



State Reached Settlement on Contracting Out for Seismic Retrofit

In November 1998, the Business, Transportation and Housing (BT&H) Agency reached a settlement with the Professional Engineers of California Government (PECG)—an organization representing state-employed engineers—over the current use of private consulting engineers in the Department of Transportation’s (Caltrans’) seismic retrofit program. The settlement ensures that Caltrans’ seismic retrofit program, a \$3.5 billion investment in the safety of the state’s highways and bridges, will not be further litigated over the issue of private contracting.

Any future contracting out for engineering services (for either seismic or nonseismic work) by Caltrans will be governed by a 1997 California Supreme Court ruling.

Background on Contracting-Out Litigation

Caltrans has been involved in litigation related to private contracting since 1986, when PECG filed suit to prevent the department from con-

tracting out the design and engineering of highway projects that were traditionally performed by civil service employees. In 1990, a superior court found that Caltrans’ use of private contracting violated the civil service provisions of the California Constitution. The court enjoined Caltrans from engaging in private contracting unless it could factually demonstrate that private contracting would meet one of the following specified statutory criteria:

- It was more cost-effective.
- It was necessary to ensure timely project delivery.
- It was used to provide specialized work for which state expertise was not available.
- It was used to perform a new state function.

In order to enable Caltrans to continue contracting out engineering work, the Legislature

and the Governor enacted Chapter 433, Statutes of 1993 (SB 1209, Bergeson) which authorized the department to contract out whenever it found it necessary to do so in order to ensure timely project delivery. Additionally, Chapter 1012, Statutes of 1994 (AB 1958, Katz) authorized Caltrans to contract out for its seismic retrofit program.

Chapter 433 Ruled Unconstitutional. In 1997, the California Supreme Court ruled that Chapter 433 was unconstitutional because it did not provide sufficient factual justification (according to the criteria mentioned above) to allow for an exemption from state civil service provisions.

Agency Filed Suit on Validity of Chapter 1012. In 1995, the BT&H Agency (under Secretary Dunphy) filed suit against PEGC in order that the court could rule on the validity of Chapter 1012, and thereby confirm Caltrans' authority to contract out its seismic retrofit program. Consistent with the State Supreme Court's ruling regarding Chapter 433, however, the superior court in September 1998 found Chapter 1012 to be unconstitutional. The court concluded that Chapter 1012 lacked substantial evidence to support the legislative findings that seismic retrofit work represents a new state function and that Caltrans would not be able to satisfactorily complete the seismic retrofit projects without private contracting. The court required the department to either terminate or factually justify every outstanding private contract in the seismic retrofit program.

Rather than appeal the court's ruling, the BT&H Agency chose to settle the case.

Key Settlement Terms of *Dunphy v. PEGC*

The settlement will affect 80 contracts for seismic retrofit design and engineering services, primarily for state-owned toll bridges. In response to the court's order, the BT&H Agency provided contract-specific justifications, using the statutory criteria, for the continuation of 54 of the 80 contracts. Under the terms of the settlement, Caltrans will:

- Continue and complete 50 contracts. These include contracts for which a substantial amount of the work has been completed, and contracts for specialty work which Caltrans does not have the staff expertise to perform (such as inspection work involving deep water diving). In particular, Caltrans will continue to contract for the design of the east span of the San Francisco-Oakland Bay Bridge.
- Transfer design work under six contracts to state staff. Of the six, two will be transferred to Caltrans in entirety, while four will be split between private contractors and civil service staff.
- Establish a team of 25 Caltrans engineers to work with the consultant in designing the east span of the Bay Bridge.
- Terminate and transfer work under 24 contracts to state staff by February 1999. These contracts are for construction inspection services.

- Reimburse PEGG's legal costs totaling \$178,491.
- Provide PEGG with a list of current vacancies and advance notice of any future private contracts for engineering and related services.

In exchange, PEGG agreed to:

- Not challenge any actions taken by the agency with respect to completing the *existing* private contracts.
- Not seek an award of attorney fees in its prior case against Caltrans.
- Withdraw its request for a State Personnel Board review of the 24 construction inspection contracts that are being transferred to state civil service.

Implications of Settlement

The settlement will affect Caltrans' ability to deliver highway capital outlay improvements, including the seismic retrofit program, in the following ways.

First, the settlement ensures that the state's seismic retrofit program is not delayed by future litigation over the contracting-out issue. How-

ever, Caltrans' delivery of highway projects may still face some delays. This is because Caltrans will have to hire an additional 222 staff in the *current year*, in order to have sufficient personnel to perform all of the construction inspection and bridge design work that otherwise would have been performed through contracting out. If Caltrans is unable to hire the additional staff, the department indicates that it would redirect existing engineering staff to perform the seismic retrofit projects in order to minimize delays to the program. This would in turn delay the delivery of other nonseismic retrofit projects, including highway rehabilitation and expansion projects.

Second, the settlement provides Caltrans with an opportunity to develop its expertise in advanced bridge design and technology. As such, it will reduce Caltrans' need for future contracting out in this area.

Finally, by settling with PEGG, the BT&H Agency has implicitly accepted the Supreme Court's 1997 ruling as the final word on the issue of private contracting. Legislative efforts to increase Caltrans' authority to contract out on a programmatic basis that lack specific, factual justification, are likely to fail the constitutional test. Short of providing such justification, the only mechanism for increasing the department's ability to contract out would be through a constitutional amendment.

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Economic and Revenue Developments

Economic Growth Continues. The state's economic expansion continued through the end of 1998, although at a more moderate pace than earlier in the year. Wage and salary employment during the fourth quarter of 1998 was up by 2.8 percent from the fourth quarter of 1997, with all major industry categories except for mining posting gains. Asia's economic problems have had a negative impact on the state's computer and electronics manufacturers, which experienced small employment declines over the past 12 months. However, the slowdowns have been offset by healthy gains in other industries such as construction, finance, services, and a variety of manufacturing businesses outside of the high-tech categories. The California unemployment rate stood at 5.9 percent in December, compared to 4.3 percent nationwide.

Revenues on Track So Far. Revenues for the July-through-December period totaled \$26.1 billion, a nearly 8 percent increase from

the same period of the prior year. (The revenue growth rate in the second half of 1998-99 will be considerably lower, due to the effects of the recently enacted tax cuts on final personal income tax payments.) Overall, revenues during the first half of the year tracked to the projections assumed in the *1998-99 Budget Act*—falling just \$57 million below the projected level.

New Budget Projects Lower Revenues During Remainder of Year. The *1999-00 Governor's Budget* forecasts General Fund revenues of \$56.3 billion in the current year and \$60.3 billion in 1999-00. The revised estimate for the current year is down about \$700 million from the estimate contained in the *1998-99 Budget Act*, due primarily to lower estimates of cash receipts from the state's three major taxes during the second half of this fiscal year. Our office will present its updated economic and revenue forecasts next month in *The 1999-00 Budget: Perspectives and Issues*.

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About the LAO

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