

## APPENDIX D: CONSTITUTIONAL AND LEGAL PRECEDENTS

### CALIFORNIA CONSTITUTION ARTICLE XIV, SECTION 4

The Legislature is hereby expressly vested with plenary power, unlimited by any provision of this Constitution, to create, and enforce a complete system of workers' compensation, by appropriate legislation, and in that behalf to create and enforce a liability on the part of any or all persons to compensate any or all of their workers for injury or disability, and their dependents for death incurred or sustained by the said workers in the course of their employment, irrespective of the fault of any party. A complete system of workers' compensation includes adequate provisions for the comfort, health and safety and general welfare of any and all workers and those dependent upon them for support to the extent of relieving from the consequences of any injury or death incurred or sustained by workers in the course of their employment, irrespective of the fault of any party; also full provision for securing safety in places of employment; full provision for such medical, surgical hospital and other remedial treatment as is requisite to cure and relieve from the effects of such injury; full provision for adequate insurance coverage against liability to pay or furnish compensation; full provision for regulating such insurance coverage in all its aspects, including the establishment and management of a State compensation insurance fund; full provision for otherwise securing the payment of compensation; and full provision for vesting power, authority and jurisdiction in an administrative body with all the requisite governmental functions to determine any dispute or matter arising under such legislation, to the end that the administration of such legislation shall accomplish substantial justice in all cases expeditiously, inexpensively, and without encumbrance of any character; all of which matters are expressly declared to be the social public policy of this State, binding upon all departments of the State government.

The legislature is vested with plenary powers, to provide for the settlement of any disputes arising under such legislation by arbitration, or by an industrial accident commission, by the courts, or by either, any, or all of these agencies, either separately or in combination, and may fix and control the method and manner of trial of any such dispute, the rules of evidence and the manner of review of decisions rendered by the tribunal or tribunals designated by it; provided, that all decisions of any such tribunal shall be subject to review by the appellate court of this State. The Legislature may combine in one statute all the provisions for a complete system of workers' compensation, as herein defined.

The Legislature shall have power to provide for the payment of an award to the state in the case of the death, arising out of and in the course of the employment, of an employee without dependents, and such awards may be used for the payment of extra compensation for subsequent injuries beyond the liability of a single employer for awards to employees of the employer.

Nothing contained herein shall be taken or construed to impair or render ineffectual in any measure the creation and existence of the industrial accident commission of this State or the State compensation insurance fund, the creation and existence of which, with all the functions vested in them, are hereby ratified and confirmed.

### FULL TEXT OF GOVERNMENT CODE SECTION 19130

The purpose of this article is to establish standards for the use of personal services contracts.

(a) Personal services contracting is permissible to achieve cost savings when all the following conditions are met:

(1) The contracting agency clearly demonstrates that the proposed contract will result in actual overall cost savings to the state, provided that:

(A) In comparing costs, there shall be included the state's additional cost of providing the same service as proposed by a contractor. These additional costs shall include the salaries and benefits of additional staff that would be needed and the cost of additional space, equipment, and materials needed to perform the function.

(B) In comparing costs, there shall not be included the state's indirect overhead costs unless these costs can be attributed solely to the function in question and would not exist if that function was not performed in state service. Indirect overhead costs shall mean the pro rata share of existing administrative salaries and benefits, rent, equipment costs, utilities and materials.

(C) In comparing costs, there shall be included in the cost of a contractor providing a service any continuing state costs that would be directly associated with the contracted function. These continuing state costs shall include, but not be limited to, those for inspection, supervision, and monitoring.

(2) Proposals to contract out work shall not be approved solely on the basis that savings will result from lower contractor pay rates or benefits. Proposals to contract out work shall be eligible for approval if the contractor's wages are at the industry's level and do not significantly undercut state pay rates.

(3) The contract does not cause the displacement of civil service employees. The term "displacement" includes layoff, demotion, involuntary transfer to a new class, involuntary transfer to a new location requiring a change of residence, and time base reductions. Displacement does not include changes in shifts or days off, nor does it include reassignment to other positions within the same class and general location.

(4) The contract does not adversely affect the state's affirmative action efforts.

5. Employees

- Employees are "at will" employees since the conversion began in 1988; they had been in state agency employment.
- Employees have remained in the state retirement system, on a non-contributing basis; (no 401K plan for the not-for-profit WCF).
- In the first year, there were reciprocal agreements with the state for employees to move from the private WCF to state civil service in other agencies.

6. Surplus

- Surplus was transferred to the new entity.

7. Environment

- Employers may insure with private carriers, WCF, or self-insure.
- Rating Law: File & Use in 30 days, file loss costs now; was File & Use on rates.

8. Fund Experience

- WCF market share is 55% of premiums; an estimated 80% of policies. Has been in the 57% - 63% range in recent years.

9. Recent Legislation

- Legislature passed a moratorium on the WCF writing health insurance.

## Workers Compensation Fund of Utah (WCF)

### 1. Structure:

- It is a quasi public, not-for-profit corporation, which operates like a mutual insurance company, created legislatively 1988-91.
- The seven member Board is appointed by the Governor.
- Is a member of the Guaranty Fund.
- It has a stock company subsidiary licensed to write health insurance.
- State Agencies must insure with WCF, other public entities may choose among WCF, commercial carriers, and self insurance.

### 2. Residual Market

- WCF is the residual market for Utah.
- It has accepted all risks since inception; in 1986, the legislature designated it as the only company to accept all risks.

### 3. History and Changes

- WCF was created legislatively in 1917 to promote competition as a Utah domiciled insurer.
- It is associated with the workers compensation act and the Occupational Disease Act.
- It was an agency of the state.
- Various studies were done in the 1980's; a management sponsored study in 1987 called for more independence for WCF.
- 1988 legislation created an independent agency, but did not cut all ties; Title 35, Chapter 3 of Utah Code.
- The Governor created and appointed the Board.
- WCF was given exemption from various state requirements in areas such as human resources, purchasing procedures, government record rules, and open public meeting rules.
- Legislation in 1990-1993 clarified the description to a quasi public corporation, enlarged the Board, made WCF subject to insurance company regulation and other changes.

### 4. Reasons for Changes

- Utah had a failed thrift problem, which caused concern for the liability of the state for regulatory oversight generally.
- There was a desire for a more arms length relationship with WCF.

(5) The savings shall be large enough to ensure that they will not be eliminated by private sector and state cost fluctuations that could normally be expected during the contracting period.

(6) The amount of savings clearly justify the size and duration of the contracting agreement.

(7) The contract is awarded through a publicized, competitive bidding process.

(8) The contract includes specific provisions pertaining to the qualifications of the staff that will perform the work under the contract, as well as assurance that the contractor's hiring practices meet applicable nondiscrimination, affirmative action standards.

(9) The potential for future economic risk to the state from potential contractor rate increases is minimal.

(10) The contract is with a firm. A "firm" means a corporation, partnership, nonprofit organization or sole proprietorship.

(11) The potential economic advantage of contracting is not outweighed by the public's interest in having a particular function performed directly by state government.

(b) Personal services contracting also shall be permissible when any of the following conditions can be met:

(1) The functions contracted are exempted from civil service by Section 4 of Article VII of the California Constitution, which describes exempt appointments.

(2) The contract is for a new state function and the Legislature has specifically mandated or authorized the performance of the work by independent contractors.

(3) The services contracted are not available within civil service, cannot be performed satisfactorily by civil service employees, or are of such a highly specialized or technical nature that the necessary expert knowledge, experience or ability are not available through the civil service system.

(4) The services are incidental to a contract for the purchase or lease of real or personal property. Contracts under this criterion, known as "service agreements," shall include, but not be limited to, agreements to service or maintain office equipment or computers that are leased or rented.

(5) The legislative, administrative, or legal goals and purposes cannot be accomplished through the utilization of persons selected pursuant to the regular civil

service system. Contracts are permissible under this criterion to protect against a conflict of interest or to insure independent and unbiased findings in cases where there is a clear need for a different, outside perspective. These contracts shall include, but not be limited to, obtaining expert witnesses in litigation.

(6) The nature of the work is such that the Government Code standards for emergency appointments apply. Such contracts shall conform with Article 8 (commencing with Section 19888) of Chapter 2.5 of Part 2.6.

(7) State agencies need private counsel because a conflict of interest on the part of the Attorney General's office prevents it from representing the agency without compromising its position. These contracts shall require the written consent of the Attorney General, pursuant to Section 11040.

(8) The contractor will provide equipment, materials, facilities, or support services that could not feasibly be provided by the state in the location where the services are to be performed.

(9) The contractor will conduct training courses for which appropriate qualified civil service instructors are not available, provided that permanent instructor positions in academies or similar setting shall be filled through civil service appointment.

(10) The services are of such an urgent, temporary, or occasional nature that the delay incumbent in their implementation under civil service would frustrate their very purpose.

(c) All persons who provide services to the state under conditions the board determines constitute an employment relationship shall, unless exempted from civil service by Section 4 of Article VII of the California Constitution, be retained under an appropriate civil service appointment.

(Amended by Stats. 1965, Ch. 794.)

## THE CIVIL SERVICE ISSUE

The California Constitution (art. XXIV) provides for permanent appointments and promotions in the state civil service "based upon merit, efficiency and fitness as ascertained by competitive examination". The intent of the provision is to limit the ability of the Executive branch to hire and terminate public employees at will in furtherance of a system of political patronage. The section creates an inevitable tension between the Executive branch's desire to manage the public workforce in furtherance of public policy and the Constitution's limitations on hiring, disciplining and terminating at will.

The case law in this area is well developed and germane to the problem at hand. Interestingly enough the early cases in this area involved the State Fund [Borum v.

State Comp. Ins. Funds (1947) 30 Cal.2d 575; State Comp. Ins. Fund v. Riley (1937) 9 Cal.2d 126 and Stockburger v. Riley (1937) 21 Cal. App.2d 165]. The questions addressed in these early cases revolved on whether the civil service provisions of the constitution required that all work done in furtherance of the state's interest needed to be done by employees hired through the civil service process. In a subsequent case California State Employees' Association v. Williams, the question addressed was whether the state could contract out a new function rather than perform it with civil service employees. The judicial findings of these early cases, subsequently codified in 1985 and 1986 in Government Code Section 19130 (cf. Appendix E) and Public Contract Code 10295ff can be considered the settled state of the law on what work must be done by civil service employees and what work can be contracted out. In effect the settled law recognizes that there is a constitutional requirement that some of the state's work should be done by civil service employees, but that there are also broad, reasonable exceptions to the general rule.

For example work can be contacted out when the skills needed are not available in the civil service, when labor is only needed on a temporary basis or when it is possible to achieve cost savings.

CSEA vs. Williams [7C.A.3d.390;86Cal.Rptr.305] both discusses the tension between the constitutional requirement for a civil service system and the state's practical need to contract for some personnel services and provides the most important judicial precedent for resolving such questions. CSEA vs. Williams recognizes the state's right to contract out new functions as long as there is no displacement of existing civil service employees.

The state of the law on contracting out was summarized and advanced in an Appellate decision in 1993, Professional Engineers vs. Department of Transportation [13 Cal.App.4th 585; 16 Cal.Rptr.2d 599]. The case involved the legislature's authorization of the design and construction of the state's first toll roads.

Although article VII does not expressly limit the state's ability to contract with private firms for provision of state services, courts have implied certain limits as essential to protect the civil service mandate against dissolution and destruction (citation omitted). Typically courts have articulated tests for determining whether employment of non-civil-service personnel violates these implied limitations. For example, under the "nature of the services test" the court inquires as to whether the nature of the contracted services is such that they could have been performed by a civil servant. If so, the agency must proceed under the civil service mandate. (*State Compensation Ins. Fund v. Riley* (1937) 9 Cal.2d. 126, 135 [69 P.2d 985, 111 A.L.R. 1503]; *California State Employees' Assn. v. Williams* (1970) 7 Cal.App.3d 390, 395 [86 Cal.Rptr. 305].) Under the "new state function" test, courts will ask whether the contracted services displace existing state civil service functions or, instead, embrace a new

state activity or function. The constitutional policy of a merit employment system "does not prohibit legislative experimentation in new forms to fit new functions." (7 Cal.App.3d at p. 399, upholding the statutes and resulting contract calling for private carriers to conduct administrative tasks of the Medi-Cal program.)

The court showed a willingness to move beyond these traditional tests finding:

Without question Caltrans engineers could design the roads in question and other civil servants could construct them. Nor are the design and construction of roads, new state functions or activities. But appellants take too literal an approach when they say that the demonstration projects do not translate into a new state function under *Williams*. As the trial court correctly pointed out, the novelty of the contracts and legislation lies in the privatization of project financing and management. After all, the private sector, not the state, will pay for the services engaged pursuant to the exclusive franchise agreements.

The contracting out issue is currently before the Supreme Court in the case of Professional Engineers in California Government (PECG) et al., v. Department of Transportation et al.; a case related to the contracting out of seismic retrofit design work. The decision at the appellate level found:

Although (the law in question) does not create a new state function within the meaning of *Williams*, this does not necessarily render it unconstitutional. As previously explained, government contracting with the private sector is prohibited only when contrary to the policies underlying Article VII. Those policies are "to encourage efficiency and economy in state government" and "to eliminate the 'spoils system' of political patronage." (citations omitted). . .

As with the statute at issue in *Professional Engineers v. Department of Transportation*, supra, (citations omitted) a purpose of (the law in question) is to determine the economic viability of contracting certain work to the private sector. Caltrans is required to submit a report to the Legislative Analyst by September 1, 1996, comparing projects using primarily civil service staff with similar projects using primarily outside consultants. (citation omitted) As long as legislation does not present a risk of reintroducing the spoils system to state government, the Legislature must be given reasonable latitude to experiment with different methods of job performance. We are satisfied the safeguards contained in the statute adequately respect and protect the integrity of the state civil service mandate.



In short, whatever is done with respect to privatization will have to conform to an evolving body of law relative to the civil service provisions of the Constitution. The privatization of an existing state function and existing state employees would be outside the envelope of judicially recognized exceptions to the civil service provisions of the Constitution, but the courts have been taking an increasingly tolerant attitude toward contracting out. Litigation on this issue from employee organizations is likely. The Supreme Court decision in the PEGG case will of course establish a new baseline for deciding these issues.