Seventeen laws and regulations state that the employer does not have to agree to a proposal which would limit certain enumerated rights or that the employer has the exclusive right to perform certain enumerated functions such as direct employees; hire, promote, discharge, and discipline employees; determine standards of work; maintain efficiency of government operations; and take such actions as are necessary in case of emergencies. Seven statutes provide that the employer does not have to bargain over inherent managerial policy or other subjects reserved to management.” Joyce M. Najita, Guide to Statutory Provisions in Public Sector Collective Bargaining, Scope of Negotiations, 3<sup>rd</sup> Issue (Honolulu: University of Hawaii at Manoa, Industrial Relations Center, Aug. 1981) at 7 (footnotes omitted).
30. Section 89-9(d), *Hawaii Revised Statutes* (emphasis added). Subsections (a) and (d) of section 89-9 were amended by Act 364, Session Laws of Hawaii 1993, §16, which added language cross-referencing the law relating to public school personnel. Those amendments, however, were repealed on June 30, 1995, and subsections (a) and (d) were reenacted in the form in which they read on July 7, 1993. *See* Act 364, Session Laws of Hawaii 1993, §17. While the Court in Konno cited the 1993 version of section 89-9, the language of that section remains unchanged through the date of this memorandum because of the reversion of the text of that section to the former (1993) text following the reenactment of that section.
31. University of Hawaii Prof. Assembly v. Tomasu, 79 Haw. 154, 161, 900 P.2d 161 (1995) (emphasis in original) (*quoting* In the Matter of the Hawaii State Teachers Association and the Department of Education,

- Decision No. 22, 1 HPERB 251, 266 (1972)). Moreover, pursuant to section 89-10(d), Hawaii Revised Statutes, the terms of a collective bargaining agreement supersede employer rules and regulations so long as they are not in conflict with management rights under section 89-9(d).
32. SHOPO v. Soc. of Professional Journalists, 83 Haw. 378, 403, 927 P.2d 386 (1996) (emphasis in original) (*quoting Hawaii Pub. Employment Relations Bd. v. United Pub. Workers*, 66 Haw. 461, 471, 667 P.2d 783, 790 (1983)).
  33. Id., 83 Haw. at 403; Konno, 85 Haw. at 78, 937 P.2d at 414. The Court in SHOPO further noted that section 89-19, *Hawaii Revised Statutes*, which provides that chapter 89 takes precedence “over all conflicting statutes concerning this subject matter” does not mean that all statutes, rules, or regulations may be avoided or contradicted by private contractual agreement reached by collective bargaining, since “‘parties may not do by contract that which is prohibited by statute.’” 83 Haw. at 405, *quoting Heatherly v. Hilton Haw’n Village Joint Venture*, 78 Haw. 351, 354, 893 P.2d 779, 782, *as amended on partial grant of reconsideration*, 78 Haw. 474, 896 P.2d 930 (1995). Parties to collective bargaining agreements are therefore prohibited from bargaining for provisions that are contrary to law. Nor may a court enforce a collective bargaining agreement that is contrary to public policy, so long as that policy is well defined and ascertained by reference to laws and legal precedents. Id.
  34. University of Hawaii Prof. Assembly v. University of Hawaii, 66 Haw. 207, 211, 659 P.2d 717 (1983).
  35. Hawaii Pub. Employment Relations Bd. v. United Pub. Workers, 66 Haw. at 471, *quoting Aio v. Hamada*, 66 Haw. 401, 406, 664 P.2d 727, 731 (1983). The Hawaii Public Employment Relations Board (HPERB) was established by Act in 1970. In 1985, the Legislature abolished the Hawaii Employment Relations Board (HERB), which administered private sector collective bargaining laws, effective January 1, 1986. The private sector functions of that board were transferred to HPERB, which was renamed the Hawaii Labor Relations Board (HLRB). *See Hawaii Labor Relations Board, Annual Report* (Honolulu: 1995-1996) at 2.
  36. *See Sigal*, 2 U.H. L.Rev. at 482 n. 17, *citing* 1 HPERB 586 (1975). The Board has apparently used a “balancing” test in resolving scope of bargaining issues. For example, the Board has balanced the mandate that working conditions be negotiated in section 89-9(a) with the prohibitions on agreements on certain subjects contained in section 89-9(d), Hawaii Revised Statutes. *See Hawaii Fire Fighters Association*, 2 HPERB 207, Decision No. 102 (1979); *see also Department of Education*, 1 HPERB 311, Decision No. 26 (1973).
  37. Clark (1977), *supra* n. 15, at 91.
  38. *See generally* Deborah Tussey, “Annotation: Bargainable or Negotiable Issues in State Public Employment Labor Relations,” 84 A.L.R.3d 242, 256 (1978) (§3a) and cases cited therein.
  39. *See generally* Marvin J. Levine, Privatization of Government: The Delivery of Public Goods and Services by Private Means (Alexandria, VA: International Personnel Management Assn., 1990) at 52-53; *see also* 84 A.L.R.3d 242, 258-260 (1978) (§3b) and cases cited therein.
  40. Id., *citing National Educ. Ass’n of Shawnee Mission, Inc. v. Bd. of Educ. Of Shawnee Mission, 212 Kan. 741, 512 P.2d 426, 84 LRRM 2223 (1973); PLRB v. State College Area School Dist., 337 A.2d 262, 90 LRRM 2081 (Pa.Sup.Ct. 1975); and Sutherlin Education Ass’n v. Sutherlin School Dist. No. 130, 25 Or.App. 85, 548 P.2d 204 (1976). *See also* private sector collective bargaining cases cited in 48A Am.Jur.2d, Labor and Labor Relations § 3039 (1994) at 384 - 385 (footnotes omitted).*
  41. Belvidere v. State Labor Rel. Bd., 283 Ill.App.3d 663, 218 Ill.Dec. 840, 670 N.E.2d 337, 341-342 (Ill.App. 2 Dist. 1996), *petition for leave to appeal allowed*, 171 Ill.2d 562, 677 N.E.2d 963 (1997) (emphasis added) (City’s decision to contract out paramedic services with private ambulance company held not a mandatory subject of collective bargaining).

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42. 88 N.J. 393, 443 A.2d 187 (1982).
43. 443 A.2d at 190.
44. 443 A.2d at 192-193 (emphasis added).
45. 443 A.2d at 194.
46. Clark (1977) at 94-95.
47. 379 U.S. at 211: “While not determinative, it is appropriate to look to industrial bargaining practices in appraising the propriety of including a particular subject within the scope of mandatory bargaining. Industrial experience is not only reflective on the interests of labor and management in the subject matter but is also indicative of the amenability of such subjects to the collective bargaining process.” (Footnote and internal citation omitted.)
48. 81 Wis.2d 89, 259 N.W.2d 724, 731-732 (1977).
49. 259 N.W.2d at 732.
50. Id.; see also Local 2236 v. Employment Rel. Com’n, 157 Wis.2d 708, 461 N.W.2d 286, 289 (Wis. App. 1990) (“A subcontracting decision is essentially concerned with wages and benefits, thus mandating collective bargaining.”); Saratoga Springs v. New York State Pub. Emp., 68 A.D.2d 202, 416 N.Y.S.2d 415, 419 (1979).
51. Id.
52. Id. at 92, citing Washoe County School Dist., Item #3 (Nev. Loc. Gov’t. Employee Management Relations Bd. 1971), *affirmed*, 90 Nev. 442, 530 P.2d 114 (1974), and Los Angeles County Department of Public Social Services and Department of Personnel, Case No. UFC 55.3 (1971), *affirmed*, 33 Cal.App.3d 1, 108 Cal.Rptr. 625, 83 LRRM 2916 (2d Dist. Ct. App. 1973).
53. Language similar to the “efficiency” provision of section 89-9(d)(4) is also found in section 76-46, Hawaii Revised Statutes, which prohibits dismissals of civil service employees except “for such causes as will promote the efficiency of government service.”
54. House Concurrent Resolution No. 209, S.D. 1 (1993) (emphasis added).
55. Hawaii Interim Commission on Government Redesign, Report to the 1994 Regular Session of the Seventeenth Legislature, State of Hawaii pursuant to H.C.R. No. 209, S.D. 1 (1993) (Honolulu: Jan. 19, 1994), Appendix 21: William F. Weld and David Walters, An Action Agenda to Redesign State (Washington, DC: Government, National Governors’ Association, 1993), at 42 - 64 (Privatization of Government Services and Assets).
56. Act 263, *Session Laws of Hawaii* 1994, §1, amending section 37-68, *Hawaii Revised Statutes*, requires every executive agency, where new programs are being proposed, to demonstrate that the program is an appropriate function of state government, and, as applicable, “[c]an be implemented by the public sector as cost-effectively as the private sector while meeting the same plans, goals, objectives, standards, measures of effectiveness, wage, salary, conditions of employment, and employee benefit programs of the State.” (Emphasis added.)
57. See David T. Stanley, Managing Local Government Under Union Pressure (Washington, DC: The Brookings Institution, 1972) at 90 - 92. Anti-contracting policies in cities and counties also generally receive greater strength and emphasis when they are included in union agreements. Id. In addition to job security, other

- important union issues include potential loss of job opportunities in the form of promotions, transfers, and temporary assignments for bargaining unit members, and the denial of the opportunity for bargaining unit expansion. See Konno, 85 Haw. at 67, 937 P.2d at 403.
58. June Weisberger, Recent Developments in Job Security: Layoffs and Discipline in the Public Sector, IPE Monograph No. 6 (Ithaca, NY: Institute of Public Empl., July 1976) at 1.
  59. See generally June Weisberger, Job Security and Public Employees, IPE Monograph No. 2 (Ithaca, NY: Institute of Public Empl., March 1973); see also Kurt L. Hanslowe, David Dunn, and Jay Erstling, Union Security in Public Employment: Of Free Riding and Free Association, IPE Monograph No. 8 (Ithaca, NY: Institute of Public Empl., Jan. 1978).
  60. Stanley (1972), *supra* n. 58, at 93. Nevertheless, heavily unionized states have seen increased privatization of government services in recent years. A 1993 Council of State Governments survey noted that “[l]eading all regions in the amount of reported privatization programs in the past five years was the East, one of the regions with the strongest labor unions. About half of Eastern region agencies reported privatizing over 10 percent of agency programs. The Eastern region also exhibited the highest average cost savings from privatization: 27 percent of agencies reported cost savings of over 10 percent.” Privatization 1994, ed. John O’Leary (Los Angeles: Reason Foundation, 1994) at 7.
  61. Harry A. Wellington and Ralph K. Winter, Jr., The Unions and the Cities (Washington, DC: The Brookings Institution, 1971) at 62.
  62. Id. at 63.
  63. Id.
  64. See, e.g., Local 4501, Comm. Workers v. Ohio State Univ., 24 Ohio St.3d 191, 494 N.E.2d 1082 (1986) (*per curiam*), *modifying* 12 Ohio St.3d 274, 466 N.E.2d 912 (1984) (*per curiam*); Detroit Police Officers Ass’n v. City of Detroit, 428 Mich. 79, 404 N.W.2d 595, 601 (1987) and cases cited in Southfield Police Officers Ass’n v. City of Southfield, 433 Mich. 168, 445 N.W.2d 98, 103 (1989); see also Morrisville School Dist. v. Pa. Labor Rel. Bd., 687 A.2d 5, 8 (Pa. Cmwlth. 1996) (holding under state law that employer had obligation to bargain in good faith to bona fide impasse before subcontracting any bargaining unit work).
  65. See Larry D. Scheafer, “Annotation: What Constitutes Unfair Labor Practice Under State Public Employee Relations Acts,” 9 A.L.R.4th 20, 44 - 46 (§6 - contracting work out to private employer) (1981 & 1997 Supp.).
  66. 379 U.S. at 209 (emphasis added).
  67. 379 U.S. at 213.
  68. 379 U.S. at 215 (footnote omitted).
  69. Detroit Police Officers Assn. v. City of Detroit, 428 Mich. 79, 404 N.W.2d 595, 600 (1987) (internal citations omitted).
  70. SHOPO v. Soc. of Professional Journalists, 83 Haw. 378, 405, 927 P.2d 386, 413 (1996), *quoting* In re IFPTE Local 195 v. State, 88 N.J. 393, 443 A.2d 187, 191-192 (1982).
  71. Id., 404 N.W.2d at 601, *citing* Edwards, *supra* note 10, 71 Mich. L. Rev. at 895. Michigan courts have also adopted an “*exclusivity rule*”: in cases in which job functions have been historically assigned interchangeably to both unit *and* non-unit employees, Michigan courts have held that the mere fact that the employer assigns

more of the work to one of these groups does not violate Michigan's Public Employment Relations Act or give rise to a bargaining obligation. See Southfield Police Officers Ass'n v. City of Southfield, 433 Mich. 168, 445 N.W.2d 98, 103 (1989).

72. Section 89-9(a), *Hawaii Revised Statutes*, requires the employer and exclusive representative to meet at reasonable times and negotiate in good faith regarding "wages, hours, the number of incremental and longevity steps and movement between steps within the salary range, the amounts of contributions by the State and respective counties to the Hawaii public employees health fund to the extent allowed in subsection (e), and other terms and conditions of employment ...". (Emphasis added.) See Clark (1977) at 87 ("[W]here a given statute differs from the NLRA, this is usually deemed significant.")
73. If the Hawaii Supreme Court does find a duty to bargain on the impact of the decision to contract out, the employer may fulfill these obligations in one of several ways. The duty to bargain requires a public employer to:
  1. Enter into negotiations with an open mind, that is, without a preconceived notion not to bargain;
  2. Make a sincere effort to reach agreement on mutually acceptable terms;
  3. Notify the affected union about the proposed change; and
  4. Refrain from unilaterally initiating contracting until it is bargained to an impasse with the affected union. See Levine (1990), *supra* note 40, at 53-54.
74. See *supra* note 3 and accompanying text.



## **PART VII. OTHER LEGAL ISSUES**

Other legal issues affecting privatization include procurement, tort and civil rights liability, delegation, antitrust, tax, and commerce clause issues. These are briefly addressed in turn. While space and time limitations prevent a more in depth review, the Bureau recommends that these and other issues be reviewed by a privatization task force as discussed in part IX of this memorandum.

### **A. Procurement**

The discussion in this part presumes that privatization is accomplished primarily through the contracting out of government services to the private sector. Legal issues may vary with respect to alternative forms of privatization.<sup>1</sup> In contracting out, the government, whether state or county, negotiates with the private company as to legally binding obligations, and pays the company directly for services performed. The government unit must first ensure, however, that it complies with all applicable procurement laws affecting that contract. Procurement is generally addressed in the Hawaii Revised Statutes in chapters 103 (“expenditure of public money and public contracts”), 103D (“Hawaii public procurement code”), and 103F (“purchases of health and human services”).<sup>2</sup> If the government unit fails to comply fully with all applicable procurement laws, it may face challenges from losers in the bidding process who may seek such remedies as the imposition of damages and having the contract voided.<sup>3</sup>

### **B. Tort Liability**

Under the doctrine of sovereign immunity, litigants are generally precluded from asserting an otherwise meritorious cause of action against the government unless the government consents to the suit. Historically, the federal, state, and local governments were immune from tort liability arising from activities that were considered governmental in nature.<sup>4</sup> The Eleventh Amendment to the United States Constitution denies access to the federal courts in actions against the state.<sup>5</sup> While many state constitutions (although not Hawaii’s) provide similar immunity to state and local government units, many jurisdictions have limited or abandoned their sovereign immunity by allowing tort actions under certain restrictions: “[T]oday, courts and many state legislatures are increasingly chipping away at the doctrine of sovereign immunity. The emergence of insurance as well as a feeling that a local government unit should be held responsible for its actions have punctured the doctrine of sovereign immunity. Many state statutes provide that government units are immune from actionable wrongs if they maintain insurance coverage.”<sup>6</sup> Hawaii’s state tort liability act specifically waives the State’s tort liability for state employees under certain circumstances and prohibits the recovery of punitive damages against the State.<sup>7</sup> In addition, the State may not raise the defense of sovereign immunity in a tort action against the State when the State is covered by insurance.<sup>8</sup>

Where does tort liability lie for work performed by private contractors who are under contract to perform government services? State law sometimes has extended tort immunity to private parties that are acting as agents of the sovereign, treating these agents like the government for liability purposes.<sup>9</sup> Generally, however, courts have treated the liability of a government that has contracted

away a traditional public service to a private contractor based on traditional negligence principles. The elements for a cause of action in negligence include a requirement that there be a duty, that the duty was breached, and that damages were caused by breach of that duty.<sup>10</sup> This raises the question: “What duty does a government unit owe when it grants a private contract for the performance of a public service? In general, a government unit has a duty to comply with all procedural [e.g., contractual and procurement] requirements.... In addition, and more important in terms of tort liability, a government unit has a duty to investigate and examine the qualifications of the private company with whom it seeks to do business.”<sup>11</sup> However, the government is not a guarantor that a private company will perform its contractual obligations in a proper, nonnegligent manner; rather, the government’s duty is “merely to investigate and assure itself of the legitimacy and ability of the private company to perform the contractual service.”<sup>12</sup>

### C. Civil Rights Liability

Persons who are injured by a private contractor who is performing a government function may alternatively seek to avoid the defense of sovereign immunity by pursuing a civil rights claim, showing a deprivation of the person’s “rights, privileges, or immunities under color of any statute, ordinance, regulation, custom, or usage...”.<sup>13</sup> This raises the application of the “state action” doctrine, which relates to claims brought under the federal Civil Rights Act or Due Process Clause by a private citizen for damages because of governmental intrusion. In determining whether an act constitutes state action, courts generally examine whether a sufficiently close nexus exists between the state and the challenged action, so that the action may be treated as that having been committed by the state itself.<sup>14</sup> Assuming that the government had the power to delegate the performance of public functions to a private party, can employees of private companies performing traditionally government services claim immunity from civil rights suits to the same extent as enjoyed by government employees? The United States Supreme Court has recently answered this question in the context of privately run prisons. In Richardson v. McKnight,<sup>15</sup> the Court held that prison guards employed by a private firm in Tennessee are not entitled to a qualified immunity from suit by prisoners charging a civil rights violation. Some believe that this decision may hamper efforts to privatize government jobs.<sup>16</sup>

### D. Delegation

Generally, certain powers may not be delegated from one branch of government to the private sector, such as judicial or legislative powers.<sup>17</sup> In the privatization context, legislation may be held invalid “if it empowers private persons to decide either what the law shall be or when a law shall be effective.”<sup>18</sup> Although “it is likely that some government powers will be found to be nondelegable, that constitutionally only a specific governmental actor can perform certain given functions... [, t]hese restrictions on delegation, however, will be rare; each must rest on some specific constitutional inhibition or particularized substantive concerns. Even privatization proposals involving activities that intuitively appear to be essentially governmental are unlikely to pose constitutional delegation problems.”<sup>19</sup> With respect to particular areas, such as eminent domain, statutes may give eminent domain power to persons operating a public utility, and the State may acquire private property to implement a particular privatization effort, so long as property is taken for a public purpose.<sup>20</sup>

## E. Antitrust

Federal and state antitrust laws generally prohibit such activities as price fixing, market divisions, tying and resale price maintenance agreements, and other anti-competitive arrangements. The conflict between federal antitrust policy and state police powers eventually gave rise to the state action exemption, or “Parker doctrine”, after the United States Supreme Court’s decision in Parker v. Brown,<sup>21</sup> which exempts state governments from prosecution under antitrust laws for state exercise of police power to pursue objectives that are inconsistent with open, competitive markets. Recent Court decisions have limited the Parker exemption “to situations in which the legislature specifically sets an anti-competitive policy and that policy is ‘actively supervised by the State itself.’”<sup>22</sup> In addition, under the Local Government Antitrust Act of 1984, local governments have received special statutory immunity from certain antitrust damage liability by barring recovery of damages against local governments for antitrust violations by local government employees acting in their official capacities.<sup>23</sup> However, restrictions imposed by the Parker exemption suggest that “the substitution of private for public actors will increase the exposure to antitrust constraints. ... Where private actors engage in conduct that the antitrust laws condemn, approval of the conduct by public actors whose conduct would be considered safe from liability will not suffice to protect the private actors.”<sup>24</sup>

## F. Commerce Clause

The United States Supreme Court has interpreted the Commerce Clause<sup>25</sup> of the United States Constitution prohibits certain state practices that burden goods or services from other states but not similar home-state goods or services. However, when a state or its subdivision is acting as a “market participant” engaged in interstate commerce, rather than a “market regulator”, the state would be permitted to favor its own citizens in certain market transactions. The distinction is the state acting as a market player as opposed to that of a referee. For example, as a market participant, the state can choose from which sources it wishes to buy goods or services, or to what consumers it wishes to sell. However, it has been argued that the market participant exception to commerce clause restraints is an “immunity that is unlikely to be retained following commitment of an activity into private hands.”<sup>26</sup> When the state is acting as a market participant, state residents are bearing the cost of providing a benefit to persons in that state: “When the state is bearing the cost of providing economic benefits, there is little reason for the Supreme Court to intervene, even though some inefficiency in the marketplace might be created, because the political process within the state should serve as an inner political check on the state’s decision to participate in the marketplace.”<sup>27</sup> However, this rationale is missing when the private sector, rather than the state, bears the cost of providing economic benefits to residents.

## G. Federal Statutes

In addition to the federal constitutional and case law discussed above, federal statutes may directly or indirectly affect state and county privatization efforts, including the following:

- *The Urban Mass Transit Act of 1964* may negatively impact on privatization. While that Act provides money to local transit authorities, it imposes restrictions on how

local authorities may use those funds, prohibits aid recipients from selling assets unless they repay federal grants used to purchase those assets, and requires the continuation of collective bargaining rights and employee benefits even after local authorities choose to dissolve or privatize operations;

- *The Securities Acts of 1933 and 1934* impose a “necessary, yet significant, burden on those privatization efforts which depend upon bond financing” by requiring states to carefully comply with antifraud provisions, including obtaining an attorney’s opinion letter detailing the state’s authority to issue bonds and its compliance with certain procedural guidelines;
- *The Tax Reform Act of 1986* impacts negatively on privatization by lengthening the depreciation cost-recovery period, placing a cap on the issuance of government bonds used to finance private activity, and eliminating the investment tax credit. These changes affect privatization efforts since state and local governments often finance capital projects, including water and sewage treatment facilities, through a combination of both private and public resources. Recently, however the IRS has extended the permissible time span for public agencies to allow private companies to operate, maintain, and manage contracts, from less than ten years to twenty years. The longer time limit under the new guidelines gives both governments and contractors additional options in planning and bidding;<sup>28</sup>
- *The Federal Bankruptcy Code* may impact negatively on privatization by hindering state government efforts to recover costs from defaulting contractors, since the contractor can force the state to initiate proceedings against it, even waiting for the court to render an unfavorable judgment, before filing for bankruptcy. Once a bankruptcy petition has been filed, the state cannot take further action against the private entity without first obtaining an order for relief from the bankruptcy court; and
- *The Intermodal Surface Transportation Efficiency Act of 1991* may promote privatization by allowing federal money to be combined with private money to finance construction or reconstruction of highways and tollways, and by permitting states to lend federal funds in matching grants for privately sponsored infrastructure projects.<sup>29</sup>

## H. Additional Questions

### *State constitutional provisions:*

Do privatized activities violate:

- Article I, Section 21, of the Hawaii Constitution, which provides that “[t]he power of the State to act in the general welfare shall never be impaired by the making of any irrevocable grant of special privileges or immunities”;

- Article VII, Section 4 of the Constitution, which prohibits appropriations of public money or property for private purposes?
- Article III, Section 1 (vesting legislative powers in a legislature); Article V, Section 1 (vesting executive powers in a governor); or Article VI, Section 1 (vesting judicial powers in the judiciary), with respect to delegating to private entities the responsibility for making quasi-legislative, quasi-judicial, or quasi-regulatory judgments or decisions, including licensing, classification, transfer, discipline, or parole?

***Liability/immunity:***

- Does privatization reduce the State's immunity from tort or other liability under the State Tort Liability Act or other law?
- Would privatization increase the State's exposure to unlimited damage liability under federal civil rights laws for state action through a private contractor?
- Does a successor private contractor that takes over a government function share in any of the liability and immunity protections of state agencies?
- Can a successor private contractor purchase casualty insurance coverage under the same or similar terms and conditions as its public predecessor?
- Does a successor private contractor inherit any party-in-interest status for litigation filed or in process with the predecessor public agency?

***Contractual terms and conditions:***

- What are the State's legal remedies if a private vendor goes out of business or goes bankrupt?
- Should state law be amended to require an explicit default clause to provide for the continuance of services should there be nonperformance of contractual obligations?
- What are the legal consequences resulting from contractual indemnification provisions between the State and its private contractor?
- Does the State or county have a reversionary interest in any fixed assets leased or given to the successor private entity upon the dissolution of that entity or contract termination?
- Are there specific provisions for a contract monitor?
- Can the private contractor be held accountable to the public? How will citizen complaints be handled?

***Employment:***

- What are the employment status and benefit continuity of former state employees hired by a successor private entity?
- What is the collective bargaining status of the new entity?
- What is the status of retention and bumping rights, seniority, severance pay, vacation leave, unemployment compensation, and other issues with respect to outsourced civil servants?
- Do comprehensive management rights clauses in collective bargaining agreements (“zipper clauses”) prevent a union from bargaining over a contracting decision?

***Miscellaneous areas:***

- Can any of the state functions and responsibilities specified in chapter 27, Hawaii Revised Statutes, be more cost-effectively contracted out to the private sector?
- If the private entity is a school, is it subject to the effects of redistricting as if it were a public school, or does it draw its students island-wide?
- If the private entity is a public safety organization, are there specific delegations of authority for the performance of transfer, release, classification, and discipline, and may it use deadly force and participate in other law enforcement data networks as if it were a public agency?
- Does the state auditor have access to a successor private entity’s records to conduct performance or financial audits?
- May the private entity participate as a public agency in any tax exemptions conferred by statute?
- What are the legal consequences involved in “deprivatization” — discontinuing the use of a private entity to deliver a program or service?

***Other state laws and administrative rules:***

State laws may need to be amended, either as provided in sample legislation attached as Appendix V, or using a similar approach, to require successor private entities that assume government functions to comply with all or portions of various state laws, or administrative rules adopted pursuant to those laws, including the following:

- Civil service and compensation laws (chapter 76 and 77);

- Financial disclosure or other applicable rules under the Code of Ethics (chapter 84, part II) (the term “employee” includes those “under contract to the State” under section 84-3);
- Benefits under the public employees health fund (chapter 87) or the employees’ retirement system (chapter 88);
- The collective bargaining law (chapter 89);
- The public procurement code (chapter 103D); or
- Purchases of health and human services (chapter 103F).

## **I. Privatization Profile**

A 1989 performance audit of state services in Colorado conducted by the Colorado State Auditor included a recommendation that a “privatization profile” be used in determining whether or not a particular service should or should not be privatized. Such a determination should involve an objective and systematic decision making review process for each service or activity at issue, which may give agencies a better overall view of the strengths and weaknesses of the proposed privatization in a standardized format. While the profile developed by the Colorado Auditor includes a number of nonlegal as well as legal questions to be reviewed by agencies, the approach is included here in an abbreviated form as an example of a thorough, well-reasoned method to systematically review the potential for privatization. Generally, before making the decision to privatize a government function, agencies are asked to answer a series of questions based on criteria related to privatization, rate each criteria, and then proceed to a detailed cost analysis if the profile shows that the service is a good candidate for privatization. The profile criteria and questions include the following:

### **1. Market Strength**

- Does the private sector provide the service?
- Can the private sector provide the service?
- Are there multiple providers? Multiple vendors ensures competition and fair contract prices.
- Is the financial commitment so large, that providers will not want to deliver the service? If the commitment is too large, it may not be easy for private firms to provide a service.
- Would privatization result in a monopoly situation? Monopolies eliminate competition and may increase costs because they can unfairly raise the price of services.

- Is the service or services being considered complex or relatively simple? Usually privatization succeeds with less complex services.

Is the service short-term or long-term? The shorter the duration of a project the more successful the privatization.

## **2. Political Resistance**

- Would the public, users of the service, interest groups, or elected officials be highly resistant to changes in provision of this service? ... If there is low political resistance to change, this may support privatization.
- Is the service a new or existing one? Privatization of a new service is easier than an existing service.

## **3. Cost-efficiency**

- Assuming that the quality and level of services remains the same, will costs decrease or increase if the service is privatized?
- Will the savings from privatizing lower government expenditures and cost of the service to the clients? The agency might report a savings on its budget, but the public might have to pay a fee to the private company. This fee in effect reduces any savings the public might receive. If the privatization reduces both the government's and the public's cost, this supports privatization.

## **4. Quality of Service**

- Will the overall quality of the service likely increase or decrease with privatization?
- Does privatization threaten preservation of client confidentiality, or impartiality toward clients?
- Will privatization compromise public trust, confidence, safety, or welfare?
- Will certain targeted population groups likely be neglected, if a private firm provides the service?
- Will accountability and responsiveness to the legislative branch, government agency, or consumer of services likely increase or decrease?
- Can the service objectives be well defined and easily measured?



- Note: Some minimal reduction in services offered or service quality might be acceptable, if outweighed by other criteria, such as dollar savings.

**5. Impact on Employees**

- Will the net effect of privatization on government employees be positive or negative?
- How many employees are affected by the privatization?
- Will civil service policies, such as affirmative action, be weakened if a private firm provides the service?

**6. Legal Barriers**

- Are there any laws that mandate who should actually provide the service (government vs. private providers)?
- Do laws have to change to allow the private sector to provide the service? If yes, are there many and highly difficult changes?
- Are there interrelationships with other programs, prescribed by law, that inhibit or prohibit privatization? If yes, this may be a barrier to privatization.
- Are there federal grant restrictions that interfere with privatization? If yes, are they high or low barriers to privatization?
- Is the privatization compatible with legislative intent?

**7. Risk**

- How great is the chance that the private firm may fail to provide the service?
- If the service is interrupted or stopped, will the consequences to the public and government be major or minor? For example, are threats to public safety or substantial disruption possible.
- Is there a risk that providers will reduce or stop services if financial losses occur?
- Does the financial risk from lawsuits from disgruntled users of the service increase or decrease?
- Does the risk of corruption or abuse increase with privatization?
- Does government benefit from sharing some of the risks with the private sector?

- Does the private firm or government have responsibility for cost overruns?

## 8. Control

- How important is it for the agency to control the delivery of services?
- Does the government agency have the ability to establish and maintain control mechanisms over the privatized service? What is the agency's ability to write and manage contracts? Can the agency adequately oversee the delivery of services, if those services are provided by a private firm?
- Is the quantity and quality of service easy to measure and control?

## 9. Resources

- Does the private sector have expertise that is not easy to develop or maintain in the government agency? Government agencies may not have the personnel and expertise that exists in the private sector. In addition, because of budget limitations, it is impossible for a government agency to maintain this expertise.
- Are there any time constraints that favor or impede privatization? The budget process may be too slow to react to crises. Privatization may be helpful where the service occurs sporadically during the year.
- Does the private sector possess needed equipment or facilities not currently owned by government?
- Are there any resource advantages government has over the private sector?
- Will privatization extend or reduce project completion dates?<sup>30</sup>

## Endnotes

1. See part III.C. of this memorandum regarding privatization alternatives.
2. Chapter 103F, Hawaii Revised Statutes, was enacted by Act 190, Session Laws of Hawaii 1997, §2, effective July 1, 1997. That Act also repealed chapter 42D, Hawaii Revised Statutes, the former law on purchases of service. However, pursuant to §13 of Act 190, the provisions of chapter 42D (as they existed immediately prior to their repeal) are to remain in full force and effect "until all contracts for grants, subsidies, and purchases of services entered into pursuant to those provisions are terminated by their terms or any other means...".
3. Mark H. Flener, "Legal Considerations in Privatization and the Role of Legal Counsel," in Public Sector Privatization: Alternative Approaches to Service Delivery, ed. Lawrence K. Finley (NY: Quorum Books, 1989) at 141 - 142.

4. Black's Law Dictionary, 5<sup>th</sup> ed. (St. Paul, MN: West Publ. Co., 1979) at 1252 ("sovereign immunity").
5. The Eleventh Amendment to the United States Constitution provides as follows: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."
6. Flener (1989), *supra* note 3, at 143. The issue of privatizing government insurance programs is addressed in Kenneth S. Abraham, "Redistributional Issues in the Privatization of Government Insurance Programs," 11 Geo. Mason U.L. Rev. 151 - 155 (1988).
7. Section 662-2, Hawaii Revised Statutes (waiver and liability of the State), provides that "[t]he State hereby waives its immunity for liability for the torts of its employees and shall be liable in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or for punitive damages." However, section 662-15 specifies a number of exceptions to this general rule, including claims "based upon an act or omission of an employee of the State, exercising due care, in the execution of a statute or regulation, whether or not such statute or regulation is valid, or based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a state officer or employee, whether or not the discretion involved has been abused...". See generally chapter 662, Hawaii Revised Statutes (state tort liability act).
8. Section 661-11, Hawaii Revised Statutes (tort claims against State when covered by insurance), provides in relevant part:

This section applies to an action where (1) the State is a party defendant; (2) the subject of the matter of the claim is covered by a primary insurance policy entered into by the State or any of its agencies; and (3) chapter 662 [the state tort liability act] does not apply. No defense of sovereign immunity shall be raised in an action under this section. However, the State's liability under this section shall not exceed the amount of, and shall be defrayed exclusively by, the primary insurance policy.

In Konno, the contract entered into between the County and the private contractor (WMI) provided that WMI would assume liability for claims arising from the landfill and carry environmental and liability insurance. 85 Haw. at 65. While the counties may acquire insurance policies under section 46-15.2(3), Hawaii Revised Statutes, to secure bonds to provide low and moderate income housing, and participate in and apply for flood insurance under section 46-11, there does not appear to be a similar provision with respect to the applicability of county insurance policies on county tort liability. Before tort actions may be implemented against a county, the injured person must first provide notice in writing to the county pursuant to section 46-72, Hawaii Revised Statutes. In addition, section 46-1.5(3) gives to the counties the power to approve all lawful claims against the county, but prohibits counties from "entering into, granting, or making in any manner any contract, authorization, allowance payment, or liability contrary to the provisions of any county charter or general law."

9. Jack M. Sabatino, "Privatization and Punitives: Should Government Contractors Share the Sovereign's Immunities from Exemplary Damages?," 58 Ohio State L.J. 175, 177, 201 - 207 (1997) (footnote omitted); see also Ronald A. Cass, "Privatization: Politics, Law, and Theory," 71 Marquette L.Rev. 449, 511 - 512 (1988), arguing that the government contractor defense to tort liability, extending immunity to some private actors doing business with the government, may no longer be available following privatization.
10. While there is a well-developed body of law detailing the circumstances in which private contractors can be deemed civilly liable to either the public agencies that hire them under contract law, or to third parties harmed in some way by the contractor's negligent acts or omissions under tort law or other legal doctrines, however, the law specifying the appropriate remedy to remedy the contractor's misfeasance or nonfeasance is less well developed. See Sabatino, *supra* note 9, 58 Ohio State L.J. at 177 - 178 (footnote omitted).

OTHER LEGAL ISSUES

11. Flener (1989) at 143-144; *see also* Sabatino, 58 Ohio State L.J. at 186-194 regarding contractor accountability and governmental oversight.
12. Flener (1989) at 144.
13. 42 U.S.C. §1983. Alternatively, injured persons may seek to bypass immunity problems by bringing an action directly against the government's elected officials. *See* Flener (1989) at 142. Article I, Section 5 of the Hawaii Constitution provides explicit civil rights protection in addition to the due process and equal protection provisions of the Fifth and Fourteenth Amendments to the United States Constitution, namely, that "[n]o person shall be ... denied the enjoyment of the person's civil rights or be discriminated against in the exercise thereof because of race, religion, sex or ancestry."
14. Black's Law Dictionary, 5<sup>th</sup> ed. (St. Paul, MN: West Publ. Co., 1979) at 1262 ("state action"); *see generally* Daphne Barak-Erez, "A State Action Doctrine for an Age of Privatization," 45 Syracuse L.Rev. 1169 (1995); Cass, *supra* note 9, 71 Marquette L.Rev. at 502- 508 (1988); *see also* Shirley L. Mays, "Privatization of Municipal Services: A Contagion in the Body Politic," 34 Duquesne L.Rev. 41 (1995). Barak-Erez has argued that the state action doctrine does not go far enough in an age of privatization, since it is limited to old notions regarding the state's functions; however, "the consequences of these limitations may be the inadequate protection of constitutional rights in operation of state services and activities, administered by or with the cooperation of private bodies." 45 Syracuse L.Rev. at 1192. She suggests updating the doctrine to provide that a seemingly private activity be considered a state action if it is both public in nature and the state refrains from operating an equivalent service. *See id.* at 1188 - 1192.
15. No. 96-318 (U.S. Sup. Ct., June 23, 1997) (<http://supct.law.cornell.edu/supct/html/96-318.ZS.html>).
16. *See* [Associated Press], "Guards Not Immune to Lawsuits if Prison is Privately Run," Honolulu Star-Bulletin, June 23, 1997, at A-8 ("The decision, although focusing only on prison guards, could affect private employees engaged in varied tasks — from picking up garbage to providing medical services — in a period when many state and local governments are downsizing and contracting out work.") The United States Supreme Court noted, however, that its decision was limited since the immunity question was answered narrowly, in the context in which it arose: "That context is one in which a private firm, systematically organized to assume a

- major lengthy administrative task (managing an institution) with limited direct supervision by the government, undertakes that task for profit and potentially in competition with other firms.” Richardson v. McKnight, *supra* note 15, slip op. at 7.
17. *See, e.g.*, Robert C. Ellickson, “The Legal Dimension of the Privatization Movement,” 11 Geo. Mason U.L. Rev. 157, 161 (1988) (footnote omitted): “The courts have construed some constitutional clauses as mandating governmental provision of certain services. Functions that are inherently ‘legislative,’ for example, cannot be delegated to private decision-makers. Because article II identifies the President as commander in chief, the federal government could not delegate the conduct of a war entirely to the Pinkertons. A statute that farmed out the conduct of criminal trials from courts to contractors would likely fall for improperly delegating judicial functions.” Ellickson argues, however, that while “in a few contexts there are constitutional barriers to the *achievement* of privatization, ... in considerably more contexts there are constitutional restrictions on the *terms* of privatization.” Id. at 162 (emphasis in original). For example, while delegating prison functions to private correctional facilities may be permissible, the private prison must meet certain constitutional standards, such as the Eighth Amendment prohibition against cruel and unusual punishment (cruel “or” unusual punishment under Article I, Section 12 of the Hawaii Constitution). Ellickson also suggests that rulemaking should be privatized, and that “[i]n some contexts ... there may be reason to think that private rulemaking will outperform government rulemaking.” Id. at 163.
  18. *Sutherland Stat. Const.* §4.11, Delegation to Private Persons (5<sup>th</sup> ed.; 1994 revision) at 150 (footnote omitted).
  19. Cass, 71 Marquette L.Rev. at 502 (footnote omitted). Cass argues, for example, that the nondelegation argument against the private management of prisons is unlikely to succeed since “[i]ts proponents must elaborate not just reasons why public prison employees will enjoy incentives superior to those which a private prison employee would enjoy, but also reasons for special concern about the particular conduct expected of private prison employees.” Id. at 502 n. 250. The United States Supreme Court’s recent decision in Richardson v. McKnight, *supra* n. ..., however, may cast a shadow on this argument, since private prison employees are now no longer entitled to the qualified immunity shielding public prison employees.
  20. *See, e.g.*, section 101-4, *Hawaii Revised Statutes* (right of eminent domain granted to public utilities and others); *Sutherland Stat. Const.* §4.11 (delegation to private persons) (5<sup>th</sup> ed.; 1994 rev.) at 151. Article I, Section 20, of the Hawaii Constitution provides that “[p]rivate property shall not be taken or damaged for public use without just compensation.” In addition, Article VII, Section 4 provides in part that “[n]o tax shall be levied or appropriation of public money or property made, nor shall the public credit be used, directly or indirectly, except for a public purpose.”
  21. 317 U.S. 341 (1943).
  22. Cass, 71 Marquette L.Rev. at 509, *quoting* 324 Liquor Corp. v. Duffy, 107 S.Ct. 720, 721 (1987).
  23. Id.; *see* Pub. L. No. 98-544, 98 Stat. 2750 (1984). *See also* Kenneth W. Clarkson, “Privatization at the State and Local Level,” in Privatization and State-Owned Enterprises: Lessons from the United States, Great Britain and Canada, ed. Paul W. MacAvoy, et al. (Boston, MA: Kluwer Academic Publishers, 1989) at 165; McQuillen Mun. Corp. §49.94 (violation of antitrust laws) (3<sup>rd</sup> ed.).
  24. Cass, 71 Marquette L.Rev. at 509-510 (footnotes omitted).
  25. U.S. Const. Art. I, §8, cl. 3.
  26. Cass, 71 Marquette L.Rev. at 510 (footnotes omitted); *see also* Hughs v. Alexandria Scrap Corp., 426 U.S. 794 (1976) (state bounty for scrap automobiles may favor scrap processors with an in-state plant); Reeves, Inc. v. Stake, 447 U.S. 429 (1980) (state may limit the sale of cement produced at state owned cement plant to state residents).

OTHER LEGAL ISSUES

27. John E. Nowak, Ronald D. Rotunda, and J. Nelson Young, Constitutional Law, 3<sup>rd</sup> ed. Hornbook Series (St. Paul, MN: West Publ. Co., 1986) at 284 (footnote omitted).
28. Diane Kittower, "Serving the Public with Private Partners," Governing, Vol. 10, No. 8, May 1997, at 65; *see also* Kevin Quinn and Myron Olstein, "Privatization: Public/Private Partnerships Provide Essential Services" in Public/Private Partnerships: Financing a Common Wealth, ed. Barbara Weiss (Washington, DC: Government Finance Research Center & Government Finance Officers Association, 1985) at 68 - 76.
29. *See* Florida House of Representatives Committee on Governmental Operations, Final Report on Privatization (Tallahassee: Dec. 1995) at 140 - 142.
30. Colorado State Auditor, Privatization in Colorado State Government: Performance Audit (Denver: March, 1989) at Appendix B (pp. B-1 to B-18).

## PART VIII. OTHER JURISDICTIONS

This part reviews the experiences of selected states and the federal government in resolving issues involving the tension between the privatization of public services and the civil service and merit principles in those jurisdictions.<sup>1</sup>

### A. State Governments

The following are among the states in which one or more of the following developments occurred: a Konno-type challenge or similar action was brought in that state's courts, the state resolved its privatization and civil service issues statutorily, or executive action was taken to encourage privatization.<sup>2</sup> The state courts that have addressed the relationship between privatization and the civil service and merit principles are divided in outcome. Some state courts, including those in Michigan and Ohio, have concluded that the merit principle does not restrict agency discretion to privatize.<sup>3</sup> Others, including Colorado, Louisiana, and Washington, have expressed reservations regarding the compatibility of privatization and merit principles, at least in the absence of detailed regulations specifying the circumstances in which existing classified positions may be abolished in favor of private sector contracts.<sup>4</sup>

#### 1. Alaska

In Moore v. State, Dept. of Transp.,<sup>5</sup> a 1994 case decided by the Supreme Court of Alaska, an employee for the state Department of Transportation was fired in a cost-cutting measure from his full-time position providing airport maintenance. The Department, prompted by declining state revenues, began to examine various cost-cutting options and eventually concluded that the airport at which the employee worked could be operated more economically if airport maintenance were contracted to a private firm. After soliciting bids, the Department awarded a contract to a private firm and eliminated the employee's position, terminating his state employment. The employee brought an action for declaratory relief that the Alaska Constitution prohibited the privatization of state jobs.

The issue before the Alaska Supreme Court was “whether the merit principle of employment embodied in article XII, section 6 of the Alaska Constitution forbids state agencies from seeking to reduce public spending by ‘privatizing’ state jobs— that is, by eliminating positions on the state workforce in favor of lower cost private contracts for the same services.”<sup>6</sup> The relevant constitutional provision required the Alaska Legislature to “establish a system under which the merit principle will govern the employment of persons by the State.” Similar to the Hawaii Supreme Court in Konno, the Alaska Supreme Court balanced the competing factors involved: on the one hand, the objective of the merit principle was the elimination of the spoils system of government and insulation of the state workforce from political influence; on the other hand, “the basic function of state government is to govern, not to employ; and to govern effectively, the state must govern efficiently.”<sup>7</sup>

After examining the intent of the drafters of the constitutional provision, the Court noted that the merit principle does not bind the government to retain a workforce it cannot afford— a person

isn't frozen into a job permanently simply because the person was hired under a merit system. The Court also noted that government agencies functioning under various forms of the merit system have traditionally been accorded broad latitude in eliminating jobs for economic, rather than political reasons, as when government is faced with financial or organizational difficulties. Alaska's State Personnel Act also gave broad authority to the state personnel board to provide for layoffs for economic reasons. The Court also looked at the competing policy issues concerning privatization: while privatization can reduce costs and increase government efficiency and productivity, it also affects the qualifications and conditions of employment of persons who will perform government services.

After balancing these competing interests, the Alaska Supreme Court concluded that the constitutionally required merit system should not be construed as a categorical bar to the privatization of state jobs. The Court reasoned that existing state laws— including state personnel laws and the state procurement code— largely obviated the risk of exposing state workers to political influence:

Under the laws and regulations currently in force, there appears to be relatively little danger that privatization could successfully be used as a device for subverting the merit principle's primary goal of shielding state workers and jobs from political influence. As we have previously noted, state personnel rules that deal with layoffs offer protection against political influence by ensuring that state workers who are potential targets of layoff are treated fairly and that the effects of any actual layoff are mitigated. Furthermore, the State Procurement Code establishes extensive control over agency contracting procedures. These measures are calculated to ensure that the State accords fair treatment to persons and businesses seeking to enter into state contracts.<sup>8</sup>

Finally, the Court noted that any risk arising from privatization must be balanced against the dangers of "an unduly rigid reading of the Constitution's merit system language" and that "neither the political nor the social danger of privatization appears so threatening to the merit principle" as to justify a categorical bar against privatization; to the extent that dangers proved real, existing contractual, administrative, and judicial channels for case-by-case review of agency action were sufficient to enforce the merit principle and redress aggrieved employees.<sup>9</sup>

While the dissent agreed that the Alaska Constitution did not stand as a categorical bar to the privatization of state jobs for economic reasons, the dissent argued that the Alaska Supreme Court was "ill-equipped to resolve the genuinely difficult policy issues inherent in the tension between privatization of government services and preservation of Alaska's merit personnel system."<sup>10</sup> Instead, the dissent maintained that it was up to the Alaska Legislature to enact discrete standards setting the preconditions for privatization in order to ensure that privatization did not subvert the state's merit system. Those standards "should be fashioned after a careful evaluation of the effects of privatization on the state's merit system for public employment as a whole, rather than upon a case-specific consideration of the effect of a single agency's particular plan upon individual employees."<sup>11</sup>

## 2. Arizona



The Arizona Legislature overwhelmingly passed pro-privatization legislation in 1996, which benefitted from strong support from Arizona Governor Fife Symington and a new emphasis placed on public-private competition, rather than solely on privatization:

Arizona staffers have clearly absorbed well the lessons from the successes and failures of other privatization programs. After observing how other states have seen their competition programs slowed and sidetracked by well-meaning, but ultimately misguided, legislative mandates, they structured the privatization legislation for maximum executive flexibility. Unlike some other states, the Arizona approach is to let the agencies select their own projects, rather than having them dictated from the governor's office. This approach tends to soften agency hostility to competition. The disadvantage is that agencies have a tendency to put forward only small and noncontroversial projects, thereby reducing the potential scope and impact of the competition program.<sup>12</sup>

Arizona's competition program is based in that state's Governor's Office for Excellence in Government, which seeks to ensure that a consistent methodology guides state competition efforts. That office has also developed an extensive training program to teach state staffers and managers the basics of competitive contracting, including determinations of in-house costs and drafting requests for proposals, and has also published a Competitive Government Handbook for state managers.<sup>13</sup> Selected flowcharts from that handbook outlining Arizona's competitive government process and other information regarding competitive government opportunities have been attached as Appendix H; sample legislation based on the Arizona competitive government program is attached as Appendix L.

### **3. California**

The most recent case discussing the intersection of privatization and civil service and merit principles in California is that of Professional Engineers v. DOT,<sup>14</sup> decided in May 1997 by the California Supreme Court. In that case, a labor organization and a citizen/taxpayer filed suit in 1986 to enjoin the California Department of Transportation ("Caltrans") from contracting with private entities to carry out state highway projects that were traditionally performed by state civil servants. In 1990, the trial court enjoined Caltrans from privately contracting out engineering and inspection services to private entities that state civil servants had traditionally performed on state highway projects, finding that Caltrans had failed to show that these contracts were more cost-effective or that state workers could not adequately perform the work. Before discussing how the Supreme Court resolved the case, it is necessary to have some understanding of the general legal principles at issue in California.

Article VII of the California Constitution defines the civil service as including "every officer and employee" of the state, with certain exceptions, and further 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." Under established case law dating back to 1937, California had adopted the "nature of the services" test by interpreting article VII (and its predecessor section) as prohibiting private contracting, whether for permanent or temporary services, if those services were of a type that persons selected through civil service could perform "adequately and competently."<sup>15</sup> Later cases have expanded this test by adding "new state function" and "cost

savings” tests. Under the “new state function” test, the nature of the services test is inapplicable if the contract with a private entity is to perform new functions not previously undertaken by the state or covered by an existing agency, or if the services do not otherwise duplicate the functions of an existing agency. The “costs savings” test generally allows for the review of cost savings or efficiency as a relevant, although not conclusive, factor in applying the nature of the services test in determining the propriety of private contracting. In addition, the state, on an experimental basis and out of considerations of efficiency and economy, might also properly release a former function in favor of privatization without offending civil service principles.<sup>16</sup>

The California Legislature subsequently enacted new legislation in 1993 (Chapter 433) that reflected broad approval of private contracting by Caltrans. That chapter specified the California Legislature’s intent to give Caltrans the continued flexibility to contract privately as needed to assure timely project delivery, and to afford a new and independent basis upon which to justify contracting out. The new legislation further noted that Caltrans’ use of private consultants had allowed Caltrans to accelerate state highway construction projects costing nearly \$1 billion, that private consultants to assist in project delivery was a new state function that did not duplicate existing departmental functions, and that a stable contracting out program using private consultants was needed to allow Caltrans to competently complete its projects. The essence of this intervening legislation was to authorize Caltrans’ privatization efforts and bypass the trial court’s injunction.<sup>17</sup>

The issue before the California Supreme Court in Professional Engineers was whether chapter 433 was consistent with article VII of the California Constitution, and, in particular, whether that law authorized the contracts at issue under the conditions set forth in the new law, affording a proper ground for dissolving or modifying the trial court’s injunction. The Court disagreed with a decision by the Court of Appeal that Chapter 433 alone justified dissolution of the 1990 injunction, finding that principles announced in prior case law required a contrary holding: “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.”<sup>18</sup>

While acknowledging that the private contracting restriction, the “nature of the services” test, and its exceptions do not appear in the language of Article VII of the California Constitution, but rather are derived from judicial interpretations of that section, the Court found insufficient policy or other reasons to overrule or disapprove sixty years of settled case law or for ignoring traditional principles of *stare decisis*.<sup>19</sup> The Court further noted that the California Constitution Revision Commission considered and rejected an approach that would have given the Legislature the open-ended authority to create exemptions from civil service in any area in which the Legislature believed that public policy would be better served by an alternative, noting that legislators would be subject to severe pressures to carve out various exceptions to the application of the civil service laws, which could compromise the integrity of the civil service system.<sup>20</sup>

The Court also argued that California case law was typical of the restraints that many other jurisdictions, including the federal government, had imposed on private contracting, noting that while many other states allow private contracting, most states, like California, have substantial restrictions, such as efficiency and economy requirements, to protect their civil service systems from deteriorating through privatization. Moreover, applicable case law carved out a broad exception in allowing the

state to contract privately if the civil service was unable to perform the work “adequately and competently.” Finally, the Court maintained that while civil service mandate did not preclude outright privatization of an existing state function, the present case did not involve withdrawal of a state function, and Chapter 433 did not afford an independent basis for overturning the trial court’s injunction. The Court concluded that California judicial decisions interpreting article VII of the Constitution were “reasonable, practical ones aimed at preserving the state’s civil service from dissolution or decay without unduly hampering state agencies such as Caltrans from private contracting whenever the circumstances reasonably justify it.”<sup>21</sup>

Two dissents were filed in this case. One dissent, authored by Justice Baxter, argued that the majority opinion failed to properly defer to a valid legislative enactment and thereby overstepped its functions in invalidating Chapter 433: “When properly viewed, Chapter 433 represents a constitutionally valid effort by the Legislature to encourage private contracting in furtherance of the objectives of efficiency and economy in state government. In holding otherwise, the majority inappropriately substitute their judgment for that of the Legislature and improperly limit the Department of Transportation’s (Caltrans’s) opportunities to take advantage of private sector efficiencies.”<sup>22</sup>

The other dissent, authored by Justice Ardaiz, argued that the Legislature, in enacting Chapter 433, essentially found that it is more efficient and less expensive not to expand state government when certain types of engineering services can be performed by the private sector, and the trial court erred in rejecting the Legislature’s findings. Justice Ardaiz maintained that the majority’s reasoning was contrary to well-established precedent, impaired the Legislature’s ability to perform its constitutional functions, and created a review process that may violate the principle of separation of powers. Like Justice Baxter, Justice Ardaiz concluded that the Legislature’s findings must be afforded sufficient deference; otherwise, the judiciary may be seen “as assuming the role of arbiter of social and fiscal policy, a role which is properly left to the representative branch of government.”<sup>23</sup>

It has been noted that California has some of the “most restrictive anticompetition laws in the country.” Public employee unions, however, have exerted strong political opposition to any changes in these laws. Legislative proposals in 1996 to remove many of these obstacles died in committee, and similar legislation in 1997 “has virtually no chance of passing this year. With little hope for movement in the legislature, some state privatization supporters are contemplating going to the voters in 1998 with a ballot initiative aimed at removing obstacles to contracting out.”<sup>24</sup>

#### 4. Colorado

In Colorado Ass’n of Pub. Emp. v. Dept. of Highways,<sup>25</sup> certain state employees and the Colorado Association of Public Employees filed a petition for a declaratory order with the Colorado State Personnel Board, alleging that the state Department of Highways had decided to reorganize and contract out the duties of those employees to private sector vendors who were not within the state personnel system. The petition alleged that contracting out would eliminate civil service positions which included duties that were commonly and historically performed by state employees, in violation of Colorado statutes and the Colorado Constitution. The Board sustained the authority of the Department to contract with private vendors for services previously performed by state employees

within the state personnel (i.e., civil service) system. Upon appeal to the Colorado Supreme Court, the Court reversed the Board's decision, finding that absent legislative or regulatory guidelines concerning substitution of private sector providers for state personnel system employees, the Department's action was inconsistent with the state personnel system structure established under the Colorado Constitution.

The Court first noted that the Civil Service Amendment to the Colorado Constitution was originally adopted in 1918 in response to legislative hostility towards a merit-based civil service, which promotes competence in government by requiring the selection of public employees according to merit and fitness as determined by competitive tests of competence. A merit-based personnel system, the Court noted, frees that system from political pressures and curtailed political patronage. The state personnel system also furthers other state policies, such as nondiscrimination and affirmative action, by implementing them in the state employment process. Since the adoption of the Civil Service Amendment, the Court noted that it had "zealously protected the integrity of the state personnel system and has not hesitated to strike down statutes authorizing employment or promotion inconsistent with the merit system."<sup>26</sup>

The Court also noted that under the Department's privatization plan, the private sector employees would be contracted at a lesser expense, but would not be selected by merit and would not be subject to state personnel policies, thereby departing from traditional state employment practices. Moreover, that plan would eliminate existing employees and classified positions, allowing private employees to perform the work formerly accomplished by the state employees and implicating the tenure protection features of the Civil Service Amendment. The Court noted, however, that nowhere in the constitutional, statutory, and regulatory framework establishing the state personnel system were provisions made for the elimination of positions and substitution of private sector providers to perform services previously accomplished by state employees.<sup>27</sup>

The Court then balanced the competing factors involved in privatization decisions, noting that privatization of government services had major policy implications for the state personnel system: while "[p]rivatization can provide important benefits by reducing costs and increasing government efficiency and productivity.... privatization operates as a labor policy in that it affects the qualifications and conditions of employment of persons who will perform services for the government. ... Since government is a labor intensive service industry, privatization achieves savings primarily by reducing labor costs."<sup>28</sup> The Court went on to note, however, that the cost advantages of private firms may result from their freedom from state civil service laws:

For example, private companies have great latitude in selecting, promoting, transferring and terminating employees; they are not required to employ competitive tests of competence. Absent specific statutory requirements, private contractors need not follow the legislatively mandated pay scales, veteran's preferences, and other employment practices that apply to the civil service. The civil service laws and regulations protect public workers from arbitrary and oppressive treatment, and require due process protections before disciplinary action or termination; private employees lack these protections. These constraints are necessary in government employment to carry out the functions of the civil service, promote competence in government, and ensure a politically independent civil service. These labor policy aspects of privatization, which are essential components of its cost efficiency, have significant consequences for the civil service.<sup>29</sup>

The Court further stated that this critical impact of legislation on the civil service system implicates the legislature's role in structuring that system consistent with constitutional restraints, and that the scope and characteristics of a privatization plan required careful consideration. Until that time, no one had analyzed whether, and under what circumstances, positions in the state personnel system could be eliminated consistent with civil service protections in order to obtain the same services by privatization. Legislation, rules, or a combination of the two were therefore needed to establish standards to ensure that privatization did not subvert the policies underlying the state personnel system. Unlike the Alaska Supreme Court's decision in Moore v. State, Dept. of Transp., discussed earlier, which held that a review of agency action on a case-by-case basis was sufficient to enforce the merit principle and redress aggrieved employees, the Colorado Supreme Court in the present case found that there was a need for a comprehensive evaluation of the system as a whole: "This requires an evaluation of the effects of the concept of privatization on the state personnel system as a whole, rather than a case specific consideration of the effect of a particular privatization plan of a single state agency on individual employees."<sup>30</sup> The Court concluded that "[b]ecause privatization so directly implicates both the personnel system as a whole and the specific protections accorded state personnel system employees under article XII, §13(8) [the Civil Service Amendment to the Colorado Constitution], standards regulating privatization must be established by legislation, regulation, or some combination of the two."<sup>31</sup>

The Colorado Legislature enacted general privatization legislation in 1988 that prohibited state agencies from competing with private enterprises by engaging in "the manufacturing, processing, sale, offering for sale, rental, leasing, delivery, dispensing, distributing, or advertising of goods or services to the public which are also offered by private enterprise unless specifically authorized by law."<sup>32</sup> The Colorado Legislature subsequently enacted legislation in 1993 that addressed the concerns of the Colorado Supreme Court in Colorado Ass'n of Pub. Emp. v. Dept. of Highways.<sup>33</sup> In enacting that statute, the Legislature made the following declarations in support of the privatization of government functions, consistent with civil service principles:

... [I]t is hereby declared to be the policy of this state to encourage the use of private contractors for personal services to achieve increased efficiency in the delivery of government services, without undermining the principles of the state personnel system requiring competence in state government and the avoidance of political patronage. The general assembly recognizes that such contracting may result in variances from legislatively mandated pay scales and other employment practices that apply to the state personnel system. In order to ensure that such privatization of government services does not subvert the policies underlying the civil service system, the purpose of this part ... is to balance the benefits of privatization of personal services against its impact upon the state personnel system as a whole. The general assembly finds and declares that, in the use of private contractors for personal services, the dangers of arbitrary and capricious political action or patronage and the promotion of competence in the provision of government services are adequately safeguarded by existing laws on public procurement, public contracts, financial administration, employment practices, ethics in government, licensure, certification, open meetings, open records, and the provisions of this part .... Recognizing that the ultimate beneficiaries of all government services are the citizens of the state of Colorado, it is the intent of the general assembly that privatization of government services not result in diminished quality in order to save money.<sup>34</sup>

Sample legislation based on these Colorado statutes is provided in Appendices O (based on the 1993 law on personal services contracts establishing a balancing test) and P (based on the 1988 law relating to private enterprise).

## 5. Georgia

According to a 1997 United States General Accounting Office report (GAO) on privatization in state and local governments, privatization efforts in Georgia were advanced by Georgia's Democratic Governor (Zell Miller), who created a commission on privatization of government services in 1995 to limit government growth, reduce the scope of government, and improve government efficiency. With the Governor's support, Georgia's Legislature enacted legislation in 1996 to reform the state's civil service, making it easier for the state to hire and fire employees. According to Georgia officials, this legislation has facilitated the use of privatization by state managers.<sup>35</sup>

Under Georgia's new civil service reform law,<sup>36</sup> all state employees hired after July 1, 1996 are considered "at will" employees, meaning that they can be "promoted, demoted or transferred instantly. Their raises are offered on the basis of performance only. And they can be handed an envelope on any given afternoon instructing them to clean out their desks and clear out of the office on the spot, with no right of appeal."<sup>37</sup> The Georgia Merit System continues to cover civil service employees hired prior to July 1, 1996, numbering over 54,000, and will continue to administer benefits, but has shifted its function from regulating personnel practices to offering technical assistance to agencies on a fee-for-for service basis. While some fear that the new law "will lead to patronage hiring, on the one hand, and unshackle lousy managers, on the other", leading to abuses, others contend that there was already a significant amount of patronage occurring under the old system, that removing a cumbersome civil service system will allow managers to retain the best employees, and that the news media can be relied upon to uncover political patronage.<sup>38</sup>

Georgia's Governor has also reduced the operating funds of state agencies by instituting a budget redirection program in 1996. Under that program, all agencies were required to prioritize their current programs and activities and "identify those programs that could be eliminated or streamlined to the extent that the agencies would be able to make at least 5 percent of their total state-funded budgets available to be redirected to higher priorities. Each agency was asked to recommend how the 5 percent would be redirected to existing programs or to new programs within the agency."<sup>39</sup> The Governor then reviewed those recommended redirections and other statewide priorities and shifted those identified funds among the agencies as determined to be most cost beneficial. According to the Georgia Privatization Commission, agencies were given a six-month notice that their budgets would be cut, which required managers to determine how they could perform the same functions at a lower cost. This, in turn, led to contracting out for more services to the private sector, such as vehicle maintenance and management services for a war veterans facility.<sup>40</sup>

Sample legislation based on the Georgia statute is provided in Appendix Q.

## 6. Louisiana

While the case of Jack A. Parker & Assoc., Inc. v. State, etc.,<sup>41</sup> does not present a “Konno-type” situation in which civil servants lost their jobs to private contractors performing the same type of work, the case does illustrate the tensions inherent between privatization and the civil service system. In that case, a private contractor, who had agreed to provide professional, actuarial, and technical services to organize and maintain the state group insurance program, sued the state for monies due under the contract after the Civil Service Commission refused to approve its contract with the state. The trial court ruled that the Commission had the authority under the Louisiana Constitution to adopt rules affecting persons possessing contracts for personal services with the state, including civil service rules requiring approval of private contracts for professional services. The Louisiana Supreme Court affirmed the trial court’s decision, finding that the Commission’s rules had the force and effect of law.

The civil service rule in question (Rule 3.1(o)) required the civil service director to review contracts for personal services between the State and any person, in advance of their effective dates, “in order to insure that such agreements do not provide for the performance of such services for the State of Louisiana which could and should be performed by classified employees.”<sup>42</sup> Noting that among the purposes of the civil service was to secure adequate protection to career public employees from political discrimination, the Court found that the review of contracts entered into by the State and independent contractors “rationally fulfilled” the purposes underlying the civil service, since Rule 3.1(o) prevented state agencies from contracting away, through public service contracts, work that could and should be performed by classified employees:

Without Rule 3.1(o), governmental agencies could in time grant public service contracts for all work currently performed by classified employees and in effect abolish the classified service. The effect upon the bona fide classified employees within the state service because of a public service contract’s contractual relationship with the state government could be disastrous. For example, in 1974 there were approximately 56,000 state classified employees and today there are approximately 68,000 employees, the difference constituting approximately 18% of today’s total. If those 12,000 employees, plus employees hired as a result of resignations, terminations, and retirement had been hired under public service contracts, there would be a significant percentage of governmental employees entrusted with a very great deal of power and responsibility over the public health and welfare, and the enforcement of the State’s laws, regulations, and rules would be the [*sic*] subject to the whims of the State official with whom they contracted.<sup>43</sup>

The Louisiana Supreme Court concluded that Rule 3.1(o) was reasonable, did not violate a fundamental constitutional right of the private contractor, and did not exceed the constitutional grant of authority to the Civil Service Commission.

## 7. Maryland

Maryland has adopted a “bad faith” standard with respect to whether privatization violates civil service laws. Under that test (also described in Konno), contracting out public functions to a private entity violates civil service laws only if the employer acted in bad faith or with the intent to

circumvent those laws.<sup>44</sup> In Ball v. Board of Trustees of State Colleges,<sup>45</sup> various food personnel, who were classified service employees under the state merit system at Morgan State College in Baltimore, filed suit against the Board of Trustees of State Colleges to enjoin them from entering into a contract with a private corporation to provide food service at that college. Under that contract, the food service department at the college would have been eliminated and the services formerly performed by state employees would now be performed by a private independent contractor. The circuit court dismissed the action, and the plaintiffs appealed. The Maryland Court of Appeals held that Board of Trustees had the authority to abolish the food service department and contract out those services to a private entity without obtaining the prior approval of the State Commissioner of Personnel.

The Court first noted that the Board followed the statutory “layoff” procedure under Maryland law, which required that classified employees in positions to be abolished are to be laid off, and their names placed on an eligibility list for the affected class of position. The Court noted that while the Commissioner’s authority was required to abolish classes of positions statewide, that authority was not required to abolish individual positions in that class. The Court also noted the general rule that executive departments of government may lay off a merit system employee by abolishing the position, provided that it was for a bona fide reason and not as a subterfuge to evade the merit system laws. The appellants nevertheless argued that the case established “a nefarious precedent whereby the protection afforded State employees under the Merit System could be materially and substantially eroded by the wholesale contracting out to private contractors work performed by State employees.”<sup>46</sup> The Court rejected this argument, maintaining that “unless such action is done in good faith it is subject to challenge in court”, implying that there was no evidence of bad faith to defeat Maryland’s civil service laws in that case.<sup>47</sup>

Maryland has also established a statutory preference for state employees over private contractors with respect to certain types of work. In particular, Maryland law regarding service contracts establishes that “[t]he policy of this State is to use State employees to perform all State functions in State-operated facilities in preference to contracting with the private sector to perform those functions.”<sup>48</sup> That law also requires cost comparisons to be made before entering into a service contract, including the requirement that the cost of the service contract be compared with the cost of using state employees, and that the comparison show a savings to the state, over the duration of the contract, of twenty percent of the contract or \$200,000, whichever is less.<sup>49</sup>

Sample legislation based on the Maryland statute is provided in Appendix R.

## **8. Massachusetts**

According to the United States General Accounting Office, the Governor of Massachusetts was the “political champion” for the most recent privatization efforts in that state, calling on department managers to privatize functions and services beginning in 1991. Privatization efforts were introduced during a period when the state, which had a heavily unionized workforce, was experiencing a severe budget crisis. Privatization in such efforts as prison health care, highway maintenance, and social services revenue management operations were implemented to reduce the state budget deficit, lower government costs, and improve the quality of government services.<sup>50</sup>



However, the privatization efforts that were aggressively pursued by a Republican governor (William Weld) were equally aggressively opposed by a Democratically controlled legislature that was responsive to state employees. The administration's privatization efforts were substantially greater than past administrations, which implemented privatization on a piecemeal basis, and attracted national attention, yet remained at the center of controversy within Massachusetts. The Governor saw privatization as a means to the more efficient and less costly provision of government services, which would improve the quality of services by lowering costs significantly. The strongest interest group opposition to privatization came from public employees and their unions, in particular, Council 93 of the American Federation of State, County and Municipal Employees (AFSCME). AFSCME argued that cost savings from privatization were inflated by omissions, such as failing to include increased training costs and lower productivity from employee turnover. The union also argued that privatization decreased government accountability and control, and increased the possibility of price collusion, patronage, and political favoritism.<sup>51</sup>

The GAO noted that in the six state governments it studied, management of employee involvement in privatization "was not only important to initial efforts but also set the tone for future privatizations."<sup>52</sup> In particular, Massachusetts officials believed that their initial failure to involve state employee unions in their privatization efforts led the unions to contest and block those efforts. After this initial confrontation, according to state officials, the state attempted to improve labor-management cooperation by permitting unions to compete for several highway maintenance contracts. "Nevertheless, according to state officials, union and state legislature concerns that employee protections were not being observed under privatization contributed to the passage of legislation in 1993, over the Governor's veto, that made privatization more difficult."<sup>53</sup>

The 1993 legislation, popularly referred to as the "Pacheco law" after the original bill's sponsor, Massachusetts Senator Mark Pacheco, sought to regulate privatization in Massachusetts and was viewed by the administration as an "anti-privatization bill". Among the law's more notable provisions are the following:

- A provision giving the Massachusetts State Auditor formal review and approval powers with respect to proposed privatization for activities valued in excess of \$100,000. The state auditor, an independently elected constitutional officer, was in effect given veto power over privatization contracts;
- A requirement that private firms that win state contracts offer jobs to qualified state employees who were terminated because of the contracts and to compensate them at a rate comparable to their government pay and benefits;
- A guarantee for employees of contractors of the average private sector wage, or the state wage for similar services, whichever is lower;
- A requirement that vendors comply with affirmative action and equal opportunity laws;
- A strong conflict of interest provision barring state employees involved in the contracting process from going to work for the vendor awarded the contract; and

- A five-year limit on any contract.<sup>54</sup>

In addition, an early version of the bill required that a service was to be privatized only if there was to be a documented savings of ten percent with no decrease in the level of services. Upon opposition by the Governor, this provision was changed to require a savings from privatization, but not a fixed savings.<sup>55</sup>

Sample legislation based on the Massachusetts statute is provided in Appendix S.

## 9. Michigan

Like Maryland, Michigan has adopted a “bad faith” standard with respect to whether contracting out government functions to the private sector violates civil service laws. In Michigan State Employees v. Civil Service Com’n,<sup>56</sup> the State Employees Association and others challenged the constitutionality of two actions of the Michigan Civil Service Commission. They first argued that a new civil service provision allowing the state to contract out for personal services when the services would be performed at substantial long-term savings to the state when compared with having the service performed by classified state employees violated the Michigan Constitution. They also argued that their due process rights had been violated because the Commission disregarded a collective bargaining agreement. The Michigan Supreme Court affirmed the decision of the circuit court, which found that the plaintiffs had failed to state a claim upon which relief could be granted.

The Court first held that allowing the Civil Service Commission to use independent contractors did not violate the Michigan Constitution. In making this finding, the Court noted that one of the primary reasons for the civil service system was to discontinue the “spoils system” under which public employment was the reward for political work. However, the plaintiffs had not alleged that there was any bad faith or an attempt to reintroduce the spoils system, nor had they shown that even one layoff had been attributed to the new civil service provision. Finding that the Civil Service Commission was vested with plenary power in its sphere of authority, the Court noted that “[i]n Michigan, before a civil service position may be abolished, good faith must be established by a showing that the position is to be abolished for reasons of efficiency and economy. ... We find no harm to the civil service by virtue of this additional reason to hire independent contractors.”<sup>57</sup> The Court further held that the plaintiffs’ other argument was meritless. Finding that there was no constitutional right to collective bargaining by civil service employees, the Court held that an amendment to the employee relations policy prohibiting collective bargaining agreements that limit independent contracting therefore did not violate their due process rights.<sup>58</sup>

Writing in dissent, Chief Judge Danhof noted that while the motive of the “economic feasibility” standard adopted by the Civil Service Commission was laudable in seeking to reduce the cost to the state of certain services, the new provision would effectively dismantle the civil service wherever such an active could be deemed cost effective, and that there was a direct conflict with the intent of the constitutional provisions providing for a classified civil service. For example, if it was established that a private company providing security services could more economically or feasibly perform some of the duties currently performed by the state police, the Commission would arguably

be justified in abolishing state police positions and contracting out for those services. Moreover, the dissent argued against reviewing challenges on a case-by-case basis, maintaining that “[t]he civil service was obviously designed to obviate the problem of political patronage without having to look at each individual case and ascertain whether favoritism was involved.”<sup>59</sup>

The dissent also argued that the new provision allowing for the contracting out of presently performed services cut against the constitutional purpose of fostering a “career service in state government”, the intent of which “presumably [was] to attract qualified personnel who would be interested in state service because there was some security and because the system was designed to provide jobs based upon the merit system, not the buddy system.”<sup>60</sup> The dissent concluded that the new policy should have been found unconstitutional, since it contravened the policy of creating a system to eliminate the spoils system and encourage career service in state government.

The United States General Accounting Office noted in its 1997 privatization study that in 1991, Michigan established a Privatization Division as part of its Department of Management and Budget. The following year, Michigan’s Governor established a public-private partnership commission, which was staffed by the Privatization Division before the commission was abolished in late 1992. The reasons given for establishing the commission were to reduce the state’s budget deficit and shrink the size and scope of government.<sup>61</sup> The Michigan Public-Private Partnership Commission established a framework in 1992 for analyzing government activities known as “PERM” — to determine if they should be Privatized, Eliminated, Retained in current form, or Modified — involving a three-part analytical model.<sup>62</sup> Since 1995, the focus has shifted from agency-initiated PERM studies to Privatization Division-initiated PERM studies, especially on functions and services that cross agency lines. Michigan has also contracted out PERM studies, which are usually performed in consultation with Privatization Division staff.<sup>63</sup>

## 10. New York

Two New York cases from the 1980s review privatization attempts in that state. In Nassau Educ. Chap. v. Great Neck U. Free Sch.,<sup>64</sup> former security guards employed by the Great Neck Union Free School District challenged the abolishment of their civil service positions and sued for reinstatement to their positions, alleging that a contract with a private security company violated the New York Constitution’s civil service and merit provisions. The New York Supreme Court (the trial court in New York) ordered the guards reinstated. The Appellate Division reversed the lower court’s decision, holding that the school district’s relationship with the private employees did not amount to an employer-employee relationship so as to violate the constitution.<sup>65</sup>

In Collins v. Manhattan & Bronx Surface Transit Operating Auth.,<sup>66</sup> employees of a city transit authority subsidiary sued to enjoin their employer from appointments and promotions except from eligible lists adopted on the basis of competitive examinations. The New York Court of Appeals found that a public authority was not a “civil division” of the State within the meaning of the New York Constitution’s civil service and merit provisions, and that the city transit authority subsidiary did not fall within the scope of those provisions.

In particular, the Court maintained that the constitutional civil service provisions were addressed to the “conventional and stable duties of the functionaries of civil government”, and aimed “to supplant by a merit system a spoils system of office holding”.<sup>67</sup> The New York Legislature could not delegate these types of duties to a public authority that is excluded from the civil service system in an attempt to evade civil service requirements: “For example, the State police could not be reconstituted as a public authority with power to hire officers and employees in disregard of the constitutional mandate. ... But for the most part public authorities have been created as a means of expanding government operations into areas generally carried on by private enterprise, areas not traditionally regarded as ‘conventional and stable duties ... of civil government.’”<sup>68</sup> The Court also stated that the Legislature could not evade the constitutional requirement by creating a public authority which was completely controlled by the state or a civil division of the state. The Court concluded that the Authority was not within the scope of the constitutional provision.

In 1995, the Governor of New York established an advisory commission on privatization and a research council on privatization in order to reduce the size and scope of government and to reduce the cost and improve the quality of government services. In 1996, that privatization effort resulted in several sales of government assets and requests for proposals for the sale or lease of several other assets. The “most prominent” privatization was the \$28,000,000 long-term franchise agreement for the operation of the state-owned Long Island Freight Division, which handles over 12,000 carloads of freight annually. According to the chairman and CEO of the Empire State Development Corporation, which is in charge of implementing the governor’s privatization program, “[t]he freight division project is another example of Gov. Pataki’s belief that privatizing state-owned assets can spur economic growth, protect the environment, and generally improve performance.” Other sales included the Radisson Greens Golf Course for \$3,200,000, and \$6,700,000 worth of assets related to state laundry and food distribution, after the services were outsourced to the private sector, the latter resulting in an annual cost savings of \$4,500,000. Prison health services were also contracted out for an annual savings of \$2,300,000.<sup>69</sup>

The United States General Accounting Office noted in 1997 that an important component of New York’s privatization efforts involved providing a “safety net” for displaced workers as a part of that state’s workforce transition strategies. In particular, new collective bargaining agreements were negotiated allowing the state to lay off affected employees, provided that employees were given certain considerations, including sixty days’ written notice of intended separation, placement on a redeployment list, and an offer of redeployment if a another fillable vacancy became available in state government.<sup>70</sup> If redeployment was impossible and the employee had no displacement rights under New York’s civil service law, the employee could choose to receive severance pay, a financial stipend for an identified retraining or educational opportunity, or preferential consideration for employment with the private contractor; in addition, redeployment ensured that affected employees maintained their salary and titles comparable to their former positions.<sup>71</sup>

## 11. Ohio

Two Ohio cases from the 1980s also shed additional light on judicial resolutions to Konno-type issues. The first case, Local 4501, Comm. Workers v. Ohio State Univ.,<sup>72</sup> involved a labor union representing custodial workers employed by Ohio State University who were protected under a

collective bargaining agreement. Due to state budget reductions, the university imposed a hiring freeze, under which civil servant positions became vacant through attrition. Although these positions were neither abolished nor refilled by other civil service employees, the university entered into contracts to have the services performed by private independent contractors. The contracts were let competitively to the lowest bidders, which resulted in cost savings to the university. No civil servants were laid off or terminated as a result of the contracts. The union sought a declaration of its rights under state civil service laws and its collective bargaining agreement, as well as an injunction against the university from filling vacancies created by attrition by contracting out for services. The trial court and court of appeals found in favor of the university, noting that the university was permitted to enter into contracts with independent contractors so long as their decision was not motivated by political reasons. The Ohio Supreme Court reversed.

The Court first noted that the purpose of the civil service laws was to remove politics from public service employment. The test used by the Court was to allow for private contracts to perform government functions “[i]n the absence of proof of an intent to thwart the purposes of the civil service system”.<sup>73</sup> The university argued that its sole motive for entering into contracts with the private sector “was the benign one of economics”; however, the Court found that “[w]hile it is true that the university is seeking, and succeeding in, the cutting of costs by contracting out custodial services, in so doing it is insidiously accomplishing another goal which is totally at odds with the purposes of the civil service system.”<sup>74</sup> In particular, the Court found that the central point was that the university had imposed a hiring freeze on the premise of lack of funds, that attrition and the like had caused vacancies in civil service positions, which had not been abolished, and that the work formerly done by the civil servants still must be done. The Court found a pattern of shifting remaining civil servants into small clusters and then contracting out the remaining work. “Slowly and inevitably, the civil service system is eroded and, ultimately, eradicated entirely. The result is that the university obtains a free hand to let out all services on a contract by contract basis without any moderation or restriction by the civil service system. Political activity is no longer restrained and the laudable purpose of the civil service system is side-stepped completely.”<sup>75</sup>

Writing in dissent, Justice William Brown argued that the facts of the case conclusively demonstrated that there had been no attempt to create a spoils system by discharging employees and replacing them with political appointees, no civil servants had been laid off or terminated as a result of contracting out for services, all contracts were let to the lowest bidder following competitive bidding, the contractors were responsible for their own hiring without university input or approval, and the contracting out policy saved the university money. “These stipulations defeat rather than advance the claim of unlawful intention as they establish an economic motive for the university’s actions.”<sup>76</sup>

The Ohio Supreme Court distinguished Local 4501 in Carter v. Ohio Dept. of Health,<sup>77</sup> decided later that same year. In that case, classified civil service employees of the state Department of Health challenged the decision of the department to abolish their positions and contract out with a private entity to perform services that were formerly performed by state employees. The State Personnel Board of Review and the Court of Common Pleas upheld the abolition of those positions, while the Court of Appeals reversed those decisions. On appeal, the Ohio Supreme Court reversed again, thereby upholding the abolition of those positions.

The Court first noted that the applicable statute allowed for the abolition of classified civil service positions for reasons of economy, that the decision of the Department of Health to contract out was made for that very reason, and that the record showed that savings in the range of \$140,000 per fiscal year could be realized as a result of contracting out the services in question (data entry). The Court further noted that its decision did not violate the basic principles of the civil service system, whose purpose was “to eradicate the spoils system by protecting an employee who has civil service tenure from being arbitrarily discharged and replaced with a political appointee.”<sup>78</sup> The Court found that there was no evidence in the record that the department was attempting to thwart the purposes of the civil service system, and that, “as the purposes of civil service should not be ignored, neither should substantial savings to the taxpayers of this state. The goal of maintaining the civil service system must be balanced with the goal of a fiscally responsible state government.”<sup>79</sup> The Court distinguished Local 4501, since the university in that case did not formally abolish vacant positions or fill them with new civil service employees.

Writing in dissent, Justice Douglas of the Ohio Supreme Court argued that the statute in question was not intended to provide for the ouster of civil servants from their jobs when substantially the same work being performed by those employees was then to be performed by others in a similar capacity and no consolidation of the work had taken place. The dissent further argued that the Court’s reasoning in Local 4501 should apply, and that the majority opinion had the effect of eroding the civil service system, in which appointments were based on merit rather than politics. “What has happened, in its simplest terms, is that in fact, the position of data entry operator still exists, except that now, state employees, who believed that they were protected by the civil service laws of Ohio, have been replaced by lower paid private employees who are performing the work outside government employment.”<sup>80</sup> Moreover, the dissent noted, the abolishment of the civil service positions foreclosed the affected employees from protecting their interests through collective bargaining, since they could not bargain for a position that no longer existed. The dissent further envisioned that the majority’s decision could lead to further abuse in the future:

In its most raw and abusive form of excess, an appointing authority, seeking to abolish any or *all* of the jobs falling within its jurisdiction, would need only demonstrate that the hiring of independent contractors would result in some measure of economy to the operation of the appointing authority’s organization. Through such a systematic reduction of the civil service work force, the civil service laws would be inexorably rendered meaningless. The appointing authority, under the guise of economizing through the hiring of independent contractors, is free to rid an organization of employees deemed ‘undesirable’ because of political philosophy, race, gender or union activity.<sup>81</sup>

## 12. Virginia

According to the United States General Accounting Office, key state legislators and the Governor worked together to introduce new privatization initiatives and created a competition council in 1995 to improve the service and productivity of government services and to reduce the costs of operations.<sup>82</sup> The “Commonwealth Competition Council” was enacted as part of the Virginia Government Competition Act of 1995 as a permanent independent council to promote privatization.<sup>83</sup> Among the duties of the Council are to examine and promote methods of providing select

government-provided or government-produced programs and services through the private sector by a competitive contracting program; develop an institutional framework for a statewide competitive program to encourage innovation and competition within state government; and establish a system to encourage the use of feasibility studies and innovation to determine where competition could reduce government costs without harming the public.<sup>84</sup>

In addition, Virginia also initiated an effort to reduce its workforce by fifteen percent over three years. Following this reduction, the state transportation department and other departments began facing work backlogs. To ease the backlog, the state began contracting out to the private sector to perform the work. “Virginia officials said enabling legislation and staffing cuts together signaled the seriousness of Virginia’s effort to increase the use of privatization and managed competition.”<sup>85</sup> Under managed competition, as discussed in part III of this memorandum, government agencies in Virginia (as well as in Massachusetts and New York) may now bid on certain contracts that are open to the private sector.<sup>86</sup>

The framework established under the 1995 Virginia Act, known as the Commonwealth Competition Council (CCC) Process, was used to implement government wide privatization efforts for the first time in 1996. State agencies may be at different steps, depending on their respective requirements. In the first of five steps, the Council holds hearings to solicit input from concerned citizens, businesses, and government. Using this input and other information, the Council develops an inventory of functions or services that can be opened to competition with the private sector, which is published in the Council’s annual report. In step two, agencies conduct a public-private performance analysis of selected activities to determine whether they should be opened to private sector competition.<sup>87</sup>

Step three requires agencies to request proposals from private sector firms and some state agencies in certain cases. Council staff oversaw the cost comparison evaluation process, while an interagency team conducted an independent review of in-house costs to ensure that government costs were complete, accurate, and reasonable. In step four, agencies received sealed proposals from private firms and, if managed competition was used, from public employees. The agency announced a tentative decision to continue in-house performance or award the contract to a private bidder, for a period not exceeding five years. In the fifth and final step, the agency was required to establish an ongoing quality assurance program to ensure that the contractual cost standards and quality were met. The agency was also required to conduct a post-performance review upon the termination of the contract period.<sup>88</sup>

Sample legislation based on the Virginia statute is provided in Appendix K.

### **13. Washington State**

The 1978 case of Washington Fed’n of State Employees, AFL-CIO v. Spokane Community College,<sup>89</sup> was cited in Konno as an example of the application of the “nature of the services” test. In that case, a community college contracted with a private entity to provide custodial services for a new administration building, citing substantial projected cost savings. A state employees federation sought an injunction against the college and a declaratory judgment that the contract was void, on

the ground that custodial services had historically been provided by civil service staff employees at the college. The trial court entered summary judgment for the college. On appeal, the Washington Supreme Court reversed the lower court's decision, holding that, as a matter of law, the college had no authority to enter into a contract for new services of a type that had been regularly and historically provided, and could continue to be provided, by civil servants, and that the contract was void.

The Court found that although no civil service employees were laid off or transferred, the college's actions ignored the essential purposes of the civil service system, namely, to establish a merit system as the basis of selecting personnel. Although the college's actions were not prohibited under the specific language of Washington's Higher Education Personnel Law, the Court found that those actions violated the underlying purpose of that law:

Procurement of services ordinarily and regularly provided by classified civil servants through independent contracts, although not specifically prohibited by the State Higher Education Personnel Law, directly contravenes its basic policy and purpose. ... Therefore, where a new need for services which have been customarily and historically provided by civil servants arises, and where there is no showing that civil servants could not provide those services, a contract for such services is unauthorized and in violation of the State Higher Education Personnel Law.<sup>90</sup>

The Court further noted that the fact that there might be cost savings as a result of the contract did not change the result. The fact that the civil service laws embody a determination that the interests of the state are best served by a merit system "goes beyond considerations of mere costs to encompass other benefits such as efficiency and avoidance of the 'spoils system.' ... Thus, an anticipated or real savings in cost cannot be the basis for avoiding the policy and mandate of civil service laws."<sup>91</sup> The Court acknowledged that while some services have historically been procured by contract, the college's contract with independent contractors enlarged the authority of the director as to the types of services that may be procured, in contravention of state statutes.

In dissent, Justice Hicks argued that the Court, "[h]aving reviewed the State Higher Education Personnel Law ... and found it lacking, ... simply dons its legislative hat and drafts a provision which accomplishes what the statute did not. Such legislating by the court, undesirable in any event, is particularly flagrant in this instance." In particular, the dissent argued that the majority rule "goes far beyond the expressed purpose of the personnel statute and simply eliminates the authority to contract conferred by another statute..."<sup>92</sup> The majority's new "nature of the services" pronouncement was even more objectionable as judicial legislation in view of the fact that it violated an express statute to the contrary:

By this pronouncement, the majority provides what the legislature did not. No basis in the statute for the specifics of this rule is identified; nor does the majority refer to any express provision in the statute which is violated by the contract or which evinces a legislative intent to govern matters not affecting established positions and employees. The reason for this omission of statutory authority is quite simple—there is none. The rule announced is neither mandated nor supported by the act; it is the product of judicial fiat.<sup>93</sup>

In response to Spokane, the Washington State Legislature enacted legislation six months later that provided that neither the State Higher Education Personnel Law nor the State Civil Service Law



prohibit contracting out if the services “were regularly purchased by valid contract” by the appropriate department or agency before the effective date of that Act; provided that no such contract could be executed or renewed if it would have the effect of terminating existing classified employees or positions existing at the time of the execution or renewal of the contract.<sup>94</sup> The effect of the law was to limit the scope of *Spokane*, but only retrospectively by grandfathering contracts for services regularly purchased before the effective date of the Act. The Act did not apply when an existing state agency contracted after that date for services that it had not regularly purchased from the private sector but that were traditionally provided by civil service employees, or when a new agency contracted for services that were normally provided by civil service employees.<sup>95</sup>

## B. Federal Government

The federal government’s most extensive experience with privatization has been with contracting out as reflected in Office of Management and Budget (OMB) Circular No. A-76, considered to be “the leading statement of federal support for privatization.”<sup>96</sup> That circular, a copy of which is attached as Appendix I,<sup>97</sup> reflects the tension between privatization and the civil service system in the states. While the circular provides on the one hand that the general policy of the federal government is to “rely on commercial sources to supply the products and services the Government needs”, it also provides that contracting out will not be used to “justify departure from [civil service] law[s] or regulation[s] ... [or] for the purpose of avoiding established salary or personnel limitations.”<sup>98</sup> These intentions, as stated in the circular, namely, “diverting public functions to commercial enterprise while also safeguarding civil service regulations — are plainly inconsistent.”<sup>99</sup>

According to a 1988 report of the President’s Commission on Privatization, contracting out has been one of the federal government’s principal ways of doing business throughout the nation’s history and, in the 1987 fiscal year alone, federal departments and agencies contracted to purchase \$197,300,000,000 worth of goods and services from the private sector in areas ranging from producing rocket launch vehicles to conducting medical and educational research. While a bipartisan consensus has supported privatization for commercially available goods and services since 1955, many government agencies have nevertheless resisted contracting out.<sup>100</sup> In that year, the Eisenhower administration issued a formal policy to the effect that where the private sector could do the job, it should do the job; the government would not compete with the private sector by independently producing goods and services, except where necessary to preserve the public interest, as in cases involving national security.<sup>101</sup>

In 1966, the Bureau of the Budget issued Circular A-76 to establish formal rules governing cost competitions and defining protections to mitigate adverse effects on government employees. According to the President’s Commission, although this policy “has been reaffirmed by every administration of both political parties since 1955, the principle has not been applied effectively. Instead, each administration renews its commitment to the principle, tinkers with procedures, and ends up accomplishing little to contract commercial functions to the private sector.”<sup>102</sup> Generally, under A-76 contracting out procedures, rather than seeking to contract out all commercial activities, the circular allows government agencies currently providing goods and services to compete with private firms for the government’s work requirements. The procedure includes detailed management planning before activities are transferred to the private sector, including a review of all commercial

activities to determine whether they are appropriate for contracting out. The circular is predicated on the idea that competition will both reduce costs and increase service quality.<sup>103</sup>

The Reagan and Bush administrations praised the policies established in Circular A-76 for producing substantial savings; OMB claimed total savings of close to \$696,000,000 from fiscal years 1981 to 1987, and the equivalent of 45,737 full-time positions that were freed to perform higher priority missions. According to the OMB, the federal government saved an average of thirty percent from original costs; twenty percent when government employees won (about forty-five percent of the time) and thirty-five percent when private contractors won.<sup>104</sup> In addition, the Congressional Budget Office has estimated that federal government contracting for commercial services could affect up to 1,400,000 employees, although this estimate includes positions now protected by legislation. Moreover, if all of the services that could be contracted out are considered, the value of government-operated commercial services could be nearly \$40,000,000,000 annually.<sup>105</sup>

Despite enthusiasm with the program due to cost savings and increased efficiency, critics have condemned privatization efforts for upsetting patterns of government and creating serious morale problems among federal workers. In addition, critics charge that OMB inflated its estimates of cost savings by not including the cost of the A-76 process itself. "At one congressional hearing in 1988, witnesses pointed out that a five-year A-76 review, costing \$8 million to \$10 million to conduct, saved just \$480,000 and cost many federal workers their jobs."<sup>106</sup> Moreover, despite the OMB's estimated cost savings of \$696,000,000 over six years, "the best estimates of the annual cost to produce those savings in a single department had an error factor of 100 percent and a cost range of \$150 million...", and the United States General Accounting Office found that no one actually knew how much the A-76 review process cost.<sup>107</sup>

Resistance to contracting out government functions to the private sector has come from government managers, government employees and their unions, and members of Congress who have large constituencies of federal workers. Government managers' resistance arose for three reasons: "First, they fear that contracting out will to some degree erode their managerial control, causing performance to suffer and diminishing their effectiveness. Second, managers are concerned that jobs lost through contracting could lead to reductions of their grade levels, because the number of employees supervised is often a factor in job classification. Finally, managers want to protect their employees from adverse action."<sup>108</sup> Managers who were opposed to contracting out could obstruct implementation, for example, by failing to conduct A-76 studies or using their discretion to drag out the competition with the private sector.

Government employees have also been opposed to privatizing government functions. While OMB "tried to sell A-76 as a management-improvement program, government workers were always suspicious that the rhetoric was a cover for a strategy to increase contracting out and to eliminate their jobs."<sup>109</sup> Since personnel costs accounted for a large share of the government's costs in commercially available activities, government employees were understandably concerned that cutting government programs often meant cutting government employment:

Government employees and their unions often consider cost competition a direct threat, either from a diminution of benefits and seniority, or, in the worst case, from loss of jobs. People who choose government careers for security, stability, and patriotic reasons tend to see their

commitment as devalued by a forced move to the private sector. Federal employees' unions have lobbied vigorously against contracting out and have opposed competition for existing functions and for new government requirements. Books and pamphlets, such as *Passing the Bucks* by the American Federation of State, County, and Municipal Employees (AFSCME), contend that contracting out threatens the American way, fails to provide good-quality service, and saves less money than proponents claim.<sup>110</sup>

As a result, federal employee morale has suffered in affected agencies subject to A-76 reviews. Often, as soon as government managers announced such a review, attrition increased; workers retired, left for other government positions, or took private sector jobs.<sup>111</sup> Many critics have also argued that the cost comparison process is a sham, complained about "low-balling", and maintained that A-76 was a deliberate strategy to break public employee unions.<sup>112</sup>

On the other side of the fence, private contractors seeking to do business with the government argue that while "[t]here is no easy solution to this problem, ... maintaining life-time employment for the current Government work force is certainly not the right answer."<sup>113</sup> Moreover, while "[i]t would be impossible to tell the workers who found their careers disrupted, their pay cut, their benefits diminished, and their satisfaction reduced that the A-76 process did not have harmful or painful consequences", the number of employees who have been adversely affected by A-76 reviews is small compared to the overall size of the federal work force.<sup>114</sup>

In addition, there are already in place federal safeguards protecting federal employment. Contracting out is already regulated by procedures protecting the rights of federal employees in the executive branch, as well as by wage protections under the Service Contract Act of 1965: "[Federal employees] are entitled to 'right of first refusal' privileges to go to work for the contractor if the agency's bid loses. ... If they go to work for the contractor, employees must be paid at a comparable wage, as provided under the Service Contract Act. Employees who choose to remain with the federal agency after a contract award receive priority for transfer to positions within the agency and cannot lose their grade for a 2-year period."<sup>115</sup> In addition, if placement within the government is not possible immediately, "adversely affected employees receive priority consideration for new positions within their agencies and are eligible for out-placement assistance, including reasonable costs for training and relocation."<sup>116</sup>

Finally, recent federal laws, rules, and initiatives "have given new impetus to federal agencies to operate more effectively and efficiently."<sup>117</sup> In addition to the 1996 revision of the OMB Circular A-76 supplemental handbook,<sup>118</sup> these include the Government Performance and Results Act of 1993, which requires agencies to develop strategic plans, obtain input on desired goals from stakeholders, and measure and report progress toward achieving those goals;<sup>119</sup> the Clinger-Cohen Act of 1996, providing for new requirements regarding how information technology-related projects are to be selected and managed, which closely parallel the investment practices of leading organizations;<sup>120</sup> and the Clinton Administration's major management reform initiative known as the National Performance Review (NPR). According to the NPR, privatization is one helpful approach in assisting federal agencies to operate more efficiently.<sup>121</sup>

## Endnotes

OTHER JURISDICITONS

1. There has also been significant action at the *city and county* levels in many states regarding civil service and privatization issues; however, a review of city and county actions is beyond the scope of this memorandum. For further information on these and related issues, *see, e.g.*, John A. Rehfuess, Contracting Out in Government: A Guide to Working with Outside Contractors to Supply Public Services (San Francisco: Jossey-Bass Publishers, 1989) at pp. 211 - 216 (discussing cases of contracting out where union or employee opposition existed in Camden, NJ; Milwaukee; San Francisco; Akron, OH; West Chester, PA; Fort Walton Beach, FL; Fairfield, CA; New Orleans; Pekin, IL; and Covington, KY); National Commission for Employment Policy, Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers (study prepared by Dudek & Co., May 1988), pp. 1 - 53 (discussing privatization and employment policy in fifteen cities or counties, ranging from Los Angeles County, CA to Newark, NJ); Paul Kengor and Grant Gulibon, "'Poison Pills' for Privatization: Legislative Attempts at Regulating Competitive Contracting," Allegheny Institute Report #96-22 (Pittsburgh, PA: Allegheny Institute for Public Policy), December 1996 (discussing legislation aimed at impeding privatization, including ordinances adopted in New York City, Baltimore, Los Angeles, San Francisco, and Pittsburgh); *see also* Michael E. Meyer and David R. Morgan, Contracting for Municipal Services: A Handbook for Local Officials (Norman, OK: Univ. of Oklahoma, Bureau of Government Research, July 1979); Advisory Commission on Intergovernmental Relations, Intergovernmental Service Arrangements for Delivering Local Public Services: Update 1983 (Washington, DC, Oct. 1985); Stephen Goldsmith, "Can Business Really Do Business with Government?", Harvard Business Review, May-June 1997, pp. 110 - 121.
2. A number of studies have been conducted in other states concerning various aspects of privatization; *see, e.g.*, Colorado State Auditor, Privatization in Colorado State Government: Performance Audit (Denver: March, 1989); Florida House of Representatives Committee on Governmental Operations, Final Report on Privatization (Tallahassee: Dec. 1995); Illinois Department of Commerce and Community Affairs, Contracting for Services (Springfield: 1981); Karen L. Hruby, Privatization of State Services, Vol. I (Augusta, ME: Maine Legislature, Office of Policy and Legal Analysis, Nov. 1992); Michigan Legislative Service Bureau, Privatization: An Option for State and Local Government in Michigan (Lansing: 1987); Minnesota Office of the Legislative Auditor, Program Evaluation Division, State Contracting for Professional/Technical Services (St. Paul: Feb. 1992); Mississippi Legislature, Joint Legislative Committee on Performance Evaluation and Expenditure Review, The Privatization Potential of Mississippi's State Programs and Services (Jackson: Nov. 1992); Donald Donovan and Marsha J. Orr, Subcontracting in the Public Sector: The New York State Experience, Institute of Public Employment Monograph No. 10 (Ithaca, NY: New York State School of Industrial and Labor Relations, Cornell University, 1982); North Carolina Legislative Research Commission, State Government Reorganization and Privatization, Report to the 1995 General Assembly (Raleigh: 1996); Tennessee Comptroller of the Treasury, Office of Research, Private Contracts, Public Services: Weighing the Choices (Nashville: Nov. 1995); Virginia Joint Committee Studying Privatization of Certain State Government Functions, Interim Report, Senate Doc. No. 64 (Richmond: 1994).
3. *See, e.g.*, Michigan State Employees v. Civil Service Com'n, 141 Mich.App. 288, 367 N.W.2d 850 (Mich. Ct. App. 1985) (*per curiam*); Carter v. Ohio Dept. of Health, 28 Ohio St.3d 463, 504 N.E.2d 1108 (1986) (*per curiam*); *but see* Local 4501, Comm. Workers v. Ohio State Univ., 12 Ohio St.3d 274, 466 N.E.2d 912 (1984) (*per curiam*), *rev'd in part and aff'd in part*, 24 Ohio St.3d 191, 494 N.E.2d 1082 (1986) (*per curiam*); *see also* Moncrief v. Tate, 593 S.W.2d 312 (Texas 1980).
4. *See, e.g.*, Colorado Ass'n of Pub. Emp. v. Dept. of Highways, 809 P.2d 988 (Colo. 1991) (*en banc*); Jack A. Parker & Assoc., Inc. v. State, etc., 454 So.2d 162 (La. Ct. App. 1984), *cert. denied*, 459 So.2d 538 (La. 1984); Washington Fed'n of State Employees, AFL-CIO v. Spokane Community College, 90 Wash.2d 698, 585 P.2d 474 (1978) (*en banc*); *see generally* Moore v. State, Dept. of Transp., 875 P.2d 765, 770 nn. 4, 5 (Alaska 1994).
5. 875 P.2d 765 (Alaska 1994).
6. 875 P.2d at 766.

7. 875 P.2d at 769.
8. 875 P.2d at 771.
9. 875 P.2d at 772 - 773.
10. 875 P.2d at 775 (Rabinowitz, J., dissenting).
11. 875 P.2d at 774 - 775 (Rabinowitz, J., dissenting).
12. Privatization 1997 (Los Angeles: Reason Public Policy Institute, 1997) at 5.
13. A copy of Arizona's Competitive Government Handbook is available in the Legislative Reference Bureau library, or may be obtained by contacting the Arizona Governor's Office for Excellence in Government, phone: (602) 542-7030; fax: (602) 542-1220, attn: Melba Davidson, Executive Management Consultant, or on the Internet at: m davidson@gv.state.az.us.
14. 63 Cal.Rptr.2d 467 (Cal. 1997); *see also* Maura Dolan and Virginia Ellis, "Court Restricts State's Ability to Contract Out," Los Angeles Times, May 16, 1997, pp. A1, A20.
15. 63 Cal.Rptr.2d at 469, *quoting* State Compensation Ins. Fund v. Riley, 9 Cal.2d 126, 135 (1937).
16. *See* 63 Cal.Rptr.2d at 469-471 and cases cited therein; *see also* Malcolm S. Burnstein, Comment, "Contracting with the State Without Meeting Civil Service Requirements," 45 Cal. L. Rev. 363 (1957).
17. 63 Cal.Rptr.2d at 471-472; *see also* Cal. Gov't Code §§19130-19133 ("personal services contracts").
18. 63 Cal.Rptr.2d at 469.
19. For a discussion of the principle of *stare decisis*, see notes 34 to 36 and accompanying text in part II of this memorandum.
20. 63 Cal.Rptr.2d at 479-480.
21. 63 Cal.Rptr.2d at 486.
22. 63 Cal.Rptr.2d at 486 (Baxter, J., dissenting).
23. 63 Cal.Rptr.2d at (Ardaiz, J., dissenting).
24. Privatization 1997, *supra* note 12, at 6.
25. 809 P.2d 988 (Colo. 1991) (*en banc*).
26. 809 P.2d at 992.
27. 809 P.2d at 992 - 994.
28. 809 P.2d at 994 (citations omitted).
29. 809 P.2d at 994 (footnotes omitted).
30. 809 P.2d at 994.

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31. 809 P.2d at 995. *See also* discussion of this case in Konno v. County of Hawaii, 85 Haw. 61, 74, 937 P.2d 397, 410 (1997); Horrell v. Dept. of Admin., 861 P.2d 1194 (Colo. 1993) (*en banc*). In Horrell, the Colorado Department of Administration, in the absence of specific legislation or regulations, chose to obtain services previously performed by classified state employees from the private sector. The Court concluded that its decision in Colorado Ass'n of Public Employees v. Department of Highways controlled that case, and that the Department could not constitutionally contract out those services to private vendors absent statutes or rules setting out standards for privatization. Id., 861 P.2d at 1200.
32. Colo. Rev. Stat. §24-113-103(1) (1996); *see generally* §§24-113-101 to 24-113-105 (“state government competition with private sector”) and §§24-114-101 to 24-114-103 (“private enterprise employee protection”) (1996). *See also* Keon S. Chi, “Privatization and Contracting for State Services: A Guide,” Innovations (Lexington, KY: The Council of State Governments, April 1988) at 4.
33. *See* Colo. Rev. Stat. §§24-50-501 to 24-50-513 (1996) (“contracts for personal services”).
34. Colo. Rev. Stat. §24-50-501 (1996).
35. United States General Accounting Office, Privatization: Lessons Learned by State and Local Governments, Report to the Chairman, House Republican Task Force on Privatization, GAO/GGD-97-48 (Washington, DC: March 1997) (hereinafter, “GAO”) at 9, 11, 26.
36. S.B. No. 635, enacted as Act 816, Session Laws of Georgia 1996.
37. Jonathan Walters, “Who Needs Civil Service?” Governing, August 1997, at 17.
38. Id. at 17 - 19.
39. GAO at 11 - 12.
40. GAO at 12.
41. 454 So.2d 162 (La. Ct. App. 1984), *cert. denied*, 459 So.2d 538 (La. 1984).
42. 454 So.2d at 165 (emphasis added).
43. 454 So.2d at 166. Current Louisiana law also provides that, with respect to contracts for professional, personal, consulting, or social services, the director or assistant of the office of contractual review must have determined, among other things, that “[n]o using agency has previously performed or contracted for the performance of tasks which would be substantially duplicated under the proposed contract without appropriate written justification.” La. Rev. Stat. Ann. §39:1498(A)(5) (West 1997).
44. *See* Konno, 85 Haw. at 70, 937 P.2d at 406. In addition to Maryland, the states of Michigan, Nevada, and Texas are among those that have also adopted “bad faith” tests, in which plaintiffs must come forward with proof of defendants’ “bad faith”, or intent to circumvent the civil service laws and implement a spoils system in privatizing government functions, and in which solely economic motives are proof of good faith. *See, e.g.*, Michigan State Employees v. Civil Service Com’n, 141 Mich.App. 288, 367 N.W.2d 850 (Mich. Ct. App. 1985) (*per curiam*); University of Nevada v. State of Nevada Employees Association, 90 Nev. 105, 520 P.2d 602 (1974); Montcrief v. Tate, 593 S.W.2d 312 (Texas 1980); City of San Antonio v. Wallace, 338 S.W.2d 153 (Texas 1960); *see also* Craig Becker, “With Whose Hands: Privatization, Public Employment, and Democracy,” 6 Yale Law & Policy Review 88, 102 (1988).
45. 251 Md. 685, 248 A.2d 650 (1968).
46. 248 A.2d at 654.

47. Id.
48. Md. Code Ann. State Pers., §13-402 (Michie 1996); *see generally* §§13-401 to 13-405.
49. Md. Code Ann. State Pers., §13-405(c)(1) (Michie 1996).
50. GAO at 9, 26 - 27. While five of the six states studied by the GAO used government-wide commissions to promote privatization, identify opportunities, and establish policies and procedures for privatization initiatives, only Massachusetts did not use a commission; rather, cabinet secretaries selected the government activities to privatize, with individual departments initially using internal teams to design and implement specific initiative. Id. at 10. In addition, while the GAO found that reliable and complete cost information on government activities was needed to support privatization, Massachusetts instead relied on estimates, since complete cost data on state activities were difficult to obtain from the state’s accounting system. “However, reports by the Massachusetts State Auditor called into question the reported savings of some privatization activities, citing inadequate cost analysis before privatization as well as a lack of substantiating data on the benefits claimed following privatization.” Id. at 13 - 14.
51. Bruce A. Wallin, “The Need for a Privatization Process: Lessons from Development and Implementation,” Public Administration Review, Vol. 57, No. 1, January/February 1997, at 11 - 15.
52. GAO at 14.
53. GAO at 14. “The Massachusetts State Auditor said that in the 2 years before the law, 6 Massachusetts departments privatized approximately 20 services, but only 2 privatizations occurred between the law’s enactment and December 1996.” Id.
54. *See* Mass. Ann. Laws ch. 7, §§52-55 (Law. Co-op. 1997).
55. For additional information regarding the politics of privatization in Massachusetts, *see* Wallin (1997), *supra* note 51; *see also* Kengor and Gulibon (1996), *supra* note 1. The latter report also critiques various city ordinances imposing “living wage” and other requirements— i.e., requirements that contractors pay employees a predetermined minimum or “living” wage.
56. 141 Mich.App. 288, 367 N.W.2d 850 (Mich. Ct. App. 1985) (*per curiam*).
57. 367 N.W.2d at 852.
58. Id.
59. 367 N.W.2d at 855 (Danhof, C.J., dissenting).
60. Id. The dissent further noted that it was incongruous to vest the Civil Service Commission with authority to fix rates of compensation and approve or disapprove disbursements for all public services — including the authority to rescind and defer increases considered and proposed by the Legislature — and then allow the Commission to approve personal service contracts after performance of the job by the civil service had become uneconomical. It was to be expected that the civil service would not always be the most economical in performing certain duties, which was part of the cost of continuing “Michigan’s national leadership among state in public personnel practice.” Id. Where there was need to implement cost-effective measures, the dissent maintained, it should be exercised in fixing rates of compensation rather than contracting out.
61. GAO at 10, 28. A former senior Michigan official who studied his state’s and other privatization commissions noted that a commission’s effectiveness may be limited if it did not have a clear mission and a membership that reflected a balance between the public and private sectors. Id. at 10.

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62. GAO at 37. In the first step of that framework, an historical analysis of the activity was performed to identify factors causing the state government to become involved in the activity and whether those factors had changed. Second, the agency prepared a report recommending whether the function should be privatized, eliminated, etc., including evaluating the potential effects on customers and other state activities of changing a function or service, including a quantitative assessment of activity operations and results to be achieved. Finally, the agency prepared an analysis of the function or service's current costs, and a basis for determining the cost of operations if they would be changed. Id.
63. GAO at 37-38.
64. 445 N.Y.S.2d 812 (N.Y. App. Div. 1981), *aff'd*, 454 N.Y.S.2d 67, 439 N.E.2d 876 (N.Y. Ct. App. 1982).
65. 445 N.Y.S.2d at 814. The Court noted in passing that the New York Constitution "does not require that all governmental services be supplied by civil service employees, and contracts with private contractors have been permitted when they were legitimate attempts to have service provided in a more cost-efficient manner." Id., 445 N.Y.S.2d at 813 (citations omitted).
66. 62 N.Y.2d 361, 477 N.Y.S.2d 91, 465 N.E.2d 811 (1984).
67. 465 N.E.2d at 815 (*quoting* Matter of Social Investigator Eligibles Assn. v. Taylor, 268 N.Y. 233, 237, 197 N.E. 262).
68. 465 N.E.2d at 815 (citation omitted).
69. Privatization 1997, *supra* note 12, at 6-7.
70. GAO at 9, 16, 28 - 29.
71. GAO at 16.
72. 12 Ohio St.3d 274, 466 N.E.2d 912 (1984) (*per curiam*), *rev'd in part and aff'd in part*, 24 Ohio St.3d 191, 494 N.E.2d 1082 (1986) (*per curiam*).
73. 466 N.E.2d at 914 (*quoting* State ex rel. Sigall v. Aetna, 45 Ohio St.2d 308, 314-315, 345 N.E.2d 61 (1976)).
74. 466 N.E.2d at 914.
75. 466 N.E.2d at 915. On remand, the Ohio Supreme Court held that since the custodial service contracts that were let out by the university during its hiring freeze on civil service custodial personnel were contrary to law, the contracts in question were therefore void. Under the law of the case, the trial court was obligated to comply with the Supreme Court's mandate by ordering the termination of all contracts that were still in effect. Local 4501, Comm. Workers v. Ohio State Univ., 24 Ohio St.3d 191, 494 N.E.2d 1082 (1986) (*per curiam*).
76. 466 N.E.2d at 916 (William B. Brown, J., dissenting).
77. 28 Ohio St.3d 463, 504 N.E.2d 1108 (1986) (*per curiam*).
78. 504 N.E.2d at 1109 (*quoting* State, ex rel. Sigall v. Aetna, 45 Ohio St.2d 308, 314,345 N.E.2d 61 (1976)).
79. 504 N.E.2d at 1109.
80. 504 N.E.2d at 1111 (Douglas, J., dissenting).



81. 504 N.E.2d at 1112 (Douglas, J., dissenting). Justice Douglas further noted that other “more perilous consequences” could arise from the abolishment of civil service positions:

When an appointing authority, whether it is a city, county or the state, has abandoned its entire capacity to provide a service with civil servant employees, the private contractor is unrestrained in the demands he may make on the appointing authority. For example, a city may choose to ‘abolish’ its refuse collection department and contract out those services. When the city has laid off its refuse employees, sold its garbage trucks and landfill, its capacity to serve its citizenry is severely, and perhaps dangerously, limited. It is the contractor who then owns the trucks, hires the employees, and operates the landfill. What option is available when the price of the service is doubled or tripled by the contractor when the contract is renegotiated? Id.

In another dissenting opinion, Justice Clifford Brown agreed that the state Department of Health had unlawfully abolished civil service positions contrary to Ohio statutes. He urged the bench and bar to disregard the majority opinion as legal precedent, stating that the *per curiam* opinion failed to obtain a majority of votes to be adopted as the opinion of the court. 504 N.E.2d at 1113.

82. GAO at 9, 10, 11, 30.
83. 1995 Va. Acts, chapter 815 (S.B. No. 994), approved April 6, 1995.
84. Va. Code Ann. §9-336 (Michie 1995).
85. GAO at 11.
86. GAO at 9.
87. Step two itself consists of five parts. In the first part of the performance analysis, an evaluation is conducted of an activity’s potential for competition, assessing the private sector’s capacity and the state’s ability to measure performance for evaluation purposes. The second part assesses the full cost of operating the current activity, as well as the estimate cost of the contract for the function to be privatized. The third part addresses public policy issues concerning public safety and welfare. The fourth component focuses on such issues as personnel and transition considerations, as well as contract administration. The final step looks at implementation issues, including procurement requirements and quality assurance evaluation procedures. GAO at 40. As discussed in part IX of this memorandum, Virginia has recently adopted “COMPETE” — a fully automated, PC-operated cost comparison program to aid in the council’s decision making efforts. See Privatization 1997, *supra* note 12, at 7.
88. GAO at 40 - 41.
89. 90 Wash.2d 698, 585 P.2d 474, 477 (1978) (*en banc*).
90. 585 P.2d at 477 (citation omitted).
91. 585 P.2d at 478.
92. 585 P.2d at 479 (Hicks, J., dissenting).
93. 585 P.2d at 480 (Hicks, J., dissenting). See also Timothy P. Dowling, “Note: State Civil Service Law— Civil Service Restrictions on Contracting Out by State Agencies— *Washington Federation of State Employees v. Spokane Community College*, 90 Wn.2d 698, 585 P.2d 474 (1978),” 55 Wash. L. Rev. 419, 422 (1980), which argued that the majority decision in that case was unsound for public policy reasons.

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94. Act of April 23, 1979, 1979 Wash. Laws 1<sup>st</sup> Ex. Sess., chapter 46 (codified as Wash. Rev. Code §28B.16.240 and §41.06.380 (1979)); cited in Dowling, *supra* note 93, 55 Wash. L. Rev. at 421 n. 14. Section 28B.16.240 was subsequently recodified as §41.06.382 by Wash. Laws 1993, chapter 281, §70, effective July 1, 1993. Personal service contracts are generally regulated by chapter 39.29, Wash. Rev. Code (§§39.29.003 to 39.29.900).
95. Dowling, 55 Wash. L. Rev. at 422 (footnotes omitted). The Washington Court of Appeals later distinguished Spokane in the case of Joint Crafts Council & Teamsters Union Local 117 v. King County, 76 Wash.App. 18, 881 P.2d 1059 (1994). In that case, unions representing King County employees who repaired and maintained county vehicles sued the county, alleging that the county violated the civil service merit system by contracting out for maintenance and repair on police vehicles. The Court of Appeals found that the county did not violate civil service laws by contracting out to private entities, even though civil servants customarily and historically performed maintenance and repair services on those vehicles. Citing Spokane, the Court stated that a showing that it was *not practicable* for civil servants to provide the necessary services is sufficient to permit the use of private entities. The Court found that the record showed that the decision to contract out was not made on the basis of real or anticipated cost savings, which would have been an insufficient reason to show that civil servants could not perform the services, but that the discontinuance of the practice of repairing and maintaining police vehicles at the county's centralized facility was rendered necessary by the implementation of the county's "car per officer" program, which rendered the continued use of the facility no longer practicable. *See id.*, 881 P.2d at 1061 - 1062; *see also* Keeton v. Department of Social & Health Services, 34 Wash.App. 353, 661 P.2d 982, *review denied*, 99 Wash.2d 1022 (1983) (agency decision to close part of its operation did not violate civil service laws where it was no longer practicable to continue to have public employees do certain work).
96. Becker, *supra* note 44, 6 Yale Law & Policy Rev. at 98 (1988). OMB Circular A-76 establishes government policy to: "(a) rely generally on private commercial sources for supplies and services, if certain criteria are met, while recognizing that some functions are inherently Governmental and must be performed by Government personnel, and (b) give appropriate consideration to relative cost in deciding between Government performance and performance under contract. In comparing the costs of Government and contractor performance, the Circular provides that agencies shall base the contractor's cost of performance on firm offers." 48 C.F.R. §7.301 (Oct. 1, 1996); *see generally* Federal Acquisition Regulations, 48 C.F.R. pt. 7, subpt. 7.3 ("contractor versus government performance"), subpt. 7.4 ("equipment lease or purchase"), and subpt. 7.5 ("inherently governmental functions") (Oct. 1, 1996). For a discussion of whether the Circular is an "applicable law" within the meaning of the Civil Service Reform Act of 1978's management rights provision, 5 U.S.C. §7106(a)(2), *see* IRS v. FLRA, 494 U.S. 922, 110 S.Ct. 1623, 108 L.Ed.2d 914 (1990).
97. Appendix I also contains the introduction to the OMB Circular A-76 Supplement. A copy of the complete supplement may be found on the Internet at:
- <http://www.whitehouse.gov/WH/EOP/OMB/html/circulars/a076/a076spre.html>.
98. *Id.*, *citing* OMB Circular A-76 §§4, 7(b)(6) (rev. Aug. 16, 1983). Federal civil service laws generally provide for open, competitive examinations to test the fitness of applicants for classified positions and for selections according to grade. They also require the apportionment of appointments at Washington, D.C., among the states and territories on the basis of population, and provide for a probationary period before final appointment or employment. "Freedom from obligation to contribute to any political fund or to render any political service is a principle of the law, which also declares that no person in the service has any right to use his official authority or influence to coerce the political action of any persons or body." 15A Am.Jur.2d Civil Service, §4 (1976) at 10.
99. Becker, 6 Yale Law & Policy Rev. at 98 - 99 (1988).
100. United States, President's Commission on Privatization, Privatization: Toward More Effective Government (Urbana, IL: University of Illinois Press, 1988), p. 129 (hereinafter, "President's Commission").

101. Donald F. Kettl, Sharing Power: Public Governance and Private Markets (Washington, DC, 1993), p. 41.
102. President's Commission at 129-130. Circular A-76 has undergone revisions in 1979, 1983, and 1996.
103. Id. at 131.
104. Kettl (1993), *supra* note 101, at 46 - 47.
105. President's Commission at 130 (footnote omitted); *see also* United States Congress, Congressional Budget Office, Contracting Out: Potential for Reducing Federal Costs (Washington, DC: June 1987).
106. Kettl (1993) at 56 (footnote omitted).
107. Id.; *see also* Gary L. Ackerman, "The Federal Experience with Contracting Out," in When Public Services Go Private: Not Always Better, Not Always Honest, There May Be a Better Way (Washington, DC: American Federation of State, County and Municipal Employees, AFL-CIO, 1987) at 13 - 17.
108. President's Commission at 136.
109. Kettl (1993) at 58.
110. President's Commission at 139 (footnote omitted).
111. Kettl (1993) at 59. Kettl quotes one Department of Defense official as follows:
- The major problem with A-76 is with the human spirit — it's a real downer. If you back away from the details, the concept of competition, what we're doing is taking 10,000 employees a year and threatening the hell out of them.... These [reviews] can drag on for years. There's a tremendous problem with morale, people leaving for other jobs.
- Id. (footnote omitted). Kettl described an A-76 study conducted at one DOD installation in June 1981. By the time the contract was let four years later, so many employees had left that a number of maintenance jobs went undone, and the government had to ask the contractor to begin work before the official contract start date to relieve the backlog. Id.
112. Id. at 60 - 61. With respect to low-balling — the procedure in which contractors deliberately submit a significantly understated bid to get a job, and then allow costs to rise after winning the contract — Kettle quoted one government official who testified at a congressional hearing as follows:
- I guess the word that comes to mind is "frustration." When you consider a study that has taken years to complete, when you see contractors coming in low-balling and then six months later they default, when you see contractors come in and do shoddy work that the Government employees then have to go back behind them and redo, I can't say that it's an effective management tool. Id. at 60 (footnote omitted).
113. Id. at 61 (footnote omitted).
114. Id. at 62.
115. President's Commission at 140 - 141 (citations omitted).
116. Id. at 141.
117. GAO at 2.

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118. The latest revision to A-76 by the OMB was designed “to enhance federal performance through competition and choice, seek the most cost-effective means of obtaining commercial products and support services, and provide new administrative flexibility in agencies’ decisions to retain services in-house or contract them out.” GAO at 2.
119. Id.; see Pub. L. 103-62, Aug. 3, 1993, 107 Stat. 285. The legislative history to that Act noted that “[m]uch has been made of the seeming inconsistency between the public’s desire for a wide range of government services, and that same public’s disdain for government and objections to paying higher taxes. ... [P]art of the explanation for this apparent inconsistency can be seen in the results of a recent public opinion poll which shows that Americans, on average, believe that as much as 48 cents out of every Federal tax dollar is wasted. In other words, the public believes that it is not getting the level and quality of government service for which it is paying.” S. Rep. No. 103-58, 103d Cong., 1<sup>st</sup> Sess. (1993) at 2 (U.S. Code Cong. & Admin. News, 1993, Vol. 2, Pub. L. 103-62, at 328).
120. Id.; see Pub. L. 104-208, Div. A, Title I, §101(f) [Title VIII, §808(a), (b)], Sept. 30, 1996. The GAO noted that this Act was originally the Federal Acquisition Reform Act of 1996 and the Information Technology Management Reform Act of 1996, and was subsequently renamed the Clinger-Cohen Act on Sept. 30, 1996. See also Executive Order No. 13011 regarding Federal Information Technology (July 16, 1996, 61 F.R. 37657; reprinted at 40 U.S.C. §1401 note) and Executive Order No. 13005 regarding Empowerment Contracting (May 21, 1996, 61 F.R. 26069; reprinted at 41 U.S.C. §251 note). The first executive order, among other things, establishes as federal policy that executive agencies significantly improve the management of their information system, including the acquisition of information technology, and establishes a Chief Information Officers Council as the principal interagency forum to improve agency practices in such areas as the design, modernization, use, sharing, and performance of agency information resources. The latter order seeks to foster the growth of federal contractors in economically distressed areas to ensure that those contractors become viable businesses for the long term, both to promote efficiency in federal procurement and to help to empower those communities.
121. GAO at 2. A bill has also been recently introduced in Congress that would require the federal government to procure from the private sector, with certain exceptions, the goods and services it needs to carry out its functions. That bill, the “Freedom From Government Competition Act” (S. 314, H.R. 716) (1997), has been criticized by a representative of the Office of Management and Budget as being unnecessary because of existing policy and outsourcing activities taking place under the revised OMB Circular A-76, and because it may prevent public employees from competing with the private sector for federal agency work. See “Government Operations: Mandatory Outsourcing Bill Criticized at Senate Hearing, Revision Likely,” BNA Federal Contracts Daily (Wash., DC: Bur. of Natl. Affairs Inc., June 23, 1997); see also United States General Accounting Office, Privatization and Competition: Comments on S. 314, the Freedom From Government Competition Act (GAO/T-GGD-97-134, June 18, 1997).

## PART IX. RECOMMENDATIONS AND CONCLUSION

### A. Recommendations

Based on an analysis of the issues and review of relevant literature relating to the Konno decision in parts II to VII of this memorandum, and a review of state and federal experiences in part VIII, the Legislative Reference Bureau makes the following recommendations:

#### 1. Privatization Task Force

***Recommendation No. 1: Establish a privatization task force to identify public services that are appropriate for privatization.***

***Discussion.*** In 1988, the Governor's Small Business Advisory Committee identified as a high priority the establishment of a task force of qualified individuals to investigate and recommend policies on privatization.<sup>1</sup> The Legislative Reference Bureau found this to be a viable mechanism for examining the feasibility of privatizing state and local government services, and recommended that the task force be comprised of local business representatives knowledgeable about privatization issues, union representatives, legislators, and other officials representing various government departments and agencies, including the University of Hawaii, the Department of Education, the Judiciary, and the Department of Budget and Finance, to study such issues as the following:

- Identify and assess the present extent of contracting out government services to the private sector;
- Identify and assess other governmental services which may be privatized at a cost savings without decreasing the quality of existing services, and which will not displace government employees;
- Review state laws and rules which might inhibit privatization as well as to ensure that public interests are protected if privatization is expanded; and
- Review other privatization options such as franchise agreements and divestiture of government responsibility for a service or services.<sup>2</sup>

The Legislative Reference Bureau further noted that the report of the task force could serve as an effective tool for government decision makers "in determining whether privatization is a viable and effective method in reducing government expenditures without jeopardizing the quality of services to the public and displacing government employees."<sup>3</sup>

The Bureau reiterates the recommendation to establish a privatization task force. The issues to be reviewed by the task force are as important today as they were ten years ago, and perhaps even more so. A thorough review of these issues may have prevented much of the litigation that has

occurred since that time. The task force should review the proposed privatization of government functions to the extent the public good is enhanced and not jeopardized. The goal is to increase tax revenues from increased business activity, increase jobs, increase resident household income, decrease government expenditures, and improve the efficiency of service delivery by stimulating private sector business activity. The task force could also review areas where duplicative or unnecessary state government functions could be consolidated.

While there have been several attempts to establish a task force to review privatization, these and related issues have not been addressed in a comprehensive manner on the state level. For example, in 1993, the Legislature adopted House Concurrent Resolution No. 209, S.D. 1, “Requesting a Study and Report on Issues Relating to the Sufficiency of Government in Hawaii.” In response to that concurrent resolution, the Interim Commission on Government Redesign was convened and issued a report recommending that the Legislature take appropriate action to continue the process of reinventing and redesigning government. Included in the Commission’s report was an “Action Agenda to Redesign State Government” from the National Governor’s Association, which included recommendations for privatizing government services and assets.<sup>4</sup> Resolutions were subsequently introduced to establish a task force to continue the work of the interim commission, but were killed in committee.<sup>5</sup>

Similarly, in 1996, the House of Representatives adopted House Resolution No. 232, H.D. 1, “Requesting the Governor to Establish a Privatization Commission to Review and Evaluate Privatization of State Government Functions”. That resolution noted that privatization would “help to make state government more cost-effective and efficient” and that “rightsizing of state government requires a comprehensive approach that incorporates increased privatization of selected programs and services...” That commission was never convened by the Governor, in view of the fact that the resolution requesting the commission was not a concurrent resolution adopted by both houses of the Legislature.<sup>6</sup>

## 2. Managed Competition

***Recommendation No. 2: Implement managed (public-private) competition to allow government agencies to compete with the private sector.***

***Discussion.*** One important factor in reforming Hawaii’s economy is to improve the efficiency in the delivery of government services for the benefit of the consumers of those services, namely, Hawaii’s citizens. Making government more efficient means changing the way it has traditionally done business and examining those areas in which it can cut costs without sacrificing the quality of public services. Streamlining government operations has increasingly meant not only introducing more cost-effective measures, but also increasing its competitiveness with the private sector and even with other governmental agencies:

As the decade of the 1990s progresses, the nature and definition of competition in government service delivery is changing. No longer is competition seen in strictly private versus private terms. Behind this new view of competition was a twofold realization. First came the somewhat obvious but quite recent recognition that if private sector organizations can reduce

service delivery costs and still earn a profit, then in-house government departments, which do not need to earn a profit, should be able to reduce costs even further. Second came the less obvious realization that competitiveness should mean the ability to meet or beat the performance of all rivals in the marketplace regardless of their status, public or private.<sup>7</sup>

The latest view of competition in government service delivery seeks to *maximize competition* without making prior judgments about which sector, whether public or private, should provide those services. Competition among service providers may both spur productivity, encourage innovation, and improve the quality of services. Competition in service delivery can take one or more of the following forms:

- ***Private vs. private:*** Two or more private firms, whether nonprofit or for profit, compete with each other.
- ***Public vs. private:*** An in-house department competes with one or more private firms.
- ***Public vs. public:*** An in-house department competes with one or more other government agencies.
- ***Public vs. public vs. private:*** An in-house department competes with a combination of other government and private sector organizations.<sup>8</sup>

For the reasons discussed in part III of this memorandum, the focus in government service delivery should not be exclusively on *privatization*, but rather on *competition*. Privatization is simply one management tool among many to help promote greater productivity and the efficient use of government resources. Unlike privatization, which implies a transfer of the delivery of government functions from the public to the private sector, a policy of competition leaves the question of whether the public or private sector will provide a particular service “up for grabs”:

Under the new competition, in-house government departments are going head-to-head with private sector organizations for the right to provide a variety of government services. In many instances, the in-house government departments are beating their private sector competitors. In some instances, in-house government departments are winning back the right to provide services that they lost to privatization and contracting out in the 1980s. The results of this new public-private competition are impressive:

- A reduction in service delivery costs
- An improvement in service quality
- An improvement in the morale of government employees, who see public-private competition as a preferable alternative to privatization and contracting out.<sup>9</sup>

In short, focusing on public-private competition rather than privatization may provide a win-win solution for Hawaii’s fiscally-strapped government, public employees and their unions, private sector entities, and taxpayers.

As discussed in part III, under “managed competition”, also referred to as “competitive contracting” or “public-private competition”, a public sector agency competes directly with private sector firms for the delivery of government services under a controlled or managed process. While managed competition is only one of a number of different management options to improve government service delivery, and has been criticized as inappropriate or ill-advised in certain circumstances,<sup>10</sup> it nevertheless appears to be an especially promising method to maximize competition. As noted in parts III and VIII of this memorandum, managed competition has already occurred on the federal, state, and local levels. The federal government has competed with the private sector in the A-76 process for nearly three decades. State governments such as Florida, Arizona, Utah, Virginia, and Texas have provided the creation of competitive government programs to encourage government competition with private or other public sector entities. Local governments such as Cleveland, Philadelphia, Phoenix, and Indianapolis have also implemented managed competition in delivering such services as wastewater treatment, child support enforcement, delinquent tax collection, street maintenance, and other areas.<sup>11</sup>

The Hawaii Economic Revitalization Task Force, convened in 1997 by Hawaii’s Governor, Senate President, and Speaker of the House of Representatives, also called for the support of “cost-efficient government services through managed public-private competition” rather than out-right privatization, to accomplish the following:

- a) Improve the overall efficiency of the public sector by providing additional opportunities and flexibility in the delivery of services;
- b) Enable State and county governments to implement public-private competition for government services through a managed process that determines whether a particular service can be provided more efficiently, effectively and economically by a public agency or a private enterprise;
- c) The managed process shall consider all relevant costs; and
- d) Establish protections for affected State and county employees, and ensure that civil service laws and merit principles are not violated.<sup>12</sup>

Other states that have already enacted legislation encouraging competitive public-private contracting have generally established a state council, board, or program on competitive government, either allowing or requiring the council to implement managed competition on a statewide basis.<sup>13</sup> The Legislature may wish to consider the following four bills, which have been drafted based on the following state laws establishing competitive government programs:

- ***The Virginia Commonwealth Competition Council***, which promotes both privatization and managed competition as appropriate (Appendix K);<sup>14</sup>
- ***The Arizona competitive government program***, allowing agencies to choose the programs they wish to consider for public-private competition (Appendix L);<sup>15</sup>



- *The Florida State Council on Competitive Government*, which promotes competition with private sources or other state agency service providers (Appendix M);<sup>16</sup> and
- *The Utah Privatization Policy Board*, while focusing on privatization, also provides for reviews of agency competition with the private sector (Appendix N).<sup>17</sup>

### 3. Contract Bidding

**Recommendation No. 3:** *Ensure that contracting out is implemented through an open, public, and well-designed contract bidding system.*

**Discussion.** Contract bidding systems should be designed in such a manner as to encourage competition and prevent corruption, collusion, and waste of taxpayer money — the chief arguments against privatization. Requiring strict compliance with public procurement laws — chapters 103, 103D, and 103F, Hawaii Revised Statutes — and designing bidding systems to prevent even the appearance of conflict or other impropriety, are critical to the success of the government’s privatization efforts:

The bidding system should be designed to encourage competition, protect the agency, and clarify expectations for the winning contractor by explicitly detailing the service specifications desired. As a rule, the bidding system should be open and competitive. Employees should be prohibited from having any financial interest in the contract, and former public employees should be prevented from representing contractors before the public agency for a certain period of time after they have left the local government’s employ. Furthermore, all bid awards should be widely publicized and a record should be kept of the search for contractors.<sup>18</sup>

The public procurement code, set forth in chapter 103D, Hawaii Revised Statutes, contemplates several methods of source selection. Under section 103D-301, all contracts are to be awarded by competitive sealed bidding except as otherwise provided. Bidding is often conducted through *invitations for bid* (IFBs) under section 103D-302 (competitive sealed bidding) or through *requests for proposals* (RFPs) under section 103D-303 (competitive sealed proposals). IFBs are formal requests or invitations for bidding that list the standards and specifications that are required for the targeted service, and are usually services that can be clearly and precisely defined. RFPs are often used when the contract specifications cannot be detailed as precisely, and are usually entered into after costs and other contract elements have been agreed upon. Competition in the RFP process is generally more informal than with the IFB process, since the RFP process often permits post-bid variations and allows negotiations, thereby placing a greater emphasis on the quality of the product rather than the cost.<sup>19</sup>

Contract specifications are the most important part of an IFB; if not drafted in sufficient detail, the government cannot compel performance by the private contractor, who is often unsure of how much to bid or what performance level is required. At the same time, however, specifications should not contain excessive detail regarding how the contractor should carry out the work:

For example, some misguided specifications for public works contracts call for particular kinds of vehicles to be used, the number of men to work on each truck, the wages to be paid, and the union to be recognized. In another instance (municipal parking garage operation in Cincinnati), bid specifications stated that ‘a bidder must agree to employ City personnel in their present positions at present pay rates and provide a comparable benefits package for a minimum of two years.’ Considering that the term of the contract was only three years and that labor is the overwhelming cost component in this activity, no savings could possibly be achieved. Clearly, such specifications transgress the bounds of management prerogatives and obviate the entire purpose of contracting for service — which is sometimes the underlying intention of those who draw up such self-defeating contracts! This is one of the barriers to contracting for service — setting specifications whose hidden purpose or ultimate effect is to make contract service as costly as government service, thereby eliminating the incentive to change.<sup>20</sup>

Ensuring an open and public bidding system is crucial to the success of privatization efforts. This is particularly important in developing successful RFPs, where frequent competitive rebidding and input from private firms can improve the way RFPs are issued. Consider the case of Indianapolis: “In every privatization effort in Indianapolis, the best results have occurred when businesses used their expertise to offer new ideas rather than to perform the same old tasks with marginally improved efficiency. In short, these companies went way beyond our requests for proposals — which basically asked them to do business as we knew it — and told us how business could be done.” A 1997 *Harvard Business Review* article by the mayor of Indianapolis, Indiana — a city cited by privatization experts for its innovations in the area of privatization<sup>21</sup> — cited the following example as one in which new ideas and management expertise from a private sector firm can change the way in which RFPs are issued:

I spend some time each week alongside municipal employees in various jobs. Working behind the construction-permit counter one afternoon, I discovered that turnaround times were awful. After my visit, one energetic manager tried to anticipate my reaction by outsourcing the review work for drainage permits — the slowest part of the process — to a private engineering firm. But one year later, the turnaround time for issuing the drainage permits had improved only slightly and the cost had increased considerably.

I complained to the firm, Christopher B. Burke Engineering, about its performance. Its response permanently changed the way Indianapolis issues RFPs. Burke pointed out that we had outsourced a bad system without providing any opportunity for creativity, and the firm had merely responded to our request.

We then rephrased the proposal and asked Burke for its help in redesigning our entire permit-issuing system. The firm helped us eliminate some permits entirely, collapse the steps required to issue others, create a system of case managers, and improve our technology. Today Burke operates under a new contract. Even though the annual number of applications for permits has increased by 25% as a result of our city’s growth, the cost of issuing permits has been reduced by 40% and the turnaround time has been chopped from an average of about four weeks to an average of 4.3 days. Our private-sector partner even allows us to offer a new service — “expedited permitting” — which for an additional fee guarantees a 48-hour turnaround.<sup>22</sup>

#### 4. Contract Monitoring and Oversight

***Recommendation No. 4: Institute a well-designed contract monitoring and oversight system.***

**Discussion.** Equally critical in efforts to privatize public services is the establishment of a well-designed contract monitoring system. “Monitoring is the chief means of safeguarding against contracting problems once the contract is signed and of ensuring that citizens are obtaining high quality services at competitive prices. Comprehensive monitoring systems include contractor reports, inspections, and citizen complaints and surveys.”<sup>23</sup> While problems associated with poor monitoring systems are rare — over \$100,000,000,000 per year is contracted out by state and local governments, but major problems are encountered in only a small percentage of cases — “even the relatively few instances of inferior service quality, waste, or criminal and unethical behavior in contracting are sometimes enough to taint all contracting efforts.”<sup>24</sup>

Essentially, contract monitoring is the process by which agencies oversee a private contractor’s performance to ensure that it meets the contractual performance standards, and is the chief means of guarding against contracting problems after a contract has been executed. Contracts can be monitored by “line” or “operating department” monitors — employees from the department who once performed the service — or “centralized” monitors — those who come from the purchasing or procurement office that arranged and awarded the contract. While line monitors may be very familiar with the program or service, “a strong familiarity with the program does not necessarily make a person a good monitor.” On the other hand, centralized monitors, while less familiar with a program’s operation, usually are knowledgeable about the contract and its provisions, and are more removed from the program and therefore more likely to be disinterested and objective and treat contractors more consistently.<sup>25</sup>

Other important aspects of contract monitoring systems are requiring contractors to present periodic reports, making on-site inspections, following up on citizen complaints, and conducting surveys of citizen or user satisfaction when possible.<sup>26</sup> In addition, periodic cost comparisons may be useful if several contractors are involved or part of the work is performed in-house.<sup>27</sup> Contract auditing, which seeks to ensure that contractors are paid as required by the contract and that all obligations are fulfilled, is also important as an independent check on both contractors as well as the government’s control managers.<sup>28</sup> Establishing an independent oversight process is especially important: “Independent oversight by an office that is outside the control of the unit responsible for operating the activity provides a more objective and unbiased evaluation of privatized activities than is possible by senior government managers or program-level managers.”<sup>29</sup>

There are a number of problems associated with contract monitoring, however: “Agents naturally have strong incentives to protect themselves — to pass on only the good news, to hide the bad news, and to discourage anyone from looking too closely at their work. Good monitoring systems, furthermore, are hard to design. Getting the right information about the agent’s performance, without drowning the principal in paper, is difficult. So too is developing a feedback system that gives the principal the needed information without interfering with the agent’s work.”<sup>30</sup> Moreover, state and local governments usually devote relatively few staff members or resources to performance monitoring:

In one Wisconsin county, for example, just 11 workers must supervise 143 contractors managing 360 separate contracts accounting from \$60 million — two-thirds of the county’s social services budget. In circumstances like these, government workers have time for little more than processing paper. Tracking how contractors are spending public money, let alone whether it is being spent effectively, is nearly impossible. In such cases oversight consists of self-reporting by contractors.<sup>31</sup>

Local governments have also begun to use autonomous inspectors general to monitor contracts and prevent corruption. For example, several New York City agencies now use independent private sector inspectors general, or “IPSIG”, to guard against fraud and racketeering in the city’s construction industry. While agencies seek to hire firms that have no illegal activities on their records, they have found that this is not always possible. In these cases, in order to get a job, a construction firm with the winning bid must pay for an autonomous inspector general to oversee all of the firm’s dealings with city officials, employees, and subcontractors. Moreover, if a formerly “clean” contractor is caught taking a kickback or involved in some other illegal activity, the work on the project does not have to cease. By making the IPSIG a part of the contract, a judge or city agency can order the IPSIG to oversee the job at the private contractor’s own expense.<sup>32</sup>

## 5. Contract Accountability and Termination

***Recommendation No. 5: Ensure that contracts with private vendors specify performance measures and desired outcomes to ensure accountability, and provide contingency plans in the event of contractor default.***

***Discussion.*** Government agencies may be reluctant to contract out because they may have concerns about losing control of the privatized service and service quality. The amount of control that the government retains over the service is often dictated by the type of service being considered for privatization: “Some services, such as street sweeping, do not require a great deal of oversight, while other functions, like educating children, require much more oversight and control. As a general rule, the more control and accountability required to perform a service, the less appealing this service will be for privatization.”<sup>33</sup>

However, concerns over maintaining control also often revolve around the agency’s inability to respond to a contractor’s inability or failure to perform a service adequately. In actuality, however, “performance failures rarely occur. Most contractors perform effectively and to agency satisfaction.”<sup>34</sup> There are a number of arrangements and contract provisions that may be used to address the contractor’s failure to perform adequately, contract interruptions, or default. For example, agencies may consider using contingency contracts with other providers, partial contracting (dividing the contract among competing contractors), or competing directly with the contractor (dividing the contract between the agency and the contractor). Provisions for the use of alternative dispute resolution techniques, such as mediation and arbitration, can also be inserted in contracts to resolve disagreements over whether the contract is being followed.<sup>35</sup>

In order to ensure that private contractors remain accountable to the government to provide quality work, contracts can include such options as developing performance measures, specifying desired outcomes, and imposing sanctions, such as reducing or suspending payments for the contractor's failure to meet certain standards, or terminating the contract for failure to perform in accordance with predetermined performance measures. The government can also reduce its risk by purchasing, or requiring the contractor to purchase, sufficient insurance coverage to protect the government against service interruptions or injuries arising from a private entity's negligent acts or omissions, or by requiring contractors to post performance bonds.<sup>36</sup> The government should also develop a contingency plan in the event a contractor defaults on the contract, declares bankruptcy, or the contract is otherwise terminated: "Many options are available for a default contingency plan such as contracting with the next lowest bidder from the original solicitation, using another current contractor, in-house delivery of the service, or intergovernmental contracting. The plan may also include establishing a capital reserve fund that would allow governments to set aside capital for the purchase of equipment or include a buy-back provision in contracts to guarantee their access to necessary equipment."<sup>37</sup>

Government agencies may also wish to include provisions in contracts that allow the agency to terminate the contract if a grant or subsidy ends, and give the agency the power to change contract service levels at its option, such as reducing street sweeping services from weekly to biweekly. It is not uncommon for a particular service to be dependent on grants or subsidies from another level of government: "Reductions in service levels due to grant or subsidy cutbacks are probably more common than actual terminations, since the level of federal grant support to state and local governments has been reduced steadily since 1975. In such cases, the agency needs the power not only to terminate the contract but also to change levels of service at its option..."<sup>38</sup> One method is for contracts to specify the desired level of service, specifying that notice will be given for any changes and that no changes will occur more often than a given number of times per year. However, contract costs may rise if agencies insist on protecting themselves against cutbacks or changed priorities: "Specifying alternative levels of contracts ... may reduce the uncertainty somewhat, and likewise the bid, but the net result is still likely to be a higher-priced contract. What the agency has done is pay a premium for the privilege of changing service levels when it desires."<sup>39</sup>

## **6. Reasons for Contracting**

***Recommendation No. 6: Develop comprehensive guidelines to address appropriate reasons for contracting out to the private sector.***

***Discussion.*** In addition to adopting guidelines for contracting out, ranging from bidding to monitoring, evaluation, and oversight, the State needs to develop comprehensive guidelines to address "the three most tricky issues: specific reasons for contracting, cost comparison method, and employee union relations."<sup>40</sup> This section and the succeeding two sections address these issues in turn.

In determining when contracting out or other private delivery approaches are appropriate, it is necessary to address the specific conditions that necessitate such an approach. Contracting out may

not be appropriate in every circumstance. Concerns such as legal considerations, difficulties in monitoring performance, and possibilities of corruption or discriminatory enforcement may preclude contracting out. In addition, caution should be used when considering the privatization of “core government functions” — those which provide for the exercise of broad discretionary authority or judgment, such as regulatory and judicial authority and enforcement powers. If agencies are considering privatizing any function that may be considered a core function, they should first seek a legal opinion from the Attorney General.<sup>41</sup>

Under guidelines developed in the State of Oregon, for example, agencies are encouraged to consider contracting when certain conditions exist, including the existence of: newly created services with significant start-up costs, specialized services and equipment, budget reductions or projected revenue shortfalls, limited position availability, a hiring freeze, the lack of a fund source or mechanism to replace equipment or facilities, a readily available market of service providers, labor intensive work requiring routine procedures and limited supervision and performance that can be easily monitored, and other areas. Under those guidelines, state agencies are expected to identify specific needs for contracting as a first step before a feasibility study is undertaken, and must address a number of different areas, including the level of skills needed, the measurement of performance and quality, the frequency that tasks are to be performed, what types of equipment and facilities will be needed, the types of staff skills needed to perform the work, and fluctuations in demand for workload or service.<sup>42</sup>

Guidelines developed by a team of researchers from the Urban Institute and the Council of State Governments in 1987 also specified criteria for assessing the feasibility of using contracting or alternative forms of service delivery, including the following:

- To what extent do [state or] federal laws or regulations make it difficult for the agency to contract the service?
- Is contracting consistent with the goals and policy direction of the agency’s leadership[, the governor’s office, and the legislature]?
- Is there likely to be positive or negative reaction by the public to contracting a service?
- Will current personnel be displaced?
- Are there likely to be important consequences of failures?
- Are the number and quality of needed personnel likely to be available in the private sector?
- Are qualified personnel or organizations likely to be available in the labor market, both initially and in the future? ...
- Are agency managers frustrated in their attempts to make desired changes in the program because of red tape, etc.?

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- Are current state employees dissatisfied with program conditions and environment?
- Does the contracting provide a constructive competitive environment?
- Is the agency experienced in administering and monitoring a contracting arrangement?
- Is there opportunity for corruption, i.e. fraud, bribes, payoffs, etc.?
- Are there interrelationships with other programs or other agencies that would be affected positively or negatively? ...
- Have there been any recent crises, major problems, or adverse publicity with the service, thus making contracting more feasible?<sup>43</sup>

A similar process has been used by the Minnesota Department of Administration, which studied the comparative costs and benefits of contracting out building and printing services in 1993 and developed the following principles for privatizing government services:

1. The department will contract for services only when there is a stable, competitive market over the longer term.
2. The department will contract for services only if it will result in significant financial savings to the state over time.
3. The department will ensure that contractors maintain or improve the quality and reliability of the contracted service and maintain or improve customer satisfaction.
4. The department will ensure that contractors safeguard the security of state customers, employees and property, and protect the confidentiality of state data where required.
5. The department will contract for service only if mechanisms can be established to ensure the accountability and responsibility of the contractor. The department will aggressively manage contracts. The department will factor the cost of contract management into the analysis of costs and benefits.
6. The department will ensure that contractors meet socio-economic provisions established in statute.
7. The department will comply with all laws covering the contracting out of services.<sup>44</sup>

Similar guidelines and questions for agencies to address have been suggested in Colorado and Tennessee regarding market strength, focusing on the availability and ability of providers and the complexity and duration of the service; anticipated political resistance; cost efficiency; the quality of service; impact on employees; legal considerations; the degree of risk to which privatization of a service may increase government exposure to liability; control over the provision of the service; and the efficient and effective use of existing government resources.<sup>45</sup>

Michigan and Virginia have also instituted innovative analytical frameworks, as discussed in part VIII of this memorandum. Since 1992, Michigan’s Public-Private Partnership Commission and Privatization Division have used a framework for analyzing government activities known as “PERM” — to determine if they should be Privatized, Eliminated, Retained in current form, or Modified — involving a three-part analytical model. In Virginia, the Commonwealth Competition Council process has been used to implement statewide privatization efforts since 1996.<sup>46</sup> Flowcharts describing the analytical frameworks of Michigan and Virginia, as well as that used by the City of Indianapolis, are attached as Appendix J.

## 7. Cost Comparisons

### ***Recommendation No. 7: Develop comprehensive guidelines to provide for detailed cost comparison methods.***

***Discussion.*** After determining whether a government activity is appropriate for privatization or other alternative service delivery, the second step is for the agency to perform a detailed cost analysis. According to a 1997 United States General Accounting Office government survey, reliable and complete cost data on government activities are needed in order to ensure a sound competitive process and assess overall performance. In particular, complete and reliable cost data simplify privatization decisions, making those decisions easier to implement and justify to potential critics.<sup>47</sup>

A detailed cost analysis entails determining the cost difference between the government provision of services and contracting out.<sup>48</sup> Performing a detailed cost analysis is important because:

- Often there are hidden costs to privatizing. These hidden costs could result in unrealistic decisions by agencies and contractors. These decisions might have to be reversed in the future. For example, if all of the costs are unknown, an agency may incorrectly estimate what it costs to provide a service.
- An agency may incorrectly continue to provide a service that could be provided cheaper by the private sector. Or, the agency may incorrectly contract for a service that it could provide cheaper than the private sector.<sup>49</sup>

One way to calculate and compare costs, as recommended by the Colorado State Auditor, is for the agency to calculate what it costs government to provide a particular service, calculate the total contracting costs, and then calculate the difference between the two. In identifying service delivery costs, the agency must take into consideration such elements as salaries and benefits of personnel, material, and equipment costs. Contracting costs include such factors as contract fees, contract development, and monitoring, and include not only the costs of the contract itself but any other on-going agency expenditures. The Auditor also recommended that the agency try to identify the characteristics that cause government to have higher or lower costs, and whether the agency could decrease costs.<sup>50</sup>

Another method is one used by the City of Indianapolis, which has been nationally recognized for using an “activity-based costing” (ABC) approach to help analysts derive the complete costs of



providing a service. Analysts were able to identify all of the activities associated with producing a service or function following ABC procedures, and were able to evaluate the resources consumed by these activities to achieve various performance levels. Since 1995, a number of agencies in Virginia have also used the ABC approach as a possible replacement for its previous cost analysis method, which was based on the federal government's A-76 process and the state's contracting.<sup>51</sup>

In 1996, Virginia's Commonwealth Competition Council introduced the "Cost Comparison Program" (COMPETE), a fully-automated, PC-operated decision making tool to provide information on privatization proposals, including:

- The fully allocated cost of a state function or activity;
- The activity cost of service units of output in a state function;
- A competitively neutral cost comparison of operating a function in-house versus the private sector; and
- Steps needed to make a function internally competitive.<sup>52</sup>

Virginia's new cost comparison process allowed state agencies to accurately compare alternative proposals, emphasizing fully allocated costs, and set benchmarks for measuring contract performance. For example, COMPETE was used successfully in the areas of child support enforcement and delinquent tax collection:

Using COMPETE to compare alternative proposals, the council elected to outsource a number of services. One of the most significant was child support enforcement. The state system faced increasing caseloads, lagging technology, and rising costs. By contracting with a private provider, the state lowered administrative costs 60 percent, and increased the number of clients served and improved customer satisfaction. Similar results were realized by outsourcing delinquent tax collections. Without increasing costs to the state, a private contractor significantly increased the collection of previously uncollected accounts.<sup>53</sup>

While obtaining complete data on costs is time-consuming, it has been reported to enhance government's ability to identify cost savings and evaluate bid proposals. In addition, working *before* privatization occurs with private firms that have expertise in an activity that is slated for privatization has been found to be beneficial in obtaining a better understanding of cost and performance issues that are likely to be encountered during privatization.<sup>54</sup> Along with cost comparison analyses, however, state officials must also decide how big the cost savings should be and how soon savings need to be realized. Guidelines in Oregon suggest that "[u]sually a reasonable break-even point of no more than three biennia should be used in deciding if contracting is cost effective. A break-even point beyond six years may be more speculative than your savings will sustain."<sup>55</sup>

## **8. Workforce Transition**

***Recommendation No. 8: Develop comprehensive guidelines to provide for a planned workforce transition after contracting out, including assistance to displaced government workers.***

**Discussion.** Contracting out government services, managed competition, and other management approaches to increasing efficiency and cost-effectiveness in government are all part of a trend over the last decade to “reinvent” or “re-engineer” government — that is, to make it more decentralized, competitive, customer-driven, and results- and market-oriented, taking its cue from the private sector.<sup>56</sup> Along with reinvention, however, is the trend toward downsizing the workforce, as the number of employees needed to perform a given function is reduced through privatization and other strategies to become more efficient and save money:

To many public employees, ... reinventing, reengineering and other forms of rethinking affected not so much how they do the job they have but, more basically, whether they have a job. After all, President Clinton declared that the purpose of reinventing the federal government was not to improve performance but to reduce the federal work force by 250,000 people.

If your purpose is to cut employees, you don't have to reinvent anything. All you have to do is redeploy some functions into the private or nonprofit sectors. Not surprisingly, the 're' decade coincides with a wave of privatization of a whole range of functions.<sup>57</sup>

One form of privatization in particular — contracting out — is often perceived as a profound threat by government-employee unions and the workers that they represent: “The push for privatization of public sector services is often motivated by the desire to reduce the size of the public sector. Consequently, the most contentious issue associated with contracting out is its impact on public sector workers, and the evidence seems to indicate that the reluctance of many jurisdictions to contract out is directly attributable to the objections of the government work force.<sup>58</sup> According to one union representative in New York City, most unions are “adamantly opposed” to privatization:

“There's been an attempt to privatize, but they're doing it piecemeal,” ... “No city has done it completely. It's more than getting away from unions. It's stripping the city of its ability to do things. We'll always fight it. The public is paying billions of dollars for things that could be done much better in-house.”<sup>59</sup>

Public employee unions have used several strategies to block state and local privatization efforts. One common tactic is to file a lawsuit against the government agency that is attempting to contract out. However, “[e]ven in cases where the union's complaints are eventually invalidated by the courts, injunctions often prevent contracts from being implemented because the private firm loses interest.”<sup>60</sup> Another method used by unions to prohibit or limit contracting out to secure the right to bid on work, as well as to protect workers affected by contracting out, is to negotiate contract clauses: “Prohibitions range from a complete ban on contracting out during the life of the agreement to a ban on any contracting out that would result in layoffs. Other clauses require public employees to give advance notice to the union, prove cost-reduction claims, and consult the union for alternative proposals.” Negotiated protections also include prohibitions against wage loss as a result of reclassification, preferred hiring lists for displaced employees, placement programs for positions

within a public agency, giving affected workers the right of first refusal for job openings, and worker retraining programs.<sup>61</sup>

A 1988 study prepared for the National Commission for Employment Policy (“NCEP”), a branch of the United States Department of Labor, on the impact of city and county contracting out on government workers is also instructive.<sup>62</sup> That study reviewed the relevant literature of federal, state, and local privatization efforts relating to employment-related policy issues, and interviewed officials from seventeen cities and counties to determine their experience with contracting out, the development of employment treatment strategies, and the success of those policies. The NCEP study reported the following findings:

- ***Job displacement from contracting out.*** Historical studies of the subsequent employment status of public employees affected by contracting out found that only five to ten percent of those employees were involuntarily laid off from their government jobs.
- ***Public assistance to displaced public employees.*** On the federal level, public assistance payments paid to public workers who were laid off due to a service contract were very low — less than 0.5 percent of the contract savings to the government. “These ‘hidden’ costs to the government are so small that they would rarely offset the financial advantage of contracting out.”
- ***Impact of contracting out on wages.*** New jobs created by private contractors generally pay lower wages than the comparable government positions that were eliminated. However, the wage disparity differed widely from service to service; for some services, wages of private contractors workers were approximately half the wages of government workers, while for other services, private sector pay levels exceeded government levels.
- ***Government v. private contractor fringe benefits.*** In almost all cases studied, worker fringe benefits were higher in government than with private contractors, especially retirement benefits. Less generous fringe benefits was a major source of cost savings for private contractors as compared with government agencies.
- ***Government v. private contractor’s use of labor.*** Increasing labor productivity was one of the primary ways that private contractors reduced their costs below those of in-house government providers. Generally, private contractors make greater use of incentive pay systems, have greater flexibility in hiring and firing employees, have lower rates of absenteeism, and employ more multi-skilled workers.
- ***Effect of contracting out on minorities and women.*** Contracting out was found not to be inherently harmful to minorities or women. Contractors were found to hire minorities in about the same percentage that government hires minorities; overall employment opportunities for minorities were therefore not reduced by privatization. Contracting out did not disproportionately affect women, since the majority of women

in government were found to be in white collar positions, whereas the vast majority of positions contracted out were blue collar jobs.

- ***Overall labor market impact of contracting out.*** “Economic theory predicts that reducing the cost of government services through contracting out will create at least as many direct and indirect employment opportunities in the private sector as will be eliminated in the public sector.” However, only one study was found that scientifically examined the secondary job market effects of contracting out; that study found that, overall, roughly an equal number of jobs were created as were lost by contracting out, although those new jobs might be located in different occupations or different regions than the local government jobs that were terminated.<sup>63</sup>

The NCEP study also found that government workers were “almost always initially hostile to new contracting out initiatives”, and that “[w]hether this hostility would ultimately block the government effort to contract out the service in question often depended upon the job protection guarantees afforded to the affected work force.” While most of the cities studied had not established formal contracting out employment policies, resolving the employment questions on an ad hoc basis, “[c]ities that had adopted accommodating employment policies for government workers in the past tended to confront the least amount of resistance in their contracting efforts. These also tended to be the cities with the most active contracting out programs.”<sup>64</sup> Formulating a contracting out policy that addressed the fears of government workers was therefore found to be a “vital” element to a successful privatization program. The principal recommendation of the NCEP study, however, was that government workers not be laid off due to contracting out with the private sector:

Our foremost recommendation is that cities and counties avoid laying off workers as a result of contracting out. Worker lay-offs almost always generate intense hostility toward the concept of privatization and close off avenues for future contracting out. In short, laying off workers is bad politics and bad public relations. Reducing the workforce through attrition or requiring government contractors to offer affected government workers the right of first refusal to the jobs they have available are more prudent strategies.<sup>65</sup>

The NCEP study concluded that the displacement of government employees was probably the most controversial issue associated with contracting out, and unless resolved satisfactorily, could be a formidable obstacle to governments seeking to privatize government services. Accordingly, based on case studies of seventeen cities and counties, that study made the following recommendations, each of which could be adopted without sacrificing the savings associated with contracting out:

- ***Target new services and major expansions of existing services for contracting out.*** Targeting new or expanded services means that there is no employee impact when services are contracted out. Once government develops an in-house capability and hires a staff to perform services, officials are understandably reluctant to contract out that function.<sup>66</sup>
- ***Whenever possible establish a “no lay-off” contracting out policy.*** Employee resistance to contracting out was found to be minimal in those cities in which government jobs of existing employees were secure.

- ***Reduce the government work force through attrition rather than lay-offs.*** While this may delay potential cost savings, it eliminates the “worst fear” of government workers and increases the chances that privatization will succeed.<sup>67</sup>
- ***Require contractors to offer the right of first refusal to affected government employees for all job openings.*** This assures government workers that they will have a reasonable chance to obtain work in the private sector for which they are fully trained.
- ***Give priority consideration during the competitive bidding process to firms that agree to hire displaced government workers.*** By offering to hire displaced workers, government realizes immediate payroll reductions and is not faced with retraining or reassigning affected workers.
- ***Encourage government employees to form private companies to provide government services.*** In certain cases, government workers may be willing and able to perform their jobs under contract with the government, rather than as government employees.
- ***Protect transferred employees against pay reductions.*** A “no pay-cut” policy for workers transferred to other government jobs avoids employee discontent.
- ***Allow the city agency to compete alongside the private sector during the competitive bidding process.*** As discussed earlier, direct public-private competition may lead to dramatic improvements in public sector efficiency.
- ***Tie management pay levels to productivity and cost reduction to encourage contracting out.*** For example, both Los Angeles County and Phoenix reward bonuses on the basis of cost reductions due to contracting out.
- ***Set aside a percentage of the savings from contracting out for job retraining and placement.*** Los Angeles County reserves five percent of the contracting out savings for a retraining fund to help reduce the government workforce.
- ***Offer early retirement benefit packages to workers displaced by contracts.*** Offering generous early retirement packages to affected employees may be less expensive than retraining or transferring personnel.
- ***Reimburse public employees for lost pension benefits as a result of leaving the government.*** Government retirement benefits often form a large percentage of total labor compensation, and form a powerful motivation for employees to stay with government. Rather than forfeiting pension benefits, employees who leave government as a result of contracting out could be given an annuity worth the employee’s accumulated pension benefits, which could be cashed in upon retirement;

alternatively, pension benefits could be made more portable, allowing workers to move to the private sector without losing accumulated benefits.

- ***Reserve all in-house service job openings for workers displaced due to contracting out.*** Implemented by the U.S. Department of Defense for several years, creating an in-house priority placement program, which reserves job openings for displaced workers, ensures that employees receive jobs that open up through normal attrition.
- ***Begin planning the privatization process far in advance.*** Successful contracting out programs have used a phase-in approach, contracting out only a portion of eligible activities each year for privatization. A “go slow” policy avoids dramatic one-time shifts in service provision from the public to private sectors, allowing officials to prepare for the transfer of employees and plan the services that will be targeted for contracting out.<sup>68</sup>

Accordingly, the Bureau recommends that comprehensive guidelines be developed to address workforce transition and assistance to displaced government workers. Legislative options include the following:

- (1) Enacting legislation similar to Virginia’s Workforce Transition Act, a copy of which is attached as Appendix T, which directs measures in that state to minimize lay-offs resulting from privatization and provides job training and benefits for workers whose jobs are eliminated;
- (2) Enacting legislation similar to Minnesota’s statute providing preferential treatment for workers affected by contracting out certain government services;<sup>69</sup> or
- (3) Adding a new law similar to chapter 394B, Hawaii Revised Statutes (“dislocated workers”), for state workers affected by contracting out, or by amending that chapter to include state workers. (That chapter currently excludes “the State or any political subdivision thereof” from the definition of “employer” in section 394B-2, Hawaii Revised Statutes.)

## **9. Alternative Approaches**

***Recommendation No. 9: Develop comprehensive guidelines for the use of alternative approaches to service delivery in addition to contracting out.***

***Discussion.*** As discussed in part III of this memorandum, while contracting out is the most common method of privatization, there are a number of alternative approaches to service delivery. Other privatization models may be more appropriate in certain circumstances, including the following examples in state and local governments:

**Service sharing.** Also known as “intergovernmental contracting”, service sharing can improve service quality and lower costs, taking advantage of economies of scale. One example is the California Contract Cities Association, which provides a networking tool and resource for southern California jurisdictions seeking to buy or sell municipal services: “City members contract with Los Angeles County, one another and private companies for everything from tree trimming to trash collection, providing services economically on a regional basis while retaining a sense of local control.... Santa Fe Springs, for example, buys its bus services from Norwalk, law enforcement from Whittier, building inspection and public works from Los Angeles County, and janitorial services from a private firm.”<sup>70</sup>

**Vouchers.** Under a voucher system, such as the federal food stamp program, the government provides vouchers to citizens needing the service, who are then free to select an organization from which to purchase goods or services with the vouchers. The organization, whether public or private, then returns the vouchers to the government for payment.<sup>71</sup> One increasingly common use of vouchers is in education. For example, the Milwaukee Parental Choice Program has provided full tuition private school vouchers to needy students in Milwaukee since 1990. While a number of restrictions apply, parental satisfaction has been high and enrollment has been increasing. Another privately provided voucher program was developed by Golden Rule Insurance in 1991, which provide tuition vouchers to elementary and secondary school children in a number of metropolitan areas, allowing them to attend the school of their choice, including religious schools. The programs grant vouchers on a first-come, first-served basis to children who are eligible for the federal free-lunch program, and are valued at half the cost of tuition up to a maximum value, with parents providing the balance.<sup>72</sup>

**Franchises.** Franchises are generally awarded by governments to private firms, either on an exclusive or nonexclusive basis, to provide a service in a certain geographical area. Citizens pay the firm directly for services received. The government primarily plays a regulatory role to set service standards, prices, or other requirements to ensure that all customers are served fairly.<sup>73</sup> Franchises differ from contracting in the following ways: “(1) the user pays the deliverer, thereby removing all or most financial transactions from the public revenue-expenditure stream; (2) delivering firms may be protected against competition within the service area, depending upon whether the franchise is exclusive or nonexclusive; and (3) the government regulates price and quality of service via the franchise (as in an electric or gas utility) instead of through contract terms and specifications.”<sup>74</sup> One example of franchising is that of the Ohio Bureau of Motor Vehicles, which for almost a decade “has allowed private ‘franchises’ to offer virtually all the motor vehicle services previously offered by government-run offices. Private for-profit businesses, as well as nonprofit groups such as the American Automobile Association, register voters and issue new driver’s licenses, license renewals, ... and ID cards. Over 200 privately run offices operate in Ohio, giving consumers many choices as to where they will do business. This provides a powerful incentive for excellent service, as each private franchise earns its revenue from a percentage of the transactions completed at its office.”<sup>75</sup>

**Volunteers.** Privatization can be carried out by using voluntary organizations or individuals to provide selected goods and services if: “(1) the need or demand is clear and enduring; (2) enough individuals are motivated to try to satisfy the need; (3) the service is within the technical and material means of the group; and (4) the results are evident to the group and provide psychic rewards and reinforcement.”<sup>76</sup> Volunteers organizations have been involved in a diverse range of areas, from

providing cleaner streets or parks to addressing social problems such as drug abuse. Police departments are increasingly using volunteers to expand community policing programs, with ten percent of departments using volunteers in 1994. For example, the San Diego Police Department has made volunteers an integral part of its community policing program, using a volunteer workforce of 800 citizens to reduce crime and improve the quality of life in that city's communities. Using both general policing volunteers and two specialized units — the Retired Senior Volunteers on Patrol and the Crisis Intervention Team — the city has noted a number of benefits, including over \$1,500,000 worth of policing man-hours from volunteers; the addition of several new policing services; better relations between the police and community; and allowing police officers to focus more time on the most serious crimes.<sup>77</sup>

These examples represent a fraction of the types of service delivery available. Other common forms of privatization used by state and local governments include the use of grants and subsidies, public-private partnerships, private donations, service shedding, deregulation, and asset sales. While the Hawaii's state and county governments already use some of these approaches,<sup>78</sup> comprehensive guidelines should be developed to ensure that as many of these alternative privatization methods as possible are explored whenever a feasibility study is conducted with respect to the proposed privatization of a government service or function.

## **10. Public-Private Partnerships**

### ***Recommendation No. 10: Work in partnership with the private sector to achieve mutually desirable goals.***

**Discussion.** Another important factor in increasing government efficiency is to work cooperatively with private entities towards goals that are mutually desirable to both the private and public sectors.<sup>79</sup> Under public-private partnerships, also referred to as joint ventures, public and private sector groups form a contractual arrangement, which may include a number of different activities in the development, ownership, financing, and operation of public facilities or services, often including infrastructure projects. Public and private resources are pooled and responsibilities divided, to allow each partner's efforts to complement the other.<sup>80</sup>

State law already establishes an economic policy of fostering "greater cooperation and coordination between the government and private sectors in developing Hawaii's employment and economic growth opportunities."<sup>81</sup> One recent example of a public-private partnership in Hawaii is the completion of the Kamalii Elementary School in Kihei, Maui, which was built by a private developer as a turnkey school and completed ahead of schedule at a large cost savings. Wailea Resorts contributed \$1,000,000 toward school construction costs. Another example is an innovative plan by the state Department of Transportation in which Kunia Residential Partners and Castle and Cooke Homes Hawaii, Inc., will pay for the planned construction of two highway projects. While the highway projects had been placed as a condition for zoning of two housing projects, the State's poor financial condition would otherwise have delayed the projects.<sup>82</sup>

The public and private sectors may also enter into a partnership to soften the impact of privatization on government workers. The mayor of Indianapolis has argued that while the loss of



public employee jobs was “[o]ne of the toughest political issues” resulting from privatization, the problem could be mitigated if government and the private sector worked together to “ensure the least pain and the most gain for those individuals who have been displaced...”.<sup>83</sup> In particular, the mayor noted that Indianapolis had reduced its non-public safety workforce by forty percent since 1992, “yet not a single frontline union worker has lost a job as a result of privatization”:

How did we do it? The example of our wastewater-treatment plants provides a road map. The privatization of the plants resulted in the largest displacement of employees of any of our competitions. Naturally, our public-employee union vigorously opposed the deal, packing hearings of the City-County Council and picketing city hall with signs suggesting that private managers would pollute the water and endanger public health.

The White River Environmental Partnership understood the sensitivity of the situation and decided to recognize the local union, making the consortium one of the few private companies in the nation to bargain with a public-employee union. With WREP’s energetic assistance, we placed every single displaced employee who wanted a job. Of the 322 employees working at the plants at the time of the transaction, WREP hired 196 — 20 more than it needed to run the plants — and relied on attrition to reach its target workforce. The company also funded outplacement services that helped most of the remaining employees find other available city jobs or jobs in the private sector.

Two years later, when the city decided to open up the maintenance of the sewer system to competitive bidding, WREP and the local labor union joined forces to submit a successful proposal.<sup>84</sup>

While the mayor noted that not every privatization effort would proceed as smoothly as that of Indianapolis’s wastewater treatment plants, businesses that want to do business with government must publicly address the following questions:

- Can we hire the displaced workers to continue doing some of the jobs?
- Can we offer them positions in another part of our company?
- Can we fund job-placement and job-training services for them?
- Can we and the local government fund a temporary “job bank” that uses displaced workers in a constructive way until attrition creates openings in other government agencies or in our company?

The mayor stressed that even though accommodating this issue might initially reduce private sector savings, businesses that work together with government help to minimize the short-term trauma of displacement and may benefit in the long run.<sup>85</sup>

## **11. Civil Service Reform**

***Recommendation No. 11: Consolidate and reform state civil service laws.***

**Discussion.** While outside of the scope of this memorandum, the Legislature may wish to amend state civil service laws if for no other reason than to pull together in one place all of the laws applying to the state and county civil service systems, rather than the more circuitous approach of the current law. For example, the scope of civil service is currently defined in three different statutes:

- For the State, in section 76-16, *Hawaii Revised Statutes*;
- For counties with populations of 500,000 or more (the city and county of Honolulu), in section 46-33, *Hawaii Revised Statutes*; and
- For counties with populations of less than 500,000 (the remaining counties), in section 76-77, *Hawaii Revised Statutes*.

As noted by the Attorney General, the plain language of section 76-3, *Hawaii Revised Statutes*, recognizes that the civil service systems need not be administered uniformly, but rather as uniformly “as is practicable.”<sup>86</sup> Nevertheless, the civil service laws are not identically or even similarly worded in areas in which one would expect such similarity. For example, section 46-33 does not include a “‘specifically exempted’ by law or statute” exception analogous to section 76-16(17) or 76-77(10).<sup>87</sup> The absence of this exception, which was at issue in Konno with respect to the County of Hawaii (in section 76-77(10)), raises questions as to whether the civil service system with respect to the City and County of Honolulu should also be subject to a similar exception.

In addition, as discussed in part V of this memorandum, the Legislature may wish to implement more comprehensive civil service reform, both to correct problems addressed in recent reports issued by the state Auditor, as well as to permit state and county government more flexibility to make changes necessary to streamline government operations and allow for increased privatization at the local government level. Another option would be to amend the state constitution to give greater power to the counties by giving local civil service laws (in county charters and ordinances) priority over state civil service laws. Alternatively, the counties could be given the power to adopt their own civil service systems subject to their conformity with certain statutory guidelines, such as ensuring consistency with merit principles. Finally, the Legislature may also wish to consider abolishing Hawaii’s civil service altogether with respect to new hires, similar to the new state employment structure recently implemented by the State of Georgia (see Appendix Q).

## **12. Collective Bargaining**

***Recommendation No. 12: Consider providing greater clarity with respect to managerial rights in the public sector collective bargaining law.***

**Discussion.** As discussed in part VI of this memorandum, the Hawaii Supreme Court in Konno did not resolve the issue of whether, or under what circumstances, privatization is subject to mandatory collective bargaining under Hawaii’s public sector collective bargaining law, chapter 89, *Hawaii Revised Statutes*. Rather than waiting for the Court to resolve the issue, however, the

Legislature may simply wish to amend the *Hawaii Revised Statutes* to establish specific statutory parameters in accordance with policies established by the Legislature. This can be accomplished in one of several ways, depending on which policies the Legislature chooses to emphasize. The most common types of statutory amendments are “management rights” provisions and “statutory preemption” provisions.

***Management rights provisions.*** In theory, management rights provisions, such as section 89-9(d), *Hawaii Revised Statutes*, should help to avoid uncertainties in what areas fall under mandatory bargaining and others under permissive bargaining: “many legislators would necessarily be sensitive to arguments that private sector decisions interpreting the NLRA do not give sufficient weight to management prerogatives in considering scope-of-bargaining issues; that the way to avoid that possibility in public employment cases is to expressly spell out a managerial-prerogative criterion rather than leave it to the judiciary to decide when a proposed subject of bargaining is a managerial-prerogative subject.”<sup>88</sup> This appears to have been the intent of the Legislature in enacting chapter 89, *Hawaii Revised Statutes*.<sup>89</sup> In practice, however, both management rights and statutory preemption may create additional ambiguities and possibly “less in the way of clarity than there would have been had they not been included in public sector labor laws”:

A problem with both management rights and statutory preemption provisions is that both are susceptible of (1) a literal interpretation that virtually cancels out the bargaining-obligation language “wages, hours, terms and conditions of employment”; (2) a nonliteral interpretation that reconciles the apparent conflict with bargaining-obligation language by giving the management rights and statutory preemption provisions an interpretation that virtually repeals them. It seems impossible to find a middle ground.<sup>90</sup>

Should the Legislature nevertheless wish to clarify that contracting out decisions are inherent managerial rights directly in the public sector collective bargaining law, a provision in Title VII of the federal Civil Service Reform Act may provide some guidance. That Act provided a statutory framework for federal labor-management relations, granting public employee labor organizations the statutory right to engage in collective bargaining. However, “to maintain the flexibility and managerial authority needed for an efficient and responsive government, Congress specifically reserved to public managers the exclusive right to make contracting out determinations. Certain matters were removed from the scope of bargaining, such as work force organization, employee assignments, layoffs, and contracting out.”<sup>91</sup> While government agencies need not negotiate over the decision to contract out, however, they must still negotiate over the effects of contracting out: “Even with regard to the reserved management rights, however, agencies are obliged to negotiate over procedures for agency officials to exercise their authority, as well as appropriate arrangements for employees adversely affected by such determinations.”<sup>92</sup> A bill that includes relevant portions of the management rights provisions of section 5 U.S.C. §7106 has been included as Appendix U.<sup>93</sup>

***Statutory preemption provisions*** are those that “limit the scope of bargaining by ... citing other laws and then declaring that those laws are not superseded by the collective bargaining law.”<sup>94</sup> As described in the discussion following recommendation no. 14 in this part, a bill has been drafted that would address the statutory authorization for existing privatization contracts between the state or counties and private contractors, giving the Legislature the option to determine whether or not the

collective bargaining laws apply with respect to each such authorization to contract out. (See Appendix V.)

### 13. Home Rule

#### ***Recommendation No. 13: Consider granting the counties broader home rule powers.***

**Discussion.** The “privatization crisis” began to settle down somewhat by July, 1997, following the resolution of lawsuits in Hawaii and Maui Counties, which imposed an orderly review process for hundreds of affected county contracts for compliance with Konno. It has been argued that the new contract review process established by court settlement in those counties has added a necessary measure of calm reflection: “Under this calmer atmosphere, government officials and unions can continue the process of sorting out public-versus-private work in a deliberate manner. And that’s not a bad idea. The Supreme Court ruling has forced both management and labor to take a fresh look at our decades-old civil service law.”<sup>95</sup> Kauai Circuit Judge George Masuoka’s November, 1997, ruling upholding a contract for the privatization of day care and training services for retarded adults has also helped to calm the privatization “crisis.”<sup>96</sup>

However, questions remain about the validity of both existing and future government contracts with private vendors. It appears that a great deal of county resources are being expended to ensure compliance with the Konno decision for existing and voided contracts, rather than focusing on new privatization efforts. The situation in Kauai is of particular concern, despite Judge Masuoka’s recent ruling upholding the state Department of Health’s privatization efforts, since the circuit court rejected that county’s earlier suit for declaratory relief, thereby requiring each affected contract in Kauai to be handled on a case-by-case basis. Each of the county attorneys to whom the author has spoken has requested legislative action on the Konno issue — specifically, a legislative measure that would give the counties greater flexibility to contract out as needed and under reasonable circumstances, consistent with merit principles. As noted in part II of this memorandum, state contracts have also been questioned in light of the Konno ruling.

With respect to the future of county privatization contracts that affect the executive, legislative, and administrative structure and organization of a county, the counties may seek greater certainty that their actions in contracting out to the private sector will not be later overturned — with respect to landfill operations or other public functions, such as corrections, waste water management, refuse collection, park maintenance, for example. Failure to provide this protection will lead to greater uncertainty in the counties as to the validity of these contracts, greater reluctance on the part of the counties to contract with the private sector in those areas, and corresponding reluctance on the part of the private sector to enter into agreements that may be voided in the future. One option that the Legislature may therefore wish to consider is to specify in the home rule provisions of the Hawaii Constitution which *particular subjects* are the province of the counties and not subject to the legislature’s authority to enact general laws allocating and reallocating powers and functions.

Alternatively, the Legislature may wish to consider amending the Constitution to give the counties *residual powers*. As described earlier, under that method, all powers not granted to the

State by the Hawaii Constitution, charter, or other law belong to the local governments. The 1968 Constitutional Convention noted that “[t]he heart of the question raised by proposals to grant counties residual powers is whether the grant of powers to local governments by the Constitution best promotes effective service to the people which is the common goal of state and local governments...”. The following reasons were offered at the 1968 Convention for retaining the status quo:

1. Experience shows that the state legislature has been responsive to the needs of the counties. For example, new responsibilities given to the counties include: (a) the appointment of liquor and police commissioners, (b) the approval of the liquor commissions’ rules and regulations by the county executive head rather than the governor, (c) the ratification of home rule charters by the county electorate alone rather than additional approval by the legislature, (d) the setting of rates for county vehicular taxes, and (e) the establishment of mass transit systems;
2. By reason of geography and history, Hawaii’s governmental structure is unique and governmental powers are centralized at the state level;
2. Responses by county officials to questions posed by members of this Committee have been that denial of residual powers would not make county charters or governments unworkable;
4. Although the exercise of residual powers is subject to control by the state legislature, the damage may have been done before corrective action is instituted;
5. Residual power without taxing power is self-defeating;
6. While the concept of residual power is clear, the kind of powers that might be exercised by the counties and which they do not now have, and the ramification of the exercise of such powers are unknown factors.<sup>97</sup>

On the other hand, noting that the Hawaii State Association of Counties urged favorable consideration of proposals to grant local governments residual powers, it was argued that the grant of residual powers would:

1. Encourage initiative and enhance responsiveness since counties would not have to wait for positive legislative enactments delegating functions;
2. Free the legislature to devote more time to problems of statewide concern;
3. Provide for the most practical working relationships between state and local governments;
4. Foster and develop among citizens a full sense of civic duty and responsibility;
5. Prevent “buck-passing” by focusing state and county responsibility;

6. Provide counties with financial resources commensurate with their public service responsibilities;
7. Give local governments true “home rule.”<sup>98</sup>

The granting of residual powers to the counties would also be consistent with the current trend in government towards devolution, or decentralization of certain powers from the federal governments to state governments, and from state governments to local governments. This movement is particularly appropriate in Hawaii, in which counties are physically discrete island units varying greatly in terms of population and area. The trend towards “reinventing” government — including the decentralization of government functions and privatization of government services — would also be served by granting counties greater flexibility to privatize those services as deemed appropriate at the local level.

The 1978 Constitutional Convention studies on the issue of local government noted a continuing preference by the Hawaii State Association of Counties for residual power, or at least a clearer allocation by the Constitution of their powers. That study also noted a recent trend to depart from the older strict construction of constitutional provisions by specifying a “liberal” construction of municipal powers in many state constitutions, most likely due to growing dissatisfaction with court rulings that confine local self-government powers. However, the problem of judicial interpretation as to whether a power or function belongs at the local or state level is only one part of the argument against the existing “allocation” provision in the Hawaii Constitution: “Many question whether functions of government can any longer be assigned to one level of government because all levels — local, state, and federal — participate in them. Governmental power cannot be allocated, it is argued, but must be shared.”<sup>99</sup> The problems associated with judicial interpretations are avoided under the residual powers method because the courts would be required to decide only that a power has been specifically denied by the state, rather than being required to weigh statewide or local concerns. Finally, the residual powers method allows local government to take the initiative in legislative action, since the Legislature would be less likely to act negatively simply to defeat the county’s power.<sup>100</sup>

Possible legislative responses include the following:

- (1) Amend the State Constitution by giving counties broad residual home rule powers. One example is Article X, Section 11 of the Alaska Constitution, which provides as follows: “A home rule borough or city may exercise all legislative powers not prohibited by law or by charter”;<sup>101</sup>
- (2) Amend the State Constitution by giving counties powers over specified areas, such as landfill operations, to insulate county government from legislative intervention in those areas. The counties could also be given control over such areas as water works, police, and liquor control;<sup>102</sup> or
- (3) Add statutory language to allow the counties greater flexibility in contracting out. For example, New Jersey law gives municipalities in that state the authority to contract with the private sector to render services on behalf of the municipality.<sup>103</sup>

## 14. *Konno's Impact*

***Recommendation No. 14: Replace Konno's "nature of the services" test with a balancing test, and address existing statutory authority to contract out government functions or services.***

***Discussion.*** Finally, the Legislature should address the impact of the Hawaii Supreme Court's decision in Konno v. County of Hawaii, which effectively placed the ball in the Legislature's court:

We emphasize that nothing in this opinion should be interpreted as passing judgment, one way or another, on the wisdom of privatization. Whether or not, as a policy matter, private entities should be allowed to provide public services entails a judgment ordinarily consigned to the legislature. Our decision today merely applies the civil service laws of this state to the example of privatization at issue in the present appeal.

As we have discussed above, privatization involves two important, but potentially conflicting policy concerns. 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. Given the importance of these policy concerns and the potential conflict between them, clear guidance from the legislature is indispensable.<sup>104</sup>

One option is for the Legislature to take no new action on Konno, allowing the status quo to continue to exist. The rationale for this option is that the Hawaii Supreme Court's opinion, which establishes the "nature of the services" test with respect to the contracting out of government functions, adequately addresses the issue of privatizing government functions, and that no additional legislative action is necessary. As discussed in part II of this memorandum, however, the Bureau believes that some form of legislative response is necessary to address these and related issues for the reasons outlined in that part. The Supreme Court's decision has the effect of discouraging privatization by "locking in" positions that have been historically and traditionally performed by civil servants under Konno. While the Counties of Hawaii and Maui have resolved some of their most pressing litigation by agreeing to a procedure to resolve affected privatization contracts, all of the counties — as well as the State, in the Bureau's opinion — are open to future litigation on this issue unless the Legislature takes action to resolve the issues presented in that opinion.

In addition to resolving the policy conflicts raised in Konno to provide greater certainty in the law and minimize future litigation, the Legislature should also address the issues raised in that decision for another important reason, namely, to assist Hawaii's struggling economy. An October, 1997, *U.S. News & World Report* article noted that "[w]hile most of the nation booms, Hawaii is mired in a protracted slump that shows no signs of easing. The state's economy has been stagnant for the past six years." The article further noted that Hawaii has led the nation in an annual cost-of-doing business survey by Regional Financial Associates for three straight years, ranked fourth highest in the nation in 1996 in the rate of business failures, has the fifth worst unemployment rate in the nation, and had a net loss of about thirteen thousand residents in 1996.<sup>105</sup> As of March, 1997, Hawaii ranked last among the states in indices of state economic momentum, job growth, and personal income growth.<sup>106</sup>

It has been argued that the Hawaii Supreme Court's decision in Konno v. County of Hawaii has exacerbated the State's economic situation since the "nature of the services" test announced in that decision effectively removes privatization as an option in almost every type of service delivery, thereby removing an important tool of state and county governments to both reduce the size of government and increase its efficiency:

This decision has triggered a frantic review of existing government contracts. But regardless of that, and whether the applicable laws had to be interpreted that way, what is the economic impact?

Economies that have been flat as long as Hawaii's need flexibility to recover. Tax revenues fail to meet predictions. It's also generally accepted that our public sector is still larger than our shrinking private sector can support....

Perhaps most important, Hawaii's economy has always depended critically on external investment. What kind of signal does such a stance send the rest of the world, which seems to be moving almost universally in the opposite direction?<sup>107</sup>

Whether or not the State or counties ultimately decide to use privatization with respect to any particular government service or activity, resolving the issues raised in Konno will at least give state and local governments another option to seek to increase government efficiency, by allowing them to consider contracting out or using other privatization options when it is deemed feasible and appropriate by the State or counties — that is, after a thorough review of all of the factors and considerations deemed necessary for the successful privatization of a particular service in compliance with comprehensive guidelines.

There are a number of options before the Legislature that address the primary conflict in Konno, i.e., resolving the tension between the policies underlying the State's civil service law and merit principles on the one hand, with the policies underlying privatization on the other, including the following:

(a) ***Balancing approach.***

In Konno, the Hawaii Supreme Court reviewed three different judicially-created tests, namely, the "nature of the services", "functional inquiry", and "bad faith" tests, to resolve the tension between privatization and the civil service when a position is privatized, and, by definition, removed from the civil service. The Court ultimately selected the "nature of the services" test as the broadest of the three tests and the most consistent with the broad language of section 76-77, Hawaii Revised Statutes. Under that test, services that had been 'customarily and historically provided by civil servants' may not be privatized without a showing that civil servants cannot provide those services.

The Legislative Reference Bureau recommends that Konno's nature of the services test be replaced with a legislatively-created balancing approach. A balancing test allows the State or counties to review proposed candidates for privatization or other type of service delivery on a case-by-case basis, unlike the nature of the services approach, giving the State and counties greater flexibility in making management decisions to increase government efficiency. Under a balancing approach, the court must weigh the costs and benefits of privatization against its impact on the civil service system



and merit principles in accordance with specific guidelines. An example of a balancing approach is Colorado's 1993 enactment regarding contracts for personal services.<sup>108</sup> As discussed in part VIII of this memorandum, that law sought to "balance the benefits of privatization of personal services against its impact upon the state personnel system as a whole" in order to ensure that privatization of government services did not undermine the policies underlying that state's civil service system.<sup>109</sup> A bill instituting a balancing approach would legislatively overrule Konno's "nature of the services" test. Sample legislation based on the Colorado statute that encourages privatization contracts but balances the benefits of those contracts with the impact on the State's civil service system is provided in Appendix O.

**(b) *Regulatory approach.***

Another approach that would also legislatively overrule Konno's "nature of the services" test is a regulatory approach. One example of a regulatory approach is Massachusetts' 1993 legislation passed over the Governor's veto.<sup>110</sup> As discussed in part VIII of this memorandum, that law sought to regulate privatization in Massachusetts by, among other things, effectively giving the Massachusetts State Auditor veto power over proposed privatization contracts for activities valued in excess of \$100,000; requiring private firms that win state contracts to offer jobs to qualified state employees who were terminated because of the contracts and compensate them at a rate comparable to their government pay and benefits; and guaranteeing certain minimum wages to the contractor's employees. While the Legislative Reference Bureau does not recommend the use of this approach in that it may tend to discourage privatization efforts, thereby removing the flexibility needed by the state and county governments to develop new management techniques to assist in Hawaii's economic recovery, the Bureau recognizes that this policy decision is ultimately the responsibility of the Legislature. Sample legislation based on the Massachusetts statute that discourages privatization by regulating privatization contracts is provided in Appendix S.

Another example is Maryland's statutory preference "to use State employees to perform all State functions in State-operated facilities in preference to contracting with the private sector to perform those functions."<sup>111</sup> As discussed in part VIII of this memorandum, that law requires cost comparisons to be made before entering into a service contract, including the requirement that the cost of the service contract be compared with the cost of using state employees, and that the comparison show certain cost savings to the state over the duration of the contract.<sup>112</sup> Sample legislation based on the Maryland statute is provided in Appendix R.

A third type of regulatory approach is Colorado's 1988 privatization statute. That statute, as discussed in part VIII, prohibits state agencies from competing with private enterprises by engaging in "the manufacturing, processing, sale, offering for sale, rental, leasing, delivery, dispensing, distributing, or advertising of goods or services to the public which are also offered by private enterprise unless specifically authorized by law."<sup>113</sup> Unlike the Massachusetts and Maryland statutes, however, the intent of that statute was "to provide additional economic opportunities to private industry and regulate competition by state agencies, including institutions of higher education."<sup>114</sup> Sample legislation based on this Colorado statute is provided in Appendix P.

(c) *Piecemeal approach.*

Motivated by fiscal pressure, many states have enacted legislation allowing for the privatization of various government operations on a piecemeal basis, i.e., providing for the privatization of only a one or more selected public functions or services at a time, rather than general privatization legislation applicable to all state or local government agencies. For example, as of January 1996, twenty-eight states had legislation enabling their corrections departments to arrange for the private management of correctional facilities, or to shift responsibility for the operation and management of prison facilities to private prison management corporations.<sup>115</sup> States have also enacted legislation ranging from the privatization of foster care<sup>116</sup> and public assistance programs<sup>117</sup> to the privatization of wastewater and sewage projects.<sup>118</sup>

A number of bills have also been introduced in the Hawaii State Legislature in the 1997 Regular Session to provide for the privatization of specific government services on a piecemeal basis. Examples include the following bills (none of which were enacted):

- HB No. 184 Correctional facilities
- HB No. 193 Publication of the Hawaii Revised Statutes and Session Laws of Hawaii
- HB No. 322 Juvenile and adult probation services
- HB No. 603 Natural energy laboratory of Hawaii facilities
- HB No. 667 People mover for the City and County of Honolulu (H.D. 2)
- HB No. 708 Certain functions of the Department of Labor and Industrial Relations
- HB No. 1061 Community long-term care
- HB No. 1062 Maintenance and operation of public buildings
- HB No. 1064 State human resources program
- HB No. 1067 State airports
- HB No. 1069 Government motor vehicles
- HB No. 1076 School lunches
- HB No. 1078 Centralized engineering and office leasing services
- HB No. 1348 State planning functions
- HB No. 1504 Diamond Head film studio (H.D. 1)
- SB No. 670 Hawaii county prisons
- SB No. 632 Photo red light and radar demonstration project for Honolulu (S.D. 2)

Privatization legislation that was signed into law in 1997 generally provided for privatization on a piecemeal basis. For example, section 5 of Act 88, Session Laws of Hawaii 1997 (amending section 451-6, *Hawaii Revised Statutes*), authorizes the Director of Commerce and Consumer Affairs to contract out to a professional testing agency to prepare, administer, and grade examinations for licensure for hearing aid dealers and fitters. Part I of Act 160 provides for the establishment of a small boat harbors pilot management program to evaluate the feasibility of instituting “community-based management” (in essence, privatization) at state small boat harbors. Section 2 of Act 333, which established the traumatic brain injury advisory board within the Department of Health, requires the board to advise the department of the feasibility of establishing agreements with private sector agencies to develop services for persons with brain injuries. Other 1997 Acts required privatization studies, e.g., Act 124, section 10 (convention center privatization plan); Act 289, section 4 (Legislative Reference Bureau study of the feasibility of privatizing the administration of the

continuing education program for real estate brokers and salespersons); and Act 328, section 57 (Auditor study of the privatization of the child and adolescent mental health program).

A piecemeal approach to privatization or competitive contracting may be a valuable way to increase the cost-effective delivery of government services, either through legislation for selected state services or legislation authorizing the counties to privatize selected services. For example, developing state-sponsored pilot or demonstration programs help to explore the implications of privatizing certain public services, which, if successful, could provide incentives for the implementation of other privatization programs. However, there are two major concerns. First, there is still a need to establish comprehensive policies and guidelines to address various other areas discussed earlier in this part, such as appropriate reasons for contracting out to the private sector, detailed cost comparison methods, providing for a planned workforce transition after contracting out, and alternative approaches to service delivery in addition to contracting out. Second, the piecemeal approach generally leaves the issues in Konno unresolved by failing to address the tension between privatization and the civil service when a position is privatized, or whether existing privatization contracts (if any) are grandfathered.

**(d) Other 1997 legislation.**

In the 1997 Regular Session, the Legislature sought to resolve the policy issues raised by Konno through several vehicles, none of which were enacted.<sup>119</sup> These included the following:

**H.B. No. 1686, H.D. 1, S.D. 1:** Sections 3, 4, and 5 of this bill amended sections 42D-10, 42D-11,<sup>120</sup> and 103D-102, *Hawaii Revised Statutes*, to provide that, any other law to the contrary notwithstanding, every expenditure of public funds by any county, agency, or governmental body made pursuant to chapters 42D or 103D, and any contract made before July 1, 1994, are exempt from the requirements of applicable civil service laws if the county, agency, or chief procurement officer determine that:

- (1) The county or agency is not acting with the intent to circumvent civil service law;
- (2) No currently employed civil servant will be discharged solely as a result of the making of the contract; and
- (3) It is in the best interest of the public to contract for those services.<sup>121</sup>

**H.B. No. 1798, S.D. 1, C.D. 1:** The intent of this bill, as stated in the purpose section, was to “temporarily remove the cloud on existing contracts created by the Konno decision to enable all existing contracts, except those specific contracts which are currently subject to a legal challenge ... to proceed to completion.” The bill, which was to be repealed on July 1, 1999, sought to achieve this objective as follows:

Section 2 of the bill declared that except as provided in the bill, “no existing contract or contract subsequently executed by a department or agency of the state or county shall be void or deemed to be void as being contrary to merit principles”, and authorized government agencies to enter into privatization contracts without restriction under the civil service laws.

Section 3 requested the Governor to convene a task force to review existing contracts to resolve pending and future disputes, and to propose resolutions to protect the merit system and allow privatization where appropriate.<sup>122</sup>

Section 4 directed the Auditor to audit certain personal services contracts of state and county agencies, consult with the Attorney General to determine whether any such contract is illegal under Konno, and make proposals to address how to remedy any illegal contracts.

Section 5 removed ten existing privatization contracts from the purview of the blanket exemption in section 2 of the bill, allowing litigation on those contracts to continue.

Section 6 stated that “[n]o authorization is given by this Act to the state or any county to enter into any new contract in which one or more of the purposes is to eliminate positions, layoff, discharge, or displace public employees.”

**S.B. No. 1472, S.D. 2, H.D. 2:** The findings section noted that “[t]he culture of the State is one of cooperation, with a long-standing history of reliance on public-private partnerships to provide [public] services”, but that “the State’s long-standing and continuous policy to provide public services through a strong and viable civil service complemented by a vigilant collective bargaining system must also be affirmed.” The Konno decision, however, had called into question the scope of public services in the context of civil service laws. The purpose of the bill was to “establish a reasonable balance to accommodate the purposes of privatization without undermining basic merit principles and the policies of civil service.” Accordingly, the bill provided in section 2 (amending chapter 103, *Hawaii Revised Statutes*) that nothing in the civil service laws or practices may be deemed to limit or otherwise qualify the authority of state or county agencies to enter into privatization contracts “to obtain services historically performed by persons or positions in the civil service, or functionally attributed to a government agency or program”, including contracts:

- (1) To disburse appropriations for certain grants, subsidies, or purchases of services;
- (2) For goods or real property for construction where services were provided incidentally to the acquisition of the goods or real property;
- (3) For services which the agency is otherwise authorized by law to obtain or provide without regard to the civil service laws;
- (4) For services performed by an independent contractor, so long as no civil servant was discharged as a result of the contractor’s performance of services, and so long as the agency certifies that the service is special or unique, is of a temporary nature, requires substantial capital outlay or operating costs that could be avoided or minimized by using a private contractor, or is a service provided by a public health facility.

Finally, section 3 of the bill provided that state or county agencies may certify that services obtained from current or prior contracts were obtained in good faith under one of the circumstances described above.

While any of these bills may serve as a vehicle to resolve the issues raised in Konno, of these three bills, it appears that only S.B. No. 1472, S.D. 2, H.D. 2, provides an appropriate balancing approach that adequately protects both civil service and merit principles on the one hand and privatization efforts on the other, by allowing agencies to enter into certain types of privatization contracts to obtain services historically performed by civil servants. H.B. No. 1686, H.D. 1, S.D. 1, adopts a type of “bad faith” test discussed in Konno, in which the agency itself determines that the agency was not acting with the intent to circumvent civil service law when it entered into a privatization contract. H.B. No. 1798, S.D. 1, C.D. 1, while addressing the immediate concerns raised by Konno, does not resolve the long-term issues raised by that case.

*(e) Review of existing privatization statutes.*

As discussed in part II of this memorandum, the Hawaii Supreme Court in Konno found that section 46-85, *Hawaii Revised Statutes*, which authorized the counties to enter into contracts for the operation of projects for solid waste disposal, was not a *specific* exemption from civil service requirements under section 76-77(10), despite the express language in section 46-85 that section was to have effect “[a]ny other law to the contrary notwithstanding...”. In particular, the Court found that section 76-77(10) expressly stated that to avoid civil service coverage, positions must be “specifically exempted” by another statute; however, since section 46-85 “mentions nothing about civil service positions, it does not include a *specific* exemption.”<sup>123</sup> Therefore, the Court concluded, landfill worker positions in Konno were still within the civil service.

In light of the Court’s findings in Konno, it is necessary to review *each* existing statutory authorization for the state or county to contract out public services to the private sector to ensure that each such authorization *states with specificity* whether or not state civil service laws apply to personnel positions affected by that contract.<sup>124</sup> In the course of amending each statutory authorization for privatization contracts, the Bureau further recommends that lawmakers:

- (1) Amend statutes authorizing both state *and* county privatization contracts;
- (2) Include provisions specifying whether certain *other* laws apply to those privatization contracts; and
- (3) Specify whether contracts entered into before the effective date of the new law are “grandfathered”, i.e., exempted from the new provisions.

As discussed in part II, uncertainty exists as to whether Konno applies to only county contracts or includes state contracts as well. Given the uncertainty as to Konno’s scope, the Bureau believes that the safer course of action would be to amend all statutorily authorized state *and* county privatization contracts. When amending those statutory provisions, it is also appropriate to include provisions specifying whether other state laws apply or do not apply to contracts entered into pursuant to that section. In addition civil service laws, other laws, such as collective bargaining, workers’ compensation, temporary disability insurance, and other laws may arguably apply. This bill gives the Legislature the option to determine whether or not state civil service laws, collective bargaining laws, or other laws apply with respect to each such statutory authorization to contract out to the private sector.

While several *Hawaii Revised Statutes* sections authorizing privatization contracts already specify whether some of these laws apply, it may be necessary to review *all* such sections so that there is no confusion in the event that a contract entered into pursuant to that section is subsequently challenged in either an administrative or judicial proceeding. Adding this specificity to the law also furthers the public policy of ensuring certainty in contractual dealings and avoids unnecessary litigation, which increases the costs of doing business in Hawaii. An example of this type of legislation is included in Appendix V.

## B. Conclusion

The Legislature has a number of options available to it depending on the policies it chooses. As discussed in this part, policy options are reflected in legislative measures ranging from Massachusetts' statute providing for the regulation of privatization to retain greater control over the delivery of government services and activities and which may have the effect of discouraging government contracting, to Colorado's statute encouraging the privatization of government functions without undermining the civil service and merit principles. It should be stressed, however, that the options presented in this memorandum are by no means comprehensive; there are a wide-ranging number of possible legislative responses, depending upon the policy direction ultimately taken by the Legislature.

The Legislative Reference Bureau believes that the Hawaii Supreme Court's opinion in Konno v. County of Hawaii, in addition to increasing the potential for litigation by calling into question a number of existing state and county contracts, also has the potential to aggravate the State's already dismal economic situation. This is because the "nature of the services" test adopted in that case, in addition to the doctrinal and practical difficulties inherent in that approach as discussed in part II of this memorandum, effectively removes privatization as an option in government service delivery, thereby eliminating an important management tool of state and county governments in increasing their efficiency. Whether or not the State or counties ultimately use privatization or some other method to improve government service delivery, there is a need to remove the legal cloud created by Konno to allow for greater competition between the public and private sectors.

Rather than simply reacting to the Konno decision, however, it may be more prudent to *first* develop long-term strategies for enhancing competition in government generally in order to increase government efficiency and cost-effectiveness, similar to that of Arizona, Virginia, Florida, Texas, and Utah, whether through privatization or other methods of service delivery, and *then* fashion a response to Konno based on the overall direction taken by the Legislature, in cooperation and partnership with the Governor and the private sector. For example, as a part of that long-term strategy, the Legislature may wish to introduce legislation to establish a statewide competitive government program similar to that enacted in the State of Arizona, including the publication and distribution of a handbook and training program to educate government agencies on the decision making and competitive government process, in order to implement a formal process to introduce competition — whether through privatization or other model — into Hawaii's service delivery system.<sup>125</sup>

While an appropriate legislative response to Konno depends to a large extent on the type of approach adopted by the State in developing a long-term strategy for improving the efficiency in the

delivery of government services, the Legislative Reference Bureau nevertheless believes that the “nature of the services” test adopted by the Hawaii Supreme Court in that case should be discarded in favor of a more flexible balancing approach, such as the approach adopted by the State of Colorado, i.e., one that balances the benefits of privatization against its impact upon the civil service system and merit principles.<sup>126</sup> In addition, the Bureau believes that the Legislature should review all existing statutory authority to contract out government functions or services by the State or the counties, to specify which laws apply to contracts entered into pursuant to those statutes. Ultimately, the goal should be to allow for greater flexibility in state and county service delivery through increased government competition — whether through privatization, managed competition, or other competitive model as developed through comprehensive guidelines — in order to increase government effectiveness and improve the State’s economy, while at the same time protecting the policies ensuring that privatization or competitive process does not undermine the policies underlying Hawaii’s civil service and merit system.

### Endnotes

1. The Governor’s Small Business Advisory Committee was established by the Governor to provide a forum for open communication between the small business community and state government, within which issues could be examined and legislative or administrative recommendations formulated for submittal to the Governor. The Committee was comprised of thirteen representatives from the private sector and state executive branch appointed by the Governor. *See* Sanford Inouye, Small Business: Current Problems and Opportunities, Report No. 4 (Honolulu: Legislative Reference Bureau, 1988) at 64-65 and n. 13.
2. Inouye (1988) at 72.
3. Id.
4. Interim Commission on Government Redesign, Report to the 1994 Regular Session of the Seventeenth Legislature, State of Hawaii pursuant to H.C.R. No. 209, S.D. 1 (1993) (Honolulu: Jan. 19, 1994), Appendix 21: William F. Weld and David Walters, An Action Agenda to Redesign State (Washington, DC: Government, National Governors’ Association, 1993) at 42 - 64 (Privatization of Government Services and Assets).
5. *See, e.g.*, House Concurrent Resolution No. 249 (1996) and House Resolution No. 239 (1996), “Requesting a Review of Practices Relating to Rightsizing Government,” both of which were held in the House Labor and Public Employment Committee on March 29, 1996.
6. Interview with Pauline Namuo, Legislative Coordinator, Office of the Governor, May 14, 1997. Other recent unsuccessful legislative measures seeking to establish a task force or other body to review the privatization of government services include: H.R. No. 113 (1993), Requesting a study on the feasibility of privatizing government functions, and H.C.R. No. 460 (1993), H.R. No. 411 (1993), S.C.R. No. 55 (1995), S.R. No. 46 (1995), S.C.R. No. 103 (1996), and S.R. No. 79 (1996), Requesting the development of an action plan to increase the privatization of state functions; *see also* H.C.R. No. 337, H.D. 1 (1995), Requesting the Auditor to include recommendations for privatization of government functions, as appropriate, in audits conducted pursuant to legislative directive or request during the 1995 regular session. In addition, section 3 of H.B. No. 1798, S.D. 1, C.D. 1 (1997) requested the Governor to convene a task force composed of representatives from state and county agencies, the judiciary and the legislature, private service providers, and public and private sector employee representatives, “to review existing contracts which may be invalid under the merit principles, amicably resolve any pending or future disputes, propose resolutions to preserve the merit system, protect legislative prerogatives in establishing specific exemptions in the civil service laws, [and] allow privatization

- where appropriate...”. H.C.R. No. 200 (1997), similarly requested the Attorney General to convene an informal task force to examine the ramifications of Konno. However, neither measure passed the Legislature.
7. "Bidding on Service Delivery: Public-Private Competition," Management Information Service Report, vol. 25, no. 11 (Nov. 1993) at 1.
  8. Id.
  9. Id. at 2.
  10. *See generally* Doug Herbst, "No Level Playing Field" and Frank Gill, "A Reasonable Alternative," in "Managed Competition: A Debate," American City & County, February 1997, at PS14 - PS17 (privatization supplement).
  11. *See generally* "Selecting Services for Public-Private Competition," Management Information Service Report, vol. 28, no. 3 (March 1996) at 8 (summary of considerations for selecting services).
  12. Recommendations of the Hawaii Economic Revitalization Task Force, Oct. 22, 1997, pp. 6 - 7.
  13. The establishment of an independent council on competitive government may help to insulate it from both political turnover and micro-management by the Legislature. Alternatively, similar functions could be assigned to an existing state agency, building in safeguards to allow that agency to maintain independence in decision making.
  14. Va. Code Ann. §§9-334 to 9-343 (1995) ("Virginia Government Competition Act of 1995").
  15. Ariz. Rev. Stat. Ann. §§41-2771 to 41-2773 (1996).
  16. Fla. Stat. §14.203 (1997); *see also* Tex. Gov't Code Ann. §§2162.001 to 2162.105 (1995), establishing a Texas State Council on Competitive Government with functions similar to that of Florida's Council.
  17. Utah Code Ann. §§63-55a-1 to 63-55a-3 (1997); section 63-55a-3(1)(b) requires the board to "review particular requests for privatization of services and issues concerning agency competition with the private sector and determine whether privatization would be feasible and would result in cost savings and ways to eliminate any unfair competition...". (Emphasis added).
  18. John Rehfuss, "Contract Monitoring Systems," in Issues & Options: Practical Ideas for Local Government Leaders, vol. 1, no. 8 (National League of Cities, Sept. 1993), at 13.
  19. *See generally* id. at 14 - 17; John A. Rehfuss, Contracting Out in Government: A Guide to Working with Outside Contractors to Supply Public Services (San Francisco: Jossey-Bass Publishers, 1989) at 71 - 83.
  20. E. S. Savas, Privatization: The Key to Better Government (Chatham, NJ: Chatham House Publishers, Inc., 1987) at 267.
  21. *See, e.g.*, United States General Accounting Office, Privatization: Lessons Learned by State and Local Governments, Report to the Chairman, House Republican Task Force on Privatization, GAO/GGD-97-48 (Washington, DC: March 1997) (hereinafter, "GAO").
  22. Stephen Goldsmith, "Can Business Really Do Business with Government?," Harvard Business Review (May-June 1997) at 116 - 117.
  23. Rehfuss (1993), *supra* note 18, at 13.



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24. Id.
25. Id. at 17.
26. Rehfuss (1993), *supra* note 18, at 17-19; *see also* Rehfuss (1989), *supra* note 19, at 84-105.
27. Savas (1987), *supra* note 20, at 270.
28. GAO, *supra* note 21, at 17.
29. Id. at 18.
30. Donald F. Kettl, Sharing Power: Public Governance and Private Markets (Washington, DC: The Brookings Institution, 1993) at 29.
31. Id. at 174.
32. Russ Freyman, "Private Eyes on Construction Contracts," Governing, vol. 11, no. 1 (Oct. 1997) at 78.
33. Kimberly J. Bandy and Stephen Grimes, Private Contracts, Public Services: Weighing the Choices (Nashville, TN: Comptroller of the Treasury, Office of Research, Nov. 1995) at 37.
34. Rehfuss (1989), *supra* note 19, at 107.
35. Id. at 108 - 109.
36. Bandy and Grimes (1995), *supra* note 33, at 24 - 25.
37. Id. at 37.
38. Rehfuss (1989), *supra* note 19, at 112.
39. Id.
40. Keon S. Chi, "Privatization and Contracting for State Services: A Guide," Innovations, RM-777 (Council of State Governments, April 1988) at 5.
41. Florida House of Representatives Committee on Governmental Operations, Final Report on Privatization (Tallahassee: Dec. 1995) at 261.
42. Id. at 7.
43. Id.; *see also* Rehfuss (1989), *supra* note 19, at 67 - 68.
44. Lisa Vecoli, "The Politics of Privatization," 15 Hamline J. of Public Law & Policy 243 at 249-250 (Spring 1994).
45. Colorado State Auditor, Privatization in Colorado State Government: Performance Audit (Denver: March, 1989) at Appendix B; Bandy and Grimes (1995), *supra* note 33, at Appendix A. *See also* part VII.I. ("privatization profile") of this memorandum for an outline of the criteria and questions developed by the Colorado State Auditor.
46. *See* GAO, *supra* note 21, at 37 - 42. As of 1994, Michigan's PERM analyses had been performed on thirty-eight different functions performed by state agencies. *See* Privatization 1994 (Los Angeles: Reason Public

- Policy Institute, 1994) at 8.
47. GAO at 12. In particular, the GAO identified six lessons learned from its review of state and local privatization efforts:
- **Political champion.** Privatization can best be introduced and sustained when a political leader champions it.
  - **Implementation structure.** Government leaders need to establish an organizational and analytic structure to ensure effective implementation.
  - **Legislative and resource changes.** Governments may need to enact legislative changes and/or reduce governmental resources to encourage greater uses of privatization.
  - **Reliable cost data.** Reliable cost data on government activities are needed to support informed privatization decisions and to assess overall performance.
  - **Strategies for workforce transition.** Governments need strategies to manage workforce transition.
  - **Monitoring and oversight.** More sophisticated monitoring and oversight are needed to protect the government's interests when its role in the delivery of services is reduced through privatization. *Id.* at 4.
48. In-house costs include such items as salaries and other personnel expenses, equipment (capital outlay) costs, and services and supplies. Administrative overhead costs includes service charges that are assessed on the basis of the government agency's number of full-time equivalent positions. Estimates for contracting costs include such items as contract management and monitoring costs, costs for staff to prepare bids, costs for training staff to administer the contract, costs to set up a monitoring system, the buyout of unused employee leave benefits, the disposal of unused equipment, and unemployment expenses if the work is performed by staff and former employees do not remain with the contractor. Chi (1988), *supra* note 40, at 7-8.
49. Colorado State Auditor (1989), *supra* note 45, at 27.
50. *Id.* at 28, Appendix C.
51. GAO at 12-13.
52. Privatization 1997 (Los Angeles: Reason Public Policy Institute, 1997) at 7.
53. *Id.* In 1996, according to Virginia's Commonwealth Competition Council, state agencies had transferred 495 functions to the private sector at a net savings of over \$3,000,000. *Id.*
54. GAO at 13.
55. Chi (1988), *supra* note 40, at 8. A recent bill introduced in California, Senate Bill No. 648, as amended (1997) (Intro. Burton), would require the Director of Finance to undertake a cost comparison analysis and prepare performance standards to be used in evaluating bids for state services to be provided by private vendors. Vendor bids would be compared against the cost of state employees performing the same work. Contracts would not be awarded unless the vendor's bid, adjusted to reflect contract administration and other transition costs, was at least 10% below the cost of using state employees. Vendors who were cited in the last three years for illegally withdrawing required wages or benefits would be barred from competing for state contracts for three years.

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56. See generally David Osborne and Ted Gaebler, Reinventing Government (Reading, MA: Addison-Wesley Publishing Co., Inc., 1992).
57. Robert D. Behn, "Management: Governments Were Caught up in a Whirl of Fresh Ideas About Managing the Public's Business," Governing, vol. 11, no. 1 (October 1997) at 41.
58. Marvin J. Levine, Privatization of Government: The Delivery of Public Goods and Services by Private Means (Alexandria, VA: International Personnel Management Assn., 1990) at 34 (emphasis added). The fact that the private employees who seek to perform the privatized function may also be unionized often does not seem to matter: "Ironically, the contractor's private employees are themselves often unionized, and so from the overall perspective of the union movement, the losses of some union leaders are balanced by the gains of others. Nevertheless, contracting is such a threat to the affected union that allegations of corruption are likely to be hurled in the heat of battle to sway the media and the public. This is the strongest argument available to the unions." Savas (1987), *supra* note 20, at 257.
59. Joe Morris, "The Unions" in Privatization: The Provision of Public Services by the Private Sector, ed. Roger L. Kemp (Jefferson, NC: McFarland & Co., Inc., 1991) at 269 - 270.
60. Levine (1990), *supra* note 58, at 46.
61. Id. at 47.
62. United States National Commission for Employment Policy, Privatization and Public Employees: The Impact of City and County Contracting Out on Government Workers, prepared for the NCEP by Dudek & Co., No. RR-88-07 (Washington, DC: May 1988) (hereinafter, "NCEP").
63. Id. at 2-3, 33. See also Levine (1990), *supra* note 58, at 34: "Most studies indicated that contracting out in the public sector creates as many jobs as it displaces. The new jobs may be in different occupations or regions of the country, but the immediate effect on employment is relatively small in most cases. This is due, however, to the modest protection public sector unions have been able to win for their members, and management's reluctance to provoke a full-scale union campaign against contracting out."
64. NCEP, *supra* note 62, at 4.
65. Id. at 5.
66. Hawaii law already requires that where new state programs are proposed, agencies must demonstrate that the program is an appropriate function of state government, and, as applicable, "[c]an be implemented by the public sector as cost-effectively as the private sector while meeting the same plans, goals, objectives, standards, measures of effectiveness, wage, salary, conditions of employment, and employee benefit programs of the State." Section 37-68(1)(B), *Hawaii Revised Statutes*.
67. While civil service positions may become vacant through attrition, contracting out to the private sector to perform the same services formerly performed by civil servants following a hiring freeze on those positions may be deemed illegal. See, e.g., Local 4501, Comm. Workers v. Ohio State Univ., 12 Ohio St.3d 274, 466 N.E.2d 912 (1984) (*per curiam*), *rev'd in part and aff'd in part*, 24 Ohio St.3d 191, 494 N.E.2d 1082 (1986) (*per curiam*); see notes 72 to 76 and accompanying text in part VIII of this memorandum. Statutory language that would prevent this type of situation may be found in section 323F-7(c), *Hawaii Revised Statutes*, relating to the duties and powers of the Hawaii health systems corporation, established by Act 262, Session Laws of Hawaii 1996, which provides in relevant part: "The duties and powers granted to the corporation may not be used to enter into contractual or business relationships which have the practical effect of allowing or are intended to allow the private sector counterparts to replace existing employee positions or responsibilities within the corporation or its facilities...".

68. See NCEP at 47 - 50. In addition to the NCEP, the U.S. General Accounting Office has also identified the following strategies as those which are necessary to manage workforce transition as a result of privatization: (1) employee involvement in the privatization process; (2) training to provide skills for either competing against the private sector or monitoring contractor performance; and (3) creating a safety net for displaced employees. GAO at 14. A 1986 study conducted by the Privatization Concerns Task Group established by the President's Council on Management Improvement offered similar policy options and recommendations in an effort to reduce employee resistance and give incentives to federal employees to participate in privatization initiatives. See Chi (1988), *supra* note 40, at 9. See also William D. Eggers and John O'Leary, "Overcoming Public Employee Opposition to Privatization," Business Forum, vol. 19, no. 1,2 (Winter/Spring 1994); "Employee Issues in Privatization," Management Information Service Report, vol. 27, no. 10 (Oct. 1995) at 7-8, discussing strategies to reduce the number of government employees displaced by privatization, including attrition, transfer, early retirement packages, temporary hiring freezes, delayed or phased implementation of a contract, and in-house re-employment. In-house human resources management and outplacement consultants may assist affected employees by providing career counseling, assistance with networking, preparing resumes, and completing applications, and by providing information regarding such issues as:
- Employee rights (e.g., bumping rights or transfers to other departments);
  - Unemployment benefits and severance pay;
  - COBRA benefits for the continuation of health insurance;
  - Pension options for vested employees; and
  - Re-employment opportunities. *Id.* at 9.
69. Minn. Stat. §179A.23 (1996) ("Limitations on contracting-out of services provided by members of a state of Minnesota or University of Minnesota bargaining unit") provides in relevant part as follows: "Any contract entered into after March 23, 1982, by the state of Minnesota or the University of Minnesota involving services, any part of which, in the absence of the contract, would be performed by members of a [bargaining] unit provided in sections 179A.10 and 179A.11, shall be subject to section 16B.07 [competitive bids] and shall provide for the preferential employment by a party of members of that unit whose employment with the state of Minnesota or the University of Minnesota is terminated as a result of that contract." (Emphasis added.)
70. Privatization 1997, *supra* note 52, at 22.
71. Harry P. Hatry, A Review of Private Approaches for Delivery of Public Services (Washington, DC: The Urban Institute Press, 1983) at 41.
72. Privatization 1994, *supra* note 46, at 11.
73. Hatry (1983), *supra* note 71, at 29.
74. William G. Colman, State and Local Government and Public-Private Partnerships: A Policy Issues Handbook (New York, NY: Greenwood Press, 1989) at 164.
75. Privatization 1997, *supra* note 52, at 8.
76. Savas (1987), *supra* note 20, at 115.
77. Privatization 1997 at 52. In 1997, the Hawaii Legislature enacted legislation to encourage persons to volunteer their time and services for the good of their communities by providing them with limited immunity and ensuring means of redress for innocent, injured parties. See section 2 of Act 351, Session Laws of Hawaii 1997, codified as chapter 662D, *Hawaii Revised Statutes*.
78. For example, it has been reported that Hawaii state government already uses vouchers for refugee health programs, internal printing, and security services. See Privatization 1994, *supra* note 46, at 7.

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79. See generally Kevin Quinn and Myron Olstein, "Privatization: Public/Private Partnerships Provide Essential Services," and Larry J. Scully and Lisa A. Cole, "Privatization: Making the Decision," in Public/Private Partnerships: Financing a Common Wealth, ed. Barbara Weiss (Washington, DC: Government Finance Research Center & Government Finance Officers Association, 1985) at 66-105; see also United States Environmental Protection Agency, Public Private Partnerships for Environmental Facilities: A Self-Help Guide for Local Governments (Washington, DC: May 1990). Public-private partnerships are not always successful, however; see, e.g., Ellen Rosell, "The Chickens Can Come Home to Roost: The Anatomy of a Local Infrastructure Crisis," Urban Affairs Quarterly, vol. 30, no. 2 (Dec. 1994) at 298-306, describing a thirty-year public-private partnership in community infrastructure development that failed the city of Palm Bay, Florida.
80. GAO at 46. "Typically, each partner share in income resulting from the partnership in direct proportion to the partner's investment. Such a venture, while a contractual arrangement, differs from typical service contracting in that the private-sector partner usually makes a substantial cash, at-risk, equity investment in the project, and the public sector gains access to new revenue or service delivery capacity without having to pay the private-sector partner." Id. at 46-47.
81. Hawaii Revised Statutes §226-6(b)(9).
82. Hawaii Department of Business, Economic Development and Tourism, Research and Economic Analysis Division, Hawaii's Economic Action Program (Honolulu: July 1997) at 32.
83. Goldsmith (1997), *supra* note 22, at 120.
84. Id.
85. Id. at 121.
86. Attorney General Op. No. 97-06 at 8, quoting section 76-3, Hawaii Revised Statutes (emphasis added). The Attorney General further commented that "[t]he difference between the City and County of Honolulu's and the County of Hawaii's implementation of the responsibilities imposed upon them by sections 841-3 and 841-12, [Hawaii Revised Statutes], illustrates the wisdom of this provision...." Id.
87. Id. at 7 n. 10.
88. Reginald Alleyne, "Statutory Restraints on the Bargaining Obligation in Public Employment," in Labor Relations Law in the Public Sector, ed. Andria S. Knapp (Chicago: American Bar Assn., 1977) at 106.
89. See conference committee report language quoted in note 3 of part VI of this memorandum.
90. Alleyne (1977), *supra* note 88, at 106. Alleyne argues that management prerogative criteria should not be expressly spelled out, since there is often already a sufficient statutory basis for protecting an employer's interests, and management rights clauses may be negotiated and included in bargaining agreements, as they are in the private sector, which tend to be more attuned to the needs of the parties. He concludes: "With little difference in results in the absence of statutory management rights provisions, the advantage of not including them in statutes will be manifested in less tortured judicial reasoning, less litigation, less decision making time by agencies and courts, and more predictable results in this already inherently difficult area of labor law." Id. at 109.
91. Levine (1990), *supra* note 58, at 55.
92. Id.

93. Other state laws also include specific provisions regarding managerial rights. *See generally* note 29 in part VI of this memorandum. For example, section 179A.07(1) of the Minnesota Statutes (1996) includes the following provision in its public employment labor relations act:

**Inherent managerial policy.** A public employer is not required to meet and negotiate on matters of inherent managerial policy. Matters of inherent managerial policy include, but are not limited to, such areas of discretion or policy as the functions and programs of the employer, its overall budget, utilization of technology, the organizational structure, selection of personnel, and direction and the number of personnel. No public employer shall sign an agreement which limits its right to select persons to serve as supervisory employees or state managers..., or requires the use of seniority in their selection.

94. Alleyne (1977), *supra* note 88, at 109.
95. Editorial, "Privatization 'Crisis' Yielding to Reason," The Honolulu Advertiser, July 5, 1997, p. A5.
96. *See* note 3 and accompanying text in part IV of this memorandum.
97. Proceedings of the Constitutional Convention of Hawaii of 1968 (Honolulu: 1973), Vol. I, at 230 (Standing Committee Report No. 53 (Majority)). The Committee members who explored this issue eventually agreed that the existing system had worked well so far, and that the uncertainties under the residual system were unclear, and therefore recommended that no further amendments be made to that constitutional provision. In particular, Standing Committee Report No. 53 (Majority) reported as follows:

Full discussion was had of the concept of residual powers. It became increasingly clear to the members of your Committee as it explored deeply into this area that there were many problems and too few answers. The general consensus of your Committee was that Hawaii's experience in having the legislature confer powers to the counties has worked well in the recent past; that the legislature has been sympathetic and responsive to county problems; and that there is no demonstrated need for the constitutional grant of residual powers to the counties.

Your Committee, while cognizant that the granting of residual powers could represent one of the most far-reaching and progressive steps Hawaii could take to bring true "home rule" to the people of Hawaii, is equally cognizant that it is a risky venture into a yet untested doctrinal area where the questions raised outnumber those answered. For example, how much residual powers can the State safely confer upon the local government? In what areas should the State preempt? Should residual powers be given to other political subdivisions as well as to the counties? Is uniformity in certain county functions and administration desirable? If there is a court-test, how will the courts rule since legal precedents concerning residual powers are limited? The implications of the adoption of the residual powers principle are, to say the least, extensive. The State of Massachusetts encountered and is still encountering massive problems when, in 1966, it granted limited residual powers to its political subdivisions. Id.

98. Id. at 229 - 230.
99. Miriam P. Beams, Hawaii Constitutional Convention Studies 1978, Article VII: Local Government (Honolulu: Legislative Reference Bureau, May 1978), at 20.
100. *See id.* at 19 - 25.

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101. Alaska Constitution, Art. X, §11 (Michie 1996). *See generally* Beams (1978), *supra* note 99, at 21, noting that Texas was considered to have adopted the residual power method by judicial interpretation, and four other states (Alaska, Massachusetts, Pennsylvania, and South Dakota) had adopted residual or shared powers language in their constitutions. Similar to the Alaska provision is the constitutional language proposed by the Advisory Commission on Intergovernmental Relations in 1962: “Municipalities and counties shall have all powers and functions not denied or limited by this constitution or by State law. This section shall be liberally construed in favor of municipalities and counties.” *Id.* at 19. *See also* Gerald E. Frug, Local Government Law, American Casebook Series (St. Paul, MN: West Publishing Co., 1988) at 87-98. The home rule provision of the model state constitution of the National Municipal League reads as follows:

Section 8.02. *Powers of Counties and Cities.* A county or city may exercise any legislative power or perform any function which is not denied to it by its charter, is not denied to counties or cities generally, or to counties or cities of its class, and is within such limitations as the legislature may establish by general law. This grant of home rule powers shall not include the power to enact private or civil law governing civil relationships except as incident to an exercise of an independent county or city power, nor shall it include power to define and provide for the punishment of a felony. Model State Constitution (New York, NY: National Municipal League, 1963) at 16; *see id.* at 15-18, 94-100.

102. The Hawaii Supreme Court in Hawaii Gov’t Employees’ Ass’n v. County of Maui, 59 Haw. 65, 85, 576 P.2d 1029 (1978), found that Maui revised charter provisions that were challenged in that case regulating the administration, structure, and organization of the departments of water supply, police, and liquor control were directly related to the organization and government of Maui County, and were therefore of local, rather than statewide, concern. *See* notes 44 to 47 in part IV of this memorandum for further discussion of this issue.

103. In particular, N.J. Stat. Ann. §40:48-5 (West 1991) (“private contracts generally”) provides as follows:

When ... any municipality is authorized to render any service to the public, it may, in lieu of providing and maintaining the equipment necessary for rendering such service at its own expense, contract with any person to render such service on behalf of the municipality, under its control and direction. No such contract shall be let until specifications showing in detail the service to be rendered shall be prepared and rules and regulations governing the same shall be adopted. The contract shall be let, after due advertisement, to the lowest responsible bidder, who shall give ample security for its proper performance.

*See also* California Senate Bill No. 428, as amended (1997) (Intro. Hurtt), authorizing the county board of supervisors of any general law county to contract with any private entity for special services when the contract will result in a more efficient and economical service.

104. Konno v. County of Hawaii, 85 Haw. 61, 74, 937 P.2d 397, 74 (1997) (emphasis added).
105. Timothy M. Ito, “Down and Out in Waikiki: While Other States Boom, Hawaii is an Economic Wipeout,” U.S. News & World Report, Oct. 13, 1997, p. 46.
106. State Policy Reports, Vol. 15, Issue 6 (March 1997) at 20 - 22.
107. “Privatization Options: Now a Missing Tool for Hawaii’s Recovery,” Economic Indicators (Honolulu: First Hawaiian Bank, July/Aug. 1997) at 1; *see also* Senate Stand. Comm. Rep. No. 1712 at 4, regarding S.B. No. 1472, S.D. 2, H.D. 1 (1997): “Ironically, the Konno decision comes at a time when the State’s financial condition and its economy suggests that even greater reliance needs to be placed upon innovative public-private partnerships if we are to maintain even our present level of public services.”
108. Colo. Rev. Stat. §§24-50-501 to 24-50-513 (1996).

109. Colo. Rev. Stat. §24-50-501 (1996).
110. Mass. Ann. Laws ch. 7, §§52-55 (Law. Co-op. 1997).
111. Md. Code Ann., State Pers., §§13-402 (Michie 1996)
112. Md. Code Ann., State Pers., §§13-405(c)(1) (Michie 1996).
113. Colo. Rev. Stat. §24-113-103(1) (1996).
114. Colo. Rev. Stat. §24-113-101 (1996). Similar legislation was enacted by the State of Arizona in 1996; *see* 1996 Ariz. Legis. Serv. Ch. 321 (S.B. 1334) (West), codified in part as Ariz. Rev. Stat. Ann. §§41-2752 to 41-2754 (1996).
115. Elizabeth Pearson and Donna Lyons, “Privatization of State Corrections Management,” NCSL Legisbrief, vol. 4, no. 6 (Jan. 1996) at 1; *see, e.g.*, Fla. Stat. ch. 957 (“Florida Correctional Privatization Commission Act”) (1996); Ohio Rev. Code Ann. §9.06 (Ohio law providing for the private operation of correctional facilities) (Baldwin 1997); and Tex. Gov’t Code Ann. ch. 495, subch. A (Texas law providing for contracts with private vendors for the financing, construction, operation, maintenance, or management of correctional facilities) (West 1997).
116. *See, e.g.*, Fla. Stat. §409.1671 (1996).
117. *See* Penelope Lemov, “The Rocky Road to Privatizing Welfare,” Governing, vol. 10, no. 10 (July 1997) at 36 - 37.
118. *See, e.g.*, Cal. Gov’t Code §§54250 to 54256 (“The Local Government Privatization Act of 1985”) (West 1997); Fla. Stat. §§153.90 to 153.94 (Florida law authorizing wastewater facility privatization contracts) (1996); Tex. Water Code Ann. §§13.511 to 13.515 (Texas law authorizing cities to enter into privatization contracts for sewage treatment and disposal) (West 1997); Utah Code Ann. §§73-10d-1 to 73-10d-7 (“Utah Privatization Act”) (1997).
119. Other bills introduced during the 1997 Regular Session did not specifically address Konno, but established policies in support of competitive contracting and privatization generally. These included the following: H.B. No. 710, amending the state plan to include fostering competition; H.B. No. 1057, regarding reviews of existing and new state programs as to their implementation by the public sector as cost-effectively as the private sector; H.B. No. 1066, allowing the State to contract with the private sector to operate and manage state functions and responsibilities; H.B. No. 1077, requiring agencies to perform “make or buy” analyses for the provision of public goods or services; H.B. No. 1170, requiring the Department of Accounting and General Services to provide for the privatization of certain government functions; and H.B. No. 2174, H.D. 1, creating a public-private infrastructure program.
120. Chapter 42D, *Hawaii Revised Statutes*, was repealed and replaced by Act 190, Session Laws of Hawaii 1997; *see* note 43 in part II of this memorandum.
121. The Senate Committee on Government Operations and Housing, in discussing the need for immediate legislative action, noted that “[t]here was almost universal consensus among the testifiers present that if public contracts were subject to Konno it would have a devastating effect on the poor, disabled, and elderly segments of the population which depend on various chapter 42D and 103D, [*Hawaii Revised Statutes*,] contracts for services and assistance, as well as a disruptive economic effect on organizations which have traditionally contracted with the State and counties.” The Committee further noted that “even if the State and the counties were successfully able to challenge the applicability of Konno to such contracts, it must be presumed that it would require months or years of litigation to reach this result. While this litigation was pending, a cloud would exist over the State’s and counties’ ability to contract for public services, and the distinct possibility



## APPENDICES A - V

(All appendices not currently available online)

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that each of these contracts might be individually subject to some type of restraining order. It would be difficult at best to even budget for some of these contingencies.” Sen. Stand. Comm. Rep. No. 1194 (H.B. No. 1686, H.D. 1 (1997)) at 2.

122. H.C.R. No. 200 (1997) similarly requested the Attorney General to convene an informal task force to examine the ramifications of Konno; that concurrently resolution, however, was not adopted.
123. 85 Haw. at 73, 937 P.2d at 409 (emphasis in original).
124. Another option is for lawmakers to amend section 76-77(10), *Hawaii Revised Statutes*, as well as section 76-16(17) (the corresponding state civil service exemption section), to delete the requirement that positions be “specifically” exempted by other state statutes in order to qualify as an exemption. While deleting the word “specifically” from these sections appears to resolve the problem, it may in fact create additional problems of ambiguity. It is also unclear whether the phrase “any other law to the contrary notwithstanding,” or similar phrase, would qualify as a general exemption under existing case law.
125. *See, e.g.*, Ariz. Rev. Stat. Ann. §§41-2771 to 41-2773 (1997). *See* notes 12 and 13 and accompanying text in part VIII of this memorandum. A bill based on Arizona’s competitive government program is attached as Appendix L.
126. *See* Colo. Rev. Stat. §§24-50-501 to 24-50-513 (1996). Sample legislation based on this Colorado statute is attached as Appendix O.