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June 29, 2011

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

ABILITY OF CITY COUNCIL TO REQUIRE LOCAL PREFERENCE OR PREVENT OUTSOURCING IN CITY CONTRACTS

## INTRODUCTION

On June 13, 2011, the City Council (Council) heard Item 150, the Preliminary Statement of Work for the Public Utilities Department Customer Service Center. The Council requested that this Office research and provide legal options for possible changes to the Preliminary Statement of Work (PSOW). This memorandum is provided in response to that request.

## DISCUSSION

### I. BACKGROUND

The Customer Service Office (CSO) is a major section within the Customer Support Division and is responsible for performing a variety of water, sewer, and storm drain account management activities within the Public Utilities Department. The Customer Support Division is composed of the following sections: Division Management, CSO, Field Services and Investigations, and the division's Systems, Applications and Products (SAP) Implementation Project Team, which is currently implementing the new SAP Customer Care Solution (CCS).

The CSO is the City's primary interface with water and sewer customers. It is a key resource in an environment where the level and consistency of customer service provided substantially influences customer perception and confidence in the City's ability to manage and deliver high quality utility services. Annually, the section handles more than 529,000 customer phone calls and emails, produces 2.8 million utility bills and related notices, reviews and resolves 160,000 billing exceptions and processes 1.8 million customer payments.

The City of San Diego intends to acquire the services of a provider (City employees or outside vendor) to service its CSO operational needs. A PSOW is the first step in the managed competition procurement process. The PSOW documents service specifications and is presented to the City Council for consideration and public comment to assure no degradation of service levels will occur as a result of the competition. Once approved, the PSOW forms the foundation for the complete Statement of Work (SOW) which will be included in the solicitation.

## II. CONSTITUTIONALITY OF LOCAL HIRE REQUIREMENTS

This Office has previously recommended against mandatory local preference goals as potentially unconstitutional under article IV, section 2, clause 1 of the U.S. Constitution (Privileges and Immunities Clause). *See attached,* City Att'y Report 2010-15 (Apr. 22, 2010). ["Local Hire Program: Legal Issues and Draft Ordinance."]

Programs such as a PSOW or final SOW that require contractors to employ a local workforce are legally problematic under the Privileges and Immunities Clause of the Federal Constitution, which prohibits a state from discriminating between its residents and non-residents without a "substantial reason" for doing so. U.S. Const. art. IV, § 2, cl. 1; *United Bldg. and Const. Trades Council of Camden County and Vicinity v. Mayor and Council of the City of Camden*, 465 U.S. 208, 222 (1984). Specifically, a public agency would have to show that non-residents "constitute a peculiar source of evil at which the statute is aimed" in order for a mandatory local hire ordinance to withstand constitutional challenge. *Id.* (*citing Toomer v. Witsell*, 334 U.S. 385, 398 (1948)). *See* City Att'y Report 2010-15 (April 22, 2010) at 1-5.

Although the Council's suggestion of a local Call Center does not expressly require local hiring, the fact that the center must be located within San Diego County or not "offshored" may still violate the Privileges and Immunities Clause. While no cases address this exact framework, if the CSO work can be effectively preferred outside the County, a court would likely find that a locus requirement has the same practical effect as imposing a penalty for failing to meet certain goals, and is therefore unconstitutional under *Camden* and its progeny. *See, e.g., Connerly v. State Personnel Board*, 92 Cal. App. 4th 16, 34 (2001) [holding that assuring the participation of a certain percentage of one group is tantamount to discriminating against another]. *See also Coalition for Economic Equity v. Wilson*, 122 F.3d 692, 702 (9th Cir.1997) [holding that, in the equal protection context, racial or gender classifications have the same legal significance whether in the form of a benefit or a burden].

If Council still wishes to have the CSO work done locally, we recommend that Council first build a factual record as to why that is important for reasons other than wanting to hire local workers. If the reason is to hire local workers, then the Council will need to determine why non-resident workers constitute a "particular source of evil" that needs to be rendered in San Diego. Further, we note that in order to qualify as "local" under the Small and Local Business Ordinance, a business must have its principle place of business and a significant employee presence in San Diego County.

Although local *workforce* requirements may be difficult to justify, courts have generally upheld local *business* preferences as constitutional. *See, e.g., Big County Foods, Inc. v. Board of Education of the Anchorage School District,* 952 F.2d 1173, 1177-79 (9th Cir. 1992) [upholding Anchorage school district program providing 7 per cent preference to in-state milk producers because school district was acting as a "market-participant"]. See also City Att'y Report 2009-9 (May 20, 2009) at 3-6. [Entitled "Legal Options for Small or Local Business Preference Programs].

The proposed local Call Center and "no offshoring" requirements in the PSOW and SOW would contain a bid requirement for achieving local hiring goals, thus it permits award to other than the lowest responsible and reliable bidder. It, therefore, runs the risk of being found unconstitutional under the Privileges and Immunities Clause. The only way to eliminate this risk completely is by excluding the San Diego County Call Center requirement and "no offshoring" requirement from the PSOW and final SOW.

## CONCLUSION

The proposed changes to the PSOW and SOW to require a locally-based Call Center and to disallow outsourcing are legally problematic under the Federal Constitution. To pursue that change, the Council will need to either describe why a local Call Center is necessary, and if the reason is to hire local workers, describe why non-residents are "a particular source of evil" who must be excluded. The City's ability to defend a legal challenge to a locally-based Call Center will depend on the strength of the Council's findings.

By _____
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RCP:cfq
Attachment: City Att'y Report 2010-15 (Apr. 22, 2010)
RC-2011-27

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April 22, 2010

REPORT TO THE COMMITTEE ON RULES, OPEN GOVERNMENT AND INTERGOVERNMENTAL RELATIONS

LOCAL HIRE PROGRAM: LEGAL ISSUES AND DRAFT ORDINANCE

## INTRODUCTION

At the February 24, 2010 hearing of the City Council's Rules, Open Government and Intergovernmental Relations Committee (Committee), the Committee considered a draft ordinance mandating that a certain percentage of City public works projects be performed by local residents.[1] This Office informed the Committee that such ordinances, sometimes referred to as "Local Hire" ordinances, may be unconstitutional under the U.S. Constitution's Privileges and Immunities Clause (U.S. Const. art. IV, § 2, cl. 1). The Committee requested the City Attorney to review and analyze the Local Hire programs of other jurisdictions, and return with a draft policy that may survive legal challenge.

## QUESTION PRESENTED

What are the City's options for adopting a Local Hire program?

## BRIEF ANSWER

If the City wishes to adopt a Local Hire program, two options are: (1) it can require that contractors agree to certain Local Hire requirements on a project-by-project basis through the use of Project Labor Agreements [PLAs], or (2) it can enact an ordinance setting forth Local Hire requirements for all public works contracts, provided that Local Hire goals are advisory and contractors retain ultimate discretion in employment decisions. Another option, posing a greater risk of challenge, is to enact an ordinance setting forth mandatory Local Hire goals.

## DISCUSSION

### I. CONSTITUTIONALITY OF LOCAL HIRE PROGRAMS

The United States Supreme Court has held that certain types of Local Hire programs may be unconstitutional. As discussed in the Report to the Committee dated October 22, 2009,

[1] The draft ordinance that the Committee considered also mandated that a certain percentage of work be performed by veterans.

entitled "Small and Local Business Preference Program: Draft Ordinance, Revisions to Council Policy 100-10, and Related Legal Issues" (RC-2009-26), programs that *require* contractors to employ a local workforce are legally problematic under the Privileges and Immunities Clause of the federal constitution, which prohibits a state from discriminating between its residents and non-residents without a "substantial reason" for doing so. U.S. Const. art. IV § 2, cl. 1; *United Bldg. and Const. Trades Council of Camden County and Vicinity v. Mayor and Council of City of Camden*, 465 U.S. 208, 222 (1984).

In *Camden*, the U.S. Supreme Court analyzed a Camden, New Jersey, ordinance requiring that 40 percent of employees working on city construction projects be Camden residents. *Id.* at 210. While the ordinance did not pose a problem under the U.S. Constitution's Commerce Clause,[2] the Court found that the opportunity for non-residents to seek employment from private contractors was a basic privilege protected under the Privileges and Immunities Clause:

> In sum, Camden may, without fear of violating the Commerce Clause, pressure private employers engaged in public works projects funded in whole or in part by the city to hire city residents. But that same exercise of power to bias the employment decisions of private contractors and subcontractors against out-of-state residents may be called to account under the Privileges and Immunities Clause . . . The opportunity to seek employment with such private employers is 'sufficiently basic to the livelihood of the Nation,' . . . as to fall within the purview of the Privileges and Immunities Clause even though the contractors and subcontractors are themselves engaged in projects funded in whole or part by the city.

*Id.* at 221-22, *citing Baldwin v. Montana Fish and Game Comm'n*, 436 U.S. 371, 388 (1978).

Since out-of-state employment was a "fundamental" privilege, the City of Camden had to demonstrate a "substantial reason" for requiring a local workforce; specifically, the city had to show that non-residents "constitute a particular source of evil at which the statute was aimed." *Id.* at 222, *citing Toomer v. Witsell*, 334 U.S. 385, 398 (1948). The Court remanded the case to the lower court to consider whether the city had presented sufficient evidence to meet this threshold.

The "peculiar source of evil" standard has proven to be a very difficult one to meet. For example, in *Hicklen v. Orbeck*, 437 U.S. 518, 525-29 (1978), the Supreme Court found an

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[2] The Commerce Clause, U.S. Const. art. 1, § 8, cl. 3, prohibits a state or local agency from discriminating against interstate commerce. However, courts have generally held that a state or local agency can favor its own residents when the local agency is contracting for goods or services directly. *See, e.g., Big County Foods, Inc. v. Board of Education of the Anchorage School District*, 952 F.2d 1173, 1177-79 (9th Cir. 1992) (upholding Anchorage school district program providing 7% preference for in-state milk producers because the school district was acting as a "market-participant").

"Alaska Hire" statute unconstitutional because Alaska failed to show the nexus between out-of-state residents and the state's unemployment problems.

> . . . Alaska Hire's discrimination against nonresidents cannot withstand scrutiny under the Privileges and Immunities Clause. For although a statute may not violate the Clause if the State shows 'something to indicate that noncitizens constitute a particular source of the evil at which the statute is aimed' (citations omitted) . . . certainly no showing was made on this record . . . .
>
> What evidence the record does contain indicates that the major cause of Alaska's high unemployment was not the influx of nonresidents seeking employment, but rather the fact that a substantial number of Alaska's jobless residents-especially unemployed Eskimo and Indian residents-were unable to secure employment either because of their lack of education and job training or because of their geographical remoteness from job opportunities . . .

*Id.* at 526-27.

Similarly, in *W.C.M. Window Co., Inc. v. Bernardi*, 730 F.2d 486, 497 (7th Cir. 1984), the Seventh Circuit held an Illinois statute requiring one hundred percent participation by local residents on public works contracts to be *prima facia* unconstitutional under the Privileges and Immunities Clause. The court noted that lack of evidence in the record justifying discrimination against out-of-state workers:

> Illinois has presented no information-statistical or otherwise . . . concerning the benefits of the preference law. We are not told the unemployment rate in Illinois' construction industry, what such unemployment costs the state, whether it would be significantly increased by throwing open public construction projects to nonresidents (which might just cause a reshuffling of jobs between public and private projects), and whether the costs-if any-to Illinois of allowing nonresident labor on such projects, costs in higher unemployment or welfare benefits paid unemployed construction workers or their families, are likely to exceed any cost savings in public construction from hiring nonresident workers.

*Id.* at 497-98. *See also Utility Contractors Assn' of New England, Inc. v. City of Worcestor*, 236 F. Supp. 2d 113, 119-20 (D. Mass. 2002) (granting preliminary injunction against City of Worcestor's Local Hire statute pursuant to Privileges and Immunities Clause; the court noted that, "[i]t is more than a stretch to suggest that nonresident employment on public construction projects . . . is responsible for the far-reaching economic problems the City describes"); *A.L. Blades & Sons, Inc. v. Yerusalim*, 121 F.3d 865, 876 (3d Cir. 1997) (striking down the

Pennsylvania Local Hire ordinance on the grounds that the Commonwealth failed to show a connection between non-resident construction workers and the "migration of economic benefit").

Moreover, courts have held that a "good faith" exception will not necessarily save an otherwise unconstitutional Local Hire statute. In *Hudson Country Building and Construction Trades Council, AFL-CIO v. City of Jersey City*, 960 F. Supp. 823, 830-31 (D. N.J. 1996), a federal court held that a Jersey City ordinance requiring contractors to make "good faith efforts" to hire 51% local residents implicated the Privileges and Immunities Clause. The court noted that the Jersey City ordinance's "good faith" requirements were not limited to documenting referral efforts, but went farther to interfere with the contractor's ultimate discretion in hiring:

> City Ordinance 96-022 is almost identical to the ordinance at question in [the *Camden* case].The conditions imposed on recipients of economic incentives by Jersey City to make a good faith effort to hire 51% Jersey city residents transcend mere interviewing requirements. In effect, the good faith requirement of Jersey City Ordinance 96-022 mandates that residents with the same skills and qualifications as out-of-state workers be given first consideration for positions with recipients of economic incentives and their contractors and subcontractors. The requirement of making a good faith effort to hire Jersey City residents is inconsistent with the recipient and its contractors and subcontractors being free to hire whomever they choose. Thus, City Ordinance 96-022 burdens the opportunity of out-of-state residents to seek employment with such private employers, a privilege protected by the Privileges and Immunities Clause.

*Id.* at 830.

The *City of Jersey* court went on to hold that while the city had demonstrated a higher unemployment rate than other nearby cities or statewide, it had "not shown that out-of-state workers are a source of unemployment and poverty within its borders." *Id.* at 831. The court ordered that the case go on to trial, since issues of fact remained regarding the relationship between non-resident workers and the city's unemployment problems. *Id.* at 834-35.

Only one known case upholds a Local Hire mandate against a Privileges and Immunities Clause challenge. In *State of Wyoming v. Antonich*, 694 P.2d 60, 64 (Wyo. 1985), the Supreme Court of Wyoming held that the "Wyoming Preference Act" [Act] was narrowly drawn to remedy the specific evil posed by out-of-state workers. The court noted that the Act merely required contractors to hire Wyoming residents when there were a "sufficient number of residents who are qualified and available to go to work." *Id.* at 63. While the Act required contractors to obtain referrals through the local employment office, it did not mandate that a specific percentage of the contractor's workforce be local residents or require contractors to dismiss their own employees as residents became available. However, an opinion of the Wyoming state court is not binding in California, and a federal court has implied that the

decision may not withstand scrutiny. *See A-G-E Corporation v. U.S. By and Through Office of Management and Budget*, 968 F.2d 650, 654 (8th Cir. 1992) (noting that, "[a] direct attack on Wyoming's resident preference statutes on [constitutional] grounds would clearly face an uphill battle . . .").

## II. LEGAL OPTIONS

Pursuant to the Committees' request, this Office reviewed the Local Hire programs of other jurisdictions to determine how they have dealt with the constitutional limitations discussed above. Exhibit A to this Report summarizes other jurisdictions' programs, the Local Hire percentages utilized, whether exemptions apply, and whether they have been legally challenged.

Based on our research of other jurisdictions and the relevant caselaw, two options for implementing a Local Hire program might pass constitutional muster: (1) the City can require that contractors agree to certain Local Hire requirements on a project-by-project basis through the use of Project Labor Agreements [PLAs], or (2) the City can enact an ordinance setting forth Local Hire requirements for all public works contracts, provided that Local Hire goals are advisory and that contractors retain ultimate discretion in employment decisions.

### A. Option 1: Project Labor Agreements.

The City may choose to implement Local Hire requirements exclusively through the use of PLAs for specific public works projects. Currently, the City of Los Angeles is taking this approach. Los Angeles has used PLAs on several large projects (see Exhibit A). While the PLAs differ slightly for each project, most have the following requirements: a goal of 30 to 40% local workers residing in the project area; an additional goal of 10 to 15% local workers from a citywide "at-risk" pool drawing from certain zip codes; and a requirement that contractors obtain referrals from labor unions, provided that contractors retain the absolute right to hire, promote, suspend, discharge or layoff employees and reject an applicant for employment subject to relevant labor union agreements.[3]

One benefit to using PLAs is that they can be modified on a case-by-case basis to best meet the needs of a particular project. PLAs may also be less susceptible to legal challenge because they do not impose across-the-board requirements, which a court may hold to be overly broad when applied to all projects. *See, e.g., Associated Builders and Contractors, Inc. v. San Francisco Airports Commission*, 21 Cal.4th 352, 366-69, 74-75 (1999)(upholding San Francisco's use of a PLA on an airport expansion project because there was a legitimate governmental interest in ensuring efficiency of the project and avoiding labor delays). Also, if a

[3] The City of Los Angeles considered a draft Local Hire ordinance in 2008 but it was never enacted. The draft ordinance would have imposed a 30% local workforce goal and a 10% disadvantaged workforce goal, where the definition of "disadvantaged" included workers from low-income, chronically underemployed areas. However, the draft ordinance contained a number of exceptions, including sole contracts, contracts covered by PLAs, and other exemptions to be promulgated by the procuring department. It is unclear whether contractors would retain ultimate hiring and firing discretion after engaging in "good faith" efforts.

contractor has had an opportunity to negotiate with the City regarding appropriate goals and terms, the contractor is less likely to initiate litigation against the City. If the City chooses to utilize PLAs on a project-by-project basis, this Office can assist in drafting contract provisions that will encourage local hiring without running afoul of the Privileges and Immunities Clause.

**B. Option 2: Local Hire Ordinance with Advisory Goals.**

The City may also opt to enact a Local Hire ordinance that would apply to all public works contracts, or if Council elects, contracts within certain dollar thresholds. If the City chooses to pursue this option, we recommend that the ordinance have the following qualities in order to protect it from legal challenge: (1) it should set advisory goals only (or not set specific goals), and (2) it should give the contractor ultimate discretion in hiring and firing. The cities of Boston, Denver, and Berkeley have taken similar approaches. We are not aware of any challenges to their ordinances.

By setting advisory, rather than mandatory goals, the City would not be discriminating against nonresident workers because the contractor is not subject to punitive measures for not meeting the goals. Moreover, if the ordinance includes referral requirements but leaves ultimate employment decisions to the contractor, the City cannot be interfering with the contractor's hiring and firing decisions. While there is no case directly addressing the point, a court may find non-resident workers' "fundamental privilege" to seek out-of-state employment is not impaired and the Privileges and Immunities Clause is not offended. A draft ordinance for Council's consideration is included with this Report as Exhibit B.

**C. Option 3: Local Hire Ordinance with Mandatory Goals.**

Another option available to the City is to enact an ordinance that includes mandatory local hiring goals. However, such an ordinance is not likely to survive legal challenge under the Privileges and Immunities Clause, even if the City can show a higher rate of unemployment than other jurisdictions. *See, e.g., City of Jersey City*, 960 F.Supp. at 831. If Council chooses to pursue this route, we would strongly recommend that the City first build a factual record demonstrating the connection between non-resident workers and local unemployment problems. Even if the City were to develop such a record, there is high risk that a court would strike the ordinance down as unconstitutional in light of the difficulties other jurisdictions have had meeting the "peculiar source of evil" standard.

Should Council opt for mandatory goals, the ordinance could be drafted so that out-of-state-workers are excluded when calculating whether Local Hire goals have been met. The cities of Cleveland and Milwaukee, for example, have taken this approach. *See City of Cleveland v. Ohio*, 508 F.3d 827, 848 (6th Cir. 2007) (finding that Cleveland Local Hire statute did not discriminate against out-of-state workers because they were excluded when calculating 20% Local Hire mandate). Such an approach may work against the public policy goal of hiring local workers, since the percentages would be skewed by not including out-of-state workers. However, this is a policy decision left to the discretion of the City Council.

## CONCLUSION

If the City Council wishes to adopt a Local Hire program, two of the three options may survive legal challenge. The City can: (1) require that contractors agree to certain Local Hire requirements on a project-by-project basis through the use of PLAs, or (2) enact an ordinance setting forth Local Hire requirements for all public works contracts, provided that Local Hire goals are advisory and contractors retain ultimate discretion in employment decisions. Another option, posing a greater risk of challenge, is to enact an ordinance setting forth mandatory Local Hire goals. If Council wishes to pursue this option, Council should establish a record showing the connection between non-resident workers and local unemployment problems, and require that out-of-state workers be excluded from calculating Local Hire percentages.

Respectfully submitted,

By

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SRS:amt
Attachments
RC-2010-15