

## Conclusion

T

he privatization of school support services has long been a topic of concern for Oregon lawmakers, school officials and the public at large. Evidence that privatization often imposed dramatic costs on local employees without producing the promised savings led legislators in 2009 to adopt a new statute to guard against the most damaging versions of contracting out.

In the first test case under the new law — the decision by the Central Point School District (CPSD) to contract out school busing — it is apparent the 2009 statute has not achieved its goal. The contract between CPSD and First Student Inc., fails the most fundamental test created by ORS 279B.033: to the extent it saves the district money, it only does so by relying on steep wage and benefit cuts for local employees. Whether this failure requires a legislative or a regulatory remedy, it is clear lawmakers' intent has not been realized in the law's application.

Furthermore, a detailed examination of bus privatization contracts points to a series of legally questionable practices, along with a handful of transactions that constitute prima facie violations of contractual agreements. The prevalence of ethically or legally suspect

practices may be the result of loopholes in legislative language or of insufficient oversight by state or local authorities. It is clear, however, that hundreds of thousands of taxpayer dollars — and perhaps millions — are being wasted as a result of insufficient controls in the privatization process. At a time when both state and local officials are facing severe budget challenges, Oregon taxpayers simply cannot afford to allow such waste to go uncorrected.

We hope this report will enable lawmakers, school officials and the public at large to take more effective steps toward guaranteeing quality services for students and to safeguard much-needed tax dollars.

► The contract between the Central Point School District and First Student Inc. fails the most fundamental test created by ORS 279B.033: to the extent it saves the district money, it only does so by relying on steep wage and benefit cuts for local employees.



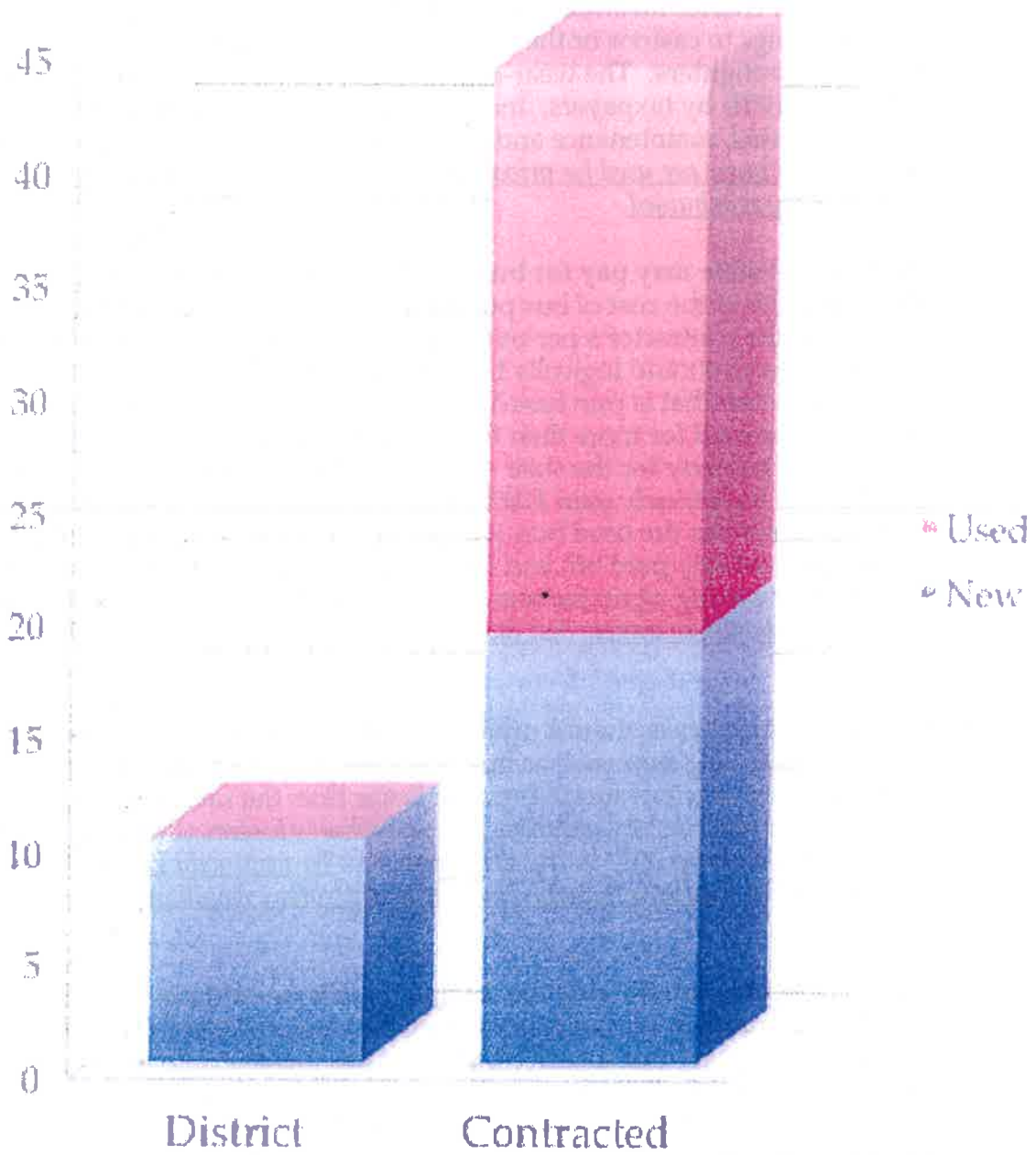
## Loopholes in ORS 279B: Problems and Pitfalls in School Bus Contracting

- **Cost-benefit analyses should include *all* the costs of contracting out, including those paid by the state as well as by the school district.** The state is the silent third party in a deal, and deals can be structured to satisfy the district and the contractor, but at the expense of state taxpayers. For example, when Lake Oswego contracted out its bussing in 2003, its RFP stipulated that contractors had to buy the district's bus fleet for \$1 million. The contractor awarded the bid – then called Laidlaw, now First Student – stated that the fleet was only worth \$650,000. The contractor then agreed to pay the district \$1 million for its fleet, but on condition that the district repay the extra \$350,000 in five yearly payments of \$80,000 per year (with interest, the \$350,000 loan became \$400,000). This was a purely financial transaction – essentially a five-year loan. But the contractor built the \$80,000 annual repayment into its cents-per-mile charges, which were submitted to the state as reimbursable “transportation expenses.” The state, in turn, paid 70% of this cost. Thus, the contractor offered a sweetener to seal the deal, and the District got \$350,000 but only had to repay 30% of that amount. It was a good deal for both parties, but only because the state picked up the tab.
- **Districts are not providing the information legislators intended.** ORS 279B states that analyses must include estimated or actual costs for employee wages and benefits, equipment, supplies, and other material costs. However, First Student refused to provide this information, claiming the components of its per-mile charges is a “trade secret.” The analysis CPSD used to show compliance with the law was explicitly fictitious: instead of actual wage and benefit costs, it simply *assumed* that First Student would offer the same wages and benefits the district had. It also completely omitted the cost of buying new buses. Contractors should be required to provide actual data, including a breakout of their per-mile charge into charges for labor; bus purchase; and other cost items.
- **Incomplete or misleading information leads to contracts being approved that clearly fail to meet the legislature's standard.** When all costs are accounted for, it appears that the district may actually suffer a net loss as a result of privatization. However, it is completely clear that any possible net savings are based entirely on lower wages and benefits, which we estimate were cut by 47%.
- **Contracting out entails a dramatic increase in bus purchases.** School buses are subject to rigorous quarterly inspections, but as long as they're roadworthy, districts can operate 20 year-old buses. Contractors insist on “industry” standards that require most buses be replaced after 12 years. If Central Point maintained in-house transportation, it would have bought 10 new buses over

five years; instead, First Student will require it to buy 19 new and 25 used buses, for a total of 44 buses purchased over the five-year contract. Districts should not be forced to purchase more buses for a contractor than they would for in-house transportation.

- **Public dollars buying private buses.** Districts are paying 100% of the cost of purchasing new buses; but these buses are used by First Student's private commercial charter business in off-school hours – weddings, corporate events, group outings to casinos or the coast, even contracting with the Forest Service to transport firefighters. The wear-and-tear and depreciation on the buses appears to be paid 100% by taxpayers. Indeed, it seems possible that taxpayers are paying the fuel, maintenance and repair costs of First Student's private charter business. If buses are used for private purposes, the district and state should be appropriately reimbursed.
- **District and state may pay for buses twice over.** It appears that Districts are charged 100% of the cost of bus purchases over five years, with these charges rolled into the contractor's per-mile charges. When a bus is fully paid for, the per-mile charge should logically be reduced; but such charges are never reduced. Thus, a new bus that is purchased in the first year of a contract and used for 12 years may be paid for more than twice over by taxpayers. A similar problem occurs – particularly for the state -- if a District buys a used bus from another District that has already paid 100% of the purchase price. If the second District is charged a price for the used bus, it is paying for something that another District has already entirely paid off; and the state, which paid 70% of the costs the first time, will be paying again for something it already helped purchase in full. Contractors should guarantee that the public will never pay more than 100% of asset costs.
- **Cost-benefit analyses should project far enough into the future to capture all relevant costs.** Expense such as bus purchase, and poor contract language such as allowing contractor rates to increase faster than the rate of inflation, compound over time. By contrast, the one-time infusion of cash from selling off a bus fleet shows up only in the first contract. To accurately gauge the tradeoffs of contracting out, cost/benefit analyses of bus privatization should project at least 15 years out.
- **School districts and the state are unable to enforce contract terms.** Taxpayers may be defrauded in ways that school districts cannot, or choose not to, enforce. In Lake Oswego, for instance, First Student has increased its fees at a rate higher than allowed in the contract; over five years, this has cost the District \$230,000. And in both Lake Oswego and Central Point, First Student is operating a private charter operation in violation of its contract, and the District has no records as to whether commercial charters may be using publicly-bought fuel, or how many private miles are being paid for by taxpayers. The state Education department does not have capacity to enforce these contracts. The law – and fraud against taxpayers -- should be enforceable through a private right of action.

## Bus Purchases over 5 years



# Executive Summary

## of "All Costs Considered: A NEW Analysis on the Contracting Out of School Support Services in Oregon"

F

ollowing a sharp acceleration in the contracting out of school support services throughout Oregon in recent years, the Labor Education and Research Center (LERC) at the University of Oregon conducted a study of this practice that was released in June 2004. The study raised questions about the quality of service provided by contractors and the social and economic costs to workers and communities when school support services, most notably transportation, custodial, and food services, are placed under private management. It also found that the cost savings for school districts promised by private contractors often did not fully materialize.

This follow-up study reviews some of the issues we first examined in 2004. We have focused especially on three of the five school districts that contracted services in the previous year: Lincoln County, Lake Oswego, and Rainier. Since nearly three years have elapsed since these districts shifted management and administration of school support services to private contractors, we now have a longer time period available in which to assess their performance. We have also conducted a follow-up survey of

workers in Lincoln County in an effort to assess the longer-term personal and social impact of privatization.

Here are our principal findings:

### I. Tallying the Social Costs: Quality of Life for Workers and Communities Adversely Affected By Contracting Out

In assessing the social costs of contracting out, we interviewed workers in Lincoln County, a district that contracted out food, transportation, and custodial services in 2003. We spoke to nearly one-third of the over 100 workers whose jobs were contracted out, questioning them about their work experience and current standard of living. We discovered numerous examples where contracting out had adversely affected workers and, by implication, the communities where they reside. Among the effects we found were the following:

#### *Employee Displacement*

Over half of the workers we surveyed in Lincoln County chose employment with private contractors. Of those who decided

► This follow-up study focuses on three school districts that contracted services in 2003. Since several years have elapsed since these districts shifted management and administration of school support services to private contractors, we were able to assess the longer-term personal and social impact of privatization.

against working for the contractors, 20 percent opted to retire, 17 percent found new jobs, and the remainder have either become self-employed or been unable to find permanent employment. Most former school district employees who found new jobs suffered pay losses ranging from \$1.00 to \$1.84 per hour.

#### *New Hires Suffer Wage Losses*

Workers who elected to remain with the private contractors had their previous school district wage maintained. However, new hires in transportation and custodial service receive less pay than they would have gotten with the school district in 2003 (3.5 and 10 percent respectively), while an entry-level food service worker's pay is the same as it was previously.

#### *Inadequate Health Insurance*

Workers employed by the private contractors pay much higher premiums and deductibles for health insurance than they paid previously with the school district. For example, a family of three using Mid Columbia's health insurance plan would pay \$3,000 in annual deductibles. An employee and his/her spouse would pay \$6,224 in annual premiums. These kinds of payments move many workers into the ranks of what experts call the "underinsured," defined as those who have insurance coverage but still face substantial out-of-pocket payments for their health care.

#### *Substandard Pensions*

In place of defined benefit pension plans, contractors offer defined contribution 401(k) plans. These plans do not require employers to match contributions made

by employees. The maximum matches that Sodexo and Mid Columbia provide are far inferior to the pension contributions previously made under the aegis of the school district. Reflecting concerns over these plans, only half of the workers we surveyed who are working for the contractors in Lincoln County have chosen to contribute to their 401(k)s.

#### *Lower Morale*

Although some workers expressed satisfaction with working conditions under the contractors, many cited a loss in morale and spirit. The primary source of these concerns was the higher costs that workers are now paying for health care and the sharply reduced retirement benefits available to them under the contractors. These concerns are reflected in our calculation of the annual wage and benefit loss that an entry-level bus driver would experience as compared with what he/she would have received as a school district employee. We calculate this loss to be nearly \$6,800.

#### *Community Consequences*

In addition to the personal impact of contracting out, there is a broader social impact. Workers who earn lower wages contribute less to the local economy as both consumers and taxpayers. The implications of reduced health care and retirement benefits suggest additional social costs that not only affect the lives of the workers involved but also influence the quality of life in their communities. As the second largest employer in Lincoln County, the school district is a pacesetter as far as wages, benefits, and living standards. In an area that is struggling to create family wage jobs and raise incomes that have consistently

failed to keep pace with state and national averages, Lincoln County's decision to contract out carries a host of unintended consequences and imposes a series of social costs with longer-term implications.

## **II. Sale of School Bus Fleets to Private Contractors Yields Questionable Benefits for School Districts and Taxpayers**

### *Dramatic and Questionable Increase in Bus Purchasing Under Contractors and Sales of Bus Fleets at Discounted Prices*

Both the Lake Oswego and Rainier school districts sold their entire bus fleets to private contractors within the past two years. In both districts, older buses that had passed state inspections and remained reliable means of pupil transportation appear to have been sold to private contractors at sharply reduced prices that do not reflect their true value to the district. These buses are then being replaced by an accelerated purchase of new busses that become the private property of the contractors, not the districts. Although these new bus purchases serve the interests of contractors, they may constitute an unnecessary expense and arguably do not represent the best interests of school districts, taxpayers, and communities. At a time when districts are struggling to conserve scarce resources, purchasing unneeded buses may represent a significant diversion of school finances.

### *Questionable Use of Public Funds to Buy Buses On Behalf of Private, For-Profit Companies*

In both Rainier and Lake Oswego, the costs for new buses purchased by contractors are apparently being factored into mileage and hourly charges that the school districts

pay for transportation service. These charges are then being submitted to the state for reimbursement. However, state regulations only permit reimbursement to school districts for bus replacement costs when districts themselves own their fleets. Therefore, by folding capital expenses into operating budgets, it appears as if Rainier and Lake Oswego may be evading the intent of state regulations and are relying on taxpayers to subsidize private contractors' purchase of new buses.

### *Questionable Use of Bus Replacement Reserve Funds as General Fund Revenue*

Under Oregon Department of Education policy, the state compensates school districts for 70 percent of the cost of new bus purchases. Districts receive reimbursement over a ten-year period, and this money is deposited in a bus replacement fund designated for this purpose.

In both Rainier and Lake Oswego, after fleets were sold to private contractors, the school districts absorbed their remaining bus replacement funds into their general budgets. Although this procedure is permissible under state regulations, it may warrant further examination as to whether it constitutes sound public policy.

### *Questionable Financial Arrangement in Lake Oswego at Expense of Taxpayers*

Lake Oswego's contract with Laidlaw Transit provided that the company pay the school district \$1 million for purchase of a bus fleet whose value was appraised at \$650,000. In effect, this arrangement resulted in Laidlaw loaning the district \$350,000 (an amount that grew to \$400,000 with interest) that was to be paid back in contract fees over a five-year period. This loan, which did



not cover any specific service, was then submitted to the state for reimbursement as "transportation services." As a result, Oregon taxpayers assumed 70 percent of this burden, or \$280,000 in costs for repayment of this loan. This transaction is of questionable propriety and, if found inappropriate, would result in less savings for the school district under its contract with Laidlaw.

Our research suggests that the sale of bus fleets by school districts to private contractors raises important ethical and legal questions that warrant further examination. Bus fleet sales also appear to contain hidden costs that diminish the financial benefits of contracting out and limit the ability of school districts to bargain effectively with their contractors.

### III. Quality of Service Problems Emerge in Lincoln County and Rainier

Our research did find several instances of concern related to the quality of service provided by private contractors. These concerns include the following:

- Lincoln County and Rainier both terminated their custodial contracts due to persistent complaints about the quality of service. The fact that both of these terminations involved custodial services suggest that private firms may have particular difficulty meeting the complex, multiple demands associated with this occupation.
- In 2004, Lincoln County replaced SBM Cleaning Services with Sodexho as its custodial services provider. Sodexho has reported a 25 percent turnover rate among its personnel, a rate much higher than that under school district management, and

several complaints have surfaced regarding the quality and consistency of service. Our Lincoln County interviewees also reported problems with cleaning materials and equipment used by the company that have affected the quality of service.

- There have been complaints from teaching staff in Lincoln County about the quality of Sodexho's breakfast program. Specific concerns have been raised about the protein and caloric content of the breakfasts served by the company, and it has been suggested that the need to generate revenue may mean that the interests of children are being shortchanged.

### IV. Projected Savings Have Not Fully Materialized or Have Been Overestimated

- Sodexho's food service operation promised a "guaranteed return" of savings to the Lincoln County School District. These savings, however, did not materialize from operational efficiencies as predicted and instead had to be subsidized by Sodexho. As a result, Sodexho has negotiated lower rates of "guaranteed return" to the district in each subsequent year of its food service contract.
- Projected savings from contracting out custodial services in Lincoln County seem to be inflated. The district appears to have overestimated what it would have cost to keep custodial operations in-house, projected higher future costs than past budget allocations indicate, and failed to account for costs that the private contractor should have assumed but instead have been shouldered by the school district.



- Under private contractors, the purchase of new buses has increased sharply and, in our view, unnecessarily. Savings attributed to contracting out transportation services in Rainier and Lake Oswego at least partially result from these districts passing the cost of these accelerated new bus purchases on to the state for reimbursement. These “savings,” however, result more from state subsidy rather than contractor efficiency and shift costs to Oregon taxpayers who assume responsibility for financing this arrangement. And as we found in Lake Oswego, if the “savings” due to the state subsidies for new bus purchases were not included in the districts’ cost/benefit analysis, the cost savings of privatizing transportation services would substantially decrease.

#### V. Oversight and Monitoring of Contractor Performance Found Lacking

After school support services have been contracted out, school districts still need to monitor contractor performance and provide school boards and the public with sufficient information to evaluate the quality of the services they are receiving. However, most of the districts we studied receive no regular written evaluations or reports on contractor performance. The Rainier School District was a notable exception in this regard. Without written reports and systematic evaluation procedures, we are concerned that school boards and the public are not receiving the information necessary to assess the performance of contractors and make informed judgments about its quality and cost-effectiveness.

Also, the amount of time that already busy school administrators can devote to oversight of contractors appears to be

limited. For example, in Lincoln County, a district that has shifted transportation, food, and custodial services to private contractors, the business manager is now responsible for overseeing work that had previously been distributed among five full-time managers. We also see the need for school districts to allocate more time for administrative oversight and rigorous monitoring in order to ensure that contractors are meeting their obligations.

• • • •

This new analysis of contracting out of school support services confirms many of the concerns we expressed in our initial study. Whether the issue be social cost, the calculation of savings, contractor performance, or school district oversight, our research underscores the continuing need for school boards, school districts, and the public to insist on careful scrutiny and exercise due diligence in assessing the claims of private contractors and the quality of their performance.



# Executive Summary

**F**aced with the ongoing prospect of diminished funding from the state, school districts throughout Oregon have been struggling to balance their budgets while continuing to provide students with a quality education. For a growing number of districts, hiring private contractors to manage and staff school support functions such as transportation, custodial, and food services has been presented as a possible cost saving option. With state funding for K-12 education likely to remain flat for the foreseeable future, pressures to consider contracting out are likely to continue and more districts will have to evaluate the merits of shifting from public to private provision of school support services.

both the potential benefits and liabilities of contracting out?

During our research we have examined government reports, school budgets, requests for proposals (RFPs), and private contracts for school support services, with a special emphasis on the five districts that contracted out support services in 2003. We have reviewed the national literature on contracting out, surveyed workers whose jobs were contracted out in the past year, and interviewed school officials, school board members, parents, workers, union leaders, and state agency personnel who oversee school support services.

• • • •

Here are our principal findings:

## I. Contracts for School Support Services May Not Deliver Promised Services and Savings to School Districts

In case studies of three contracts reached between school districts and private companies in 2003, we found that districts either incurred significantly greater costs or received significantly lower savings than school board members had initially anticipated. Even contracts that “guaranteed” savings to school districts often failed to deliver on that promise.

• *In Rainier*, two clear problems of calculation—an inadequate accounting for bus depreciation reimbursement and an improper allocation of FTE for

This report seeks to provide school boards, parents, and the general public with information and analysis that will assist them in determining whether or not contracting out is an appropriate option for their district. In the event school districts decide to contract out, we provide recommendations aimed at ensuring that taxpayer dollars are well spent and the quality of school support services is maintained. We have especially focused on the issue of cost, which is one of the central issues in the debate over contracting out. We posed the following questions:

To what extent will switching to a private contractor save money for a school district?

What are the longer-range costs to workers and communities that need to be considered in addressing

► This report seeks to provide school boards, parents, and the general public with information and analysis that will assist them in determining whether or not contracting out is an appropriate option for their district.

secretarial support staff—reduced the anticipated savings of \$57,000 per year to nearly zero. Also, depending on how one accounts for future bus depreciation and replacement needs, the school district may actually face higher long-term costs than those they would have incurred had the service remained in-house.

- *In Lincoln County*, the contractor for food services appeared to promise that the school district would receive a guaranteed return of \$115,000 in addition to the \$80,000 surplus it had carried over from the year before. Instead, it seems more likely that the district will receive only \$78,000, plus lose half of its carry-over surplus. Together, the combination of a smaller return, unforeseen management costs, and reduced surplus represents a total loss to the district of \$107,000 compared with what it expected to obtain from its agreement with the private contractor.

Lincoln County's custodial services agreement permitted the contractor, rather than the district, to determine the scope of services to be provided. The agreement also allowed additional costs to be passed on to the district above and beyond a "guaranteed" price and set low standards for employee qualifications.

In addition to these serious loopholes, our analysis suggests that the projected savings the district was to have received were greatly exaggerated. The fact that Lincoln County terminated this contract six months after its approval attests to fundamental flaws in its agreement with the private contractor.

## II. Contracting Out Carries a Hidden Social Cost That Affects Both Workers and Communities

Our research found that private contractors tend to reduce wages and benefits substantially when they assume management of school support services. A review of the five school districts that contracted out in 2003 found:

- Of the 49 workers we surveyed whose jobs were privatized in 2003, slightly over half opted to work for the contractor. Only one of the workers who found a new job was earning a higher rate of pay than he/she had enjoyed previously, and most took wage cuts of 10–25 percent in their new positions.

- Although contractors often grandfather incumbent workers who elect to remain with the school district, they pay new hires anywhere from 10 to 40 percent less in hourly wages than these workers would have received as school district employees. Also, the agreement to maintain the employee's previous wage is generally guaranteed for only the first year after privatization.

- The private contractors we surveyed offered health care benefits that were more expensive and provided less coverage than workers had received when employed by school districts.

- In place of PERS (the state Public Employees Retirement System), contractors offered less generous 401K plans that featured limited employer contributions and required employees to assume primary responsibility for saving for their retirement.

- Using wage comparisons for contracted and noncontracted custodial services in Lincoln County as a basis for estimation, we calculate for every 25 jobs that are contracted out, there is a loss of \$165,000 in wages to local employees, a loss of \$18,000 in state income tax revenues, and a loss of \$233,000 in money that would have been spent in the local economy. These figures suggest the demonstrable impact contracting out can have on a local economy, an impact that can be especially pronounced in communities where the school district is a primary source of employment.

- Contractors often claim that high percentages of incumbent workers opt to work for the private employer after jobs are contracted out.

In some districts, however, we found that less than half of the former school support employees elected to remain with the contractor.

- In another case, the contractor only offered employment to one-third of the incumbent employees. Other evidence suggests considerably higher turnover among contracted employees, in contrast to school districts where retention levels are markedly more stable. Higher rates of turnover may affect the quality of the services being provided.

### III. National Data Reveals Chronic Problems Experienced by Some Districts Who Have Contracted Out

A review of the national experience with privatization reveals a series of recurring service-related problems in some school districts where contracting out has occurred:

- Problems with the quality of staff regarding qualifications, training, motivation, and retention.
- Problems with food safety associated with food bars and “a la carte” sales.
- Problems with food quality caused by use of central kitchens and warmed-over food.
- Problems with transportation service: late arrivals, missed routes, missed meals, and missed classes.
- Problems with quality of custodial service: insufficient cleaning, untrained personnel, unmaintained systems, and unfixed problems.

### IV. Recommendations to Help School Boards and the Public Exercise Due Diligence in Considering the Appropriateness of Contracting Out

#### *Prequalification of Bidders*

Many public agencies across the country have adopted a procedure for “prequalifying”

responsible bidders. This procedure entails requiring extensive background information on contractor performance and standards that can be used to determine a more select pool of truly “responsible bidders.”

The board can then invite this group of contractors to bid on an RFP and choose the lowest bid from among this prequalified group. The information to be requested might include the following:

- Any contracts cancelled by school districts.
- Any litigation regarding contracted services.
- Any fines, penalties, warnings, or negative reviews by district or other public officials.
- Any employees fired for criminal activities or other activities affecting interaction with schoolchildren.
- Any disagreements over contract interpretation that were settled through arbitration.
- Reports of customer complaints.
- Any reports of drivers found to have motor vehicle violations.
- Record of all food safety, food health, or food-borne illness issues or complaints—whether formal legal complaints or informal complaints from students or parents, and regardless of how the complaints were ultimately resolved—at schools operated by this contractor over the past five years.

#### *Model Contract Language*

In order to help school districts avoid falling victim to hidden or unforeseen pitfalls that may endanger students, degrade the quality of services, or impose significant unanticipated costs, we offer the following recommendations for model language to be used in agreements with private contractors:

