All Costs **Considered III**:

Further Analysis on the Contracting Out of School Support Services in Oregon

Gordon Lafer, PhD
Bob Bussel, PhD
Jaxon Love, MBA

Labor Education and Research Center
University *of* Oregon

February 2013

Acknowledgement

The authors wish to thank the **Oregon School Employees Association** *for providing financial assistance for this report.*

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Introduction

to "All Costs Considered III: Further Analysis on the Contracting Out of School Support Services in Oregon"

"All Costs Considered III" marks an extension of two previous studies conducted by the Labor Education and Research Center (LERC) that examined the transfer of school support services (transportation, custodial, food service) to private operation in the state of Oregon. In our ongoing analysis of contracting out (also known as "privatization"), we have been guided by a similar set of questions. Does the shift from public to private management actually deliver promised or predicted savings to school districts? What is the personal impact of contracting out on workers who provide school support services, and what is the social impact on their communities? How does contracting out affect the quality of service for students and their families? And how can school districts perform their due diligence in weighing the potential benefits and potential costs that accompany decisions to privatize support services? In our previous studies, we found substantial evidence that the proposed savings from contracting out often failed to materialize. We also found a personal cost to workers and a social cost to communities that resulted from reduced compensation and benefits for employees working under private contractors.

▸ This study is an extension of two previous studies conducted by the Labor Education and Research Center (LERC) that examined the transfer of school support services to private operation in the state of Oregon. The focus of this study is on student transportation services, which has perhaps become the most active arena for contracting out within school districts.

Since our previous research in 2004 and 2008, several important developments have occurred that have influenced the focus of this new study. During its 2009 session, the Oregon Legislature passed a law (ORS 279B) requiring that public agencies conduct a rigorous cost-benefit analysis before they decide to contract out a given service. The law stipulates that budgetary savings resulting from this administrative transfer cannot come solely from reduced wages and benefits for workers employed by a public entity. In other words, the cost-benefit analysis must demonstrate privatization will save money and that some portion of the predicted savings derives from efficiencies other than lower compensation for employees.

We have chosen to focus this new study on student transportation services, which has perhaps become the most active arena for contracting out within school districts. In the fall of 2007, an important development occurred in the student transportation world when First Group, a United Kingdom-based transportation company, acquired Laidlaw International, the largest school transit company in North America. This purchase made First Group's United States subsidiary, Cincinnati-based First Student Inc., the nation's largest provider of school transportation services. According to a 2011 article in *School Bus Fleet*, First Student now has over 1,500 contracts with school districts in the United States. The company has continued to acquire other bus contractors throughout the U.S. and is likely to expand its efforts to attract outsourced business from school districts. In Oregon, First Student currently has contracts with 39 of the state's 198 school districts. The second largest provider of student transportation services, Pendleton-based Mid-Columbia Bus Company, serves 31 Oregon districts, and eight other private companies also have contracts to provide transportation services in Oregon. Since our previous study, six new school districts in Oregon have engaged private contractors to provide transportation services. Even with these increases, Oregon remains close to the national average for bus contracting, with nearly two-thirds of its school transportation remaining under public rather than private management.[1]

School districts' view of support services have also been shaped by broader economic developments that have occurred since we conducted our previous study. The deep recession of 2008 has had a powerful impact on many school districts that already were struggling with budgetary challenges. Because of the slow economic recovery and much lower tax revenue, districts throughout Oregon have grappled with persistent budget shortfalls and have had to make painful decisions to reduce school days, eliminate or trim student services, freeze or lower compensation for school employees, and sometimes lay off support staff and teachers. These circumstances are not likely to improve in the immediate future. Accordingly, we expect that continuing budget exigencies faced by school districts, along with the desire of private contractors to expand, may prompt more districts to consider contracting out transportation and possibly other school support services.

It is this changed context that has led us to focus much of this study on the June 2011 decision by the Central Point School District to contract student transportation services to First Student. Central Point is the first Oregon school district that elected to privatize a service under the provisions of the new state public contracting law. Given the new reporting requirements mandated under the 2009 statute, the Central Point experience offers an important opportunity to examine whether school bus privatization can generate significant savings from sources other than reduced compensation for school employees.

As we have done in our previous studies, LERC researchers conducted interviews with bus drivers previously employed by the Central Point School District to ascertain how the switch to a private contractor had affected their working conditions and standard of living. In addition, we conducted a detailed examination of the terms of contracting out in Central Point in order to assess the extent to which this contract meets the standards set by state law. We also offer additional analysis of bus contracting in the Rainier and Lake Oswego school districts to determine the costs and benefits of privatization that may only become evident over a longer time period. We conclude by offering some recommendations to school districts and communities that may assist them in complying with the requirements of the new public contracting law and exercising appropriate due diligence when they consider both the benefits and costs of outsourcing.

“A Big Impact on Longtime Employees”

The Personal and Social Cost of Contracting Out Transportation Services in Central Point

When school boards and school districts weigh the possibility of contracting out support services, they often acknowledge the potential impact of outsourcing on current employees. This subject emerged repeatedly in the spring of 2011 when the Central Point School District (CPSD) decided to issue a Request for Proposals (RFP) for private companies to take over its transportation services. During its deliberations, the school board issued a “brief” that identified the “strengths” and “weaknesses” of four different scenarios for providing student transportation services. Under the scenario that would completely shift bus service from the school district management to a private contractor, the brief mentioned “employee anxiety and disruption over outsourcing operations” as a potential “weakness.” After the CPSD school board voted on June 15, 2011, to contract out transportation services to First Student, board chair Kerry Bradshaw told the Medford *Mail Tribune* that “this was not an easy decision and not one board member wanted to do this because it has such a big impact on longtime employees.”[2]

▸ Workers employed by contractors typically suffer noticeable declines in their standard of living, including reduced wages, substandard health and retirement benefits, and the loss or curtailment of other benefits that provided workers and their families with a sense of security and well-being. Communities also incur a social cost through reduced purchasing power and the loss of other benefits associated with stable, middle-class jobs.

In previous studies published in 2004 and 2008, LERC researchers sought to assess and better understand this perennial concern: how does the outsourcing of school support services actually affect the lives of bus drivers, custodians and food service workers displaced by the shift from public management to private administration? To answer this question, we interviewed school support employees in Oregon whose jobs had been outsourced. Our interviews revealed that workers employed by contractors typically suffered noticeable declines in their standard of living, including reduced wages, substandard health and retirement benefits, and the loss or curtailment of other benefits that provided workers and their families with a sense of security and well-being. Beyond the personal cost to workers themselves, we also found that communities incurred a social cost through reduced purchasing power and the loss of other benefits associated with stable, middle-class jobs. These findings appeared consistently regardless of the specific school district, the specific contractor and the specific support service that had shifted to private administration.

Building on this previous work, LERC researchers interviewed CPSD employees in an effort to assess how they had been affected by CPSD's decision to contract out transportation services to First Student. During March and April 2012, we made repeated efforts to contact all of the bus drivers who had been employed by the district. Working from a list provided by the Oregon School Employees Association (OSEA), we conducted telephone interviews with 15 of the 34 bus drivers previously employed by CPSD, achieving a 44 percent response rate. Although our efforts to obtain a higher response were hindered by outdated or inaccurate contact information, our interview completion rate was demonstrably higher than that attained in our earlier studies.

Of the 15 drivers we interviewed, 12 are currently working for First Student, two have found work with other employers and one is unemployed. The percentage of workers who opted to accept employment with the contractor is considerably higher than our findings in earlier studies, perhaps a reflection of the more limited options available in a local economy struggling to recover from the deep and lingering recession of 2008.[3] Exhibiting the longevity characteristic of support staff employed by school districts, our group of respondents had a median seven years of service, ranging from a worker with less than one year to two employees who each had 27 years of service with CPSD. We asked the drivers an extensive set of questions to determine how contracting out has affected their wages, working conditions, and overall standard of living. Although the number of respondents is relatively small, the consistency of their answers and observations suggest that our sample accurately portrays the overall experience of most former CPSD drivers who elected to work for First Student.

Wages

In its RFP submitted to the school district in the spring of 2011, First Student agreed to "grandfather" incumbent CPSD employees who accepted its offer to work under private management and pay them at their current hourly wage. Our surveys confirmed that First Student has largely honored this pledge, with most former CPSD drivers earning the same wage they received under the OSEA contract with the school district. We observed this wage retention policy in our previous studies and it appears to be a fairly standard practice among contractors to maintain pay rates for former school district employees after assuming transportation management. Among the drivers we surveyed, hourly wages ranged from $11.30 (less than one year of seniority) to a maximum of $17.36 for the most senior employee. However, some drivers who took jobs with First Student reported wage loss due to route changes that reduced their working hours. The question of subsequent pay increases also remains uncertain. In its RFP, First Student claimed that driver wages "will increase [at] the start of the school year according to the revenue contract." At the July 30, 2012, CPSD school board meeting, First Student indicated it plans to provide pay increases in the next school year but offered no specifics on exact amounts or how widely distributed these increases will be. Without collective bargaining, this determination remains strictly in the hands of First Student management.[4]

The two drivers who found employment elsewhere reported hourly wage losses of 19 and 28 percent, respectively, in their new jobs. This testimony affirms findings in our earlier research that after jobs are contracted out, support staff members do not find comparable working conditions elsewhere, at least in the short term. Our respondents also report that new drivers are being hired at an hourly rate below what they would have earned under the union collective bargaining agreement. As First Student acknowledged in responding to the CPSD RFP, "new hires will be hired at an alternate wage scale based on other local First Student operations." However, as we will subsequently discuss, these reduced pay scales for new drivers may undercut one of the objectives CPSD outlined in the RFP: "It is essential to the District that the Contractor be able to attract and retain qualified drivers as long as possible."[5]

Several respondents did cite one beneficial change under private management—they are now eligible for unemployment benefits during school breaks and the summer months when they are not working. This option was not available to them as public employees under school district management.

Benefits

Health Insurance

Not one of the drivers we surveyed reported being enrolled in First Student's health insurance plan. In our previous studies, we found that the health insurance benefits offered employees by private contractors differed substantially from the benefit packages provided by school districts. Nonetheless, workers who did not have alternate options (e.g., coverage under a spouse's health insurance) often chose to purchase contractor-provided insurance in spite of acknowledging its limitations. In Central Point, however, workers simply found the health insurance inadequate on almost all counts. They described the plans offered by First Student as "unaffordable," noting that under the company's options employee contributions were too high, the annual allowable maximum for health care costs was too low, co-pays were too onerous and coverage was too limited. When drivers were employed by the district, CPSD paid premium costs up to a capped monthly amount ($1,114 under the 2010-11 collective bargaining agreement with OSEA) and the employee paid the balance, depending on the specific plan and level of coverage. Several drivers described their previous medical coverage as "excellent" and almost all expressed satisfaction with their previous health care arrangements, which also included dental and vision care.

We have asked First Student about the current benefits it provides bus drivers in Central Point, but at the time of this writing we have received no additional or updated information. As a result, we base our analysis on the most recent documents available: a June 11, 2011, email from First Student's director of business development to CPSD's director of human resources and the health care coverage options outlined in the Oct. 1, 2011, "benefit schedule" that First Student provided CPSD.

Under First Student's plans, almost all employees are classified as "part-time" and are required to pay the full premium for much more limited forms of coverage, be it health, dental or vision, placing these vital services beyond the reach of most workers. For example, under district management and the OSEA contract, workers paid between $4 and $25 for most medications, with an out-of-pocket employee maximum of $1,000 per year. Under First Student's plan, they paid $10-$20 for most medications, with an insurer-paid maximum of $35-$200 per month, depending on the plan chosen, and no coverage for non-formulary drugs. The CPSD/OSEA plan contained no deductibles for in-network care, while First Student's plans charged $100 individual and $200 family deductibles for similar care. Most tellingly, the plans offered under the OSEA contract contained no limit on the lifetime maximum benefit paid by the insurer, whereas the First Student plans contained lifetime maximums ranging from $5,000-$25,000 per year. Lifetime limits have been disallowed under the Patient Protection and Affordable Care Act passed in 2010. However, this wide disparity underscores the distinct differences between the CPSD/OSEA and First Student plans. It suggests why no former CPSD bus drivers employed by First Student, at least among those we interviewed, chose coverage under the company's insurance plans.[6]

Retirement

As was the case with health insurance, none of the former CPSD drivers we interviewed who are now employed by First Student opted to participate in First Student's retirement plan. Under school district administration and the OSEA contract, workers were covered under the Oregon Public Employee Retirement System (PERS). CPSD contributed 6 percent of each worker's pay to the retirement accounts of its bus drivers and "picked up" a matching 6 percent contribution from the employee. According to the workers we interviewed and "additional benefit package information" First Student provided to CPSD during the RFP process, the company offers a "401K retirement savings plan" that features a "$250 employer match." Although we lack specific data on the retirement funds accumulated by workers when they were employed by the school district, we assume that many, especially among the most senior employees, were able to amass significant savings for their retirement. However, the stark difference between a defined benefit plan, such as PERS, and a defined contribution plan with such a limited employer match is readily apparent, and it is hardly surprising that none of the drivers we interviewed have chosen to participate.

Leave Time

Another striking disparity between contractor and school district employment lies in the area of holiday pay, sick days and personal leave. Given the challenges many workers face in balancing the demands of work and family life, having time available to spend with one's family, tend to a sick child or recuperate from personal illness is vital in relieving personal stress and enhancing the quality of family life. The drivers we interviewed noted that they received few of these benefits from First Student. According to First Student's benefit package, it only offers employees two paid annual holidays and provides no sick days or personal leave. Under the OSEA collective bargaining agreement with CPSD, workers received ten paid holidays, ten days of paid sick leave (or one day for each month they were employed) and two additional personal days. Workers were also able to accumulate unused sick leave, allowing them greater flexibility in the event of personal or family illness. The limited leave time provided under First Student's benefit package diminishes this flexibility, placing a greater burden on workers in reconciling the demands of work and family responsibilities.

The lack of paid sick leave raises an additional concern. According to recent scholarly research, in response to limited or non-existent sick leave, many workers have embraced the practice of "presenteeism," the tendency to show up for work in spite of illness. Researchers have documented numerous adverse effects that accompany presenteeism, including diminished productivity, prolonged recovery time from illness and the potential for spreading illness to co-workers or clients. The potential safety and health implications of presenteeism, especially in an occupation that places bus drivers in daily contact with children, must be considered as real possibilities in a work arrangement where no paid sick leave is offered.[7]

Working Conditions

We asked workers to compare their working conditions (attention to safety, access to training, availability of resources, tools and supplies and quality of supervision) under school district and First Student management. We offer several caveats in discussing these findings.

We conducted our interviews seven to eight months after First Student assumed management of transportation services in CPSD, and it is quite possible the company has had insufficient time to implement fully its policies and practices. Many of the workers we spoke to expressed unhappiness with the shift to private management and this disgruntlement doubtless has influenced their evaluation of working conditions under First Student. With these caveats in mind, we offer some tentative observations about issues that emerged during our interviews and the insights they yield in comparing working conditions under CPSD and contractor management.

Although most drivers we interviewed saw relatively few differences in their working conditions under First Student, they did express concern over several changes affecting the conduct of their work. Under CPSD management, drivers performed "pre-trip inspections" of their busses before both their morning and afternoon runs to make sure their vehicles were in good working order. First Student has eliminated the afternoon pre-trip inspection and employs a new device ("Zonar") that drivers are now required to use in conducting inspections. As one driver acknowledged, some of the objections to Zonar may reflect dissatisfaction over having to adapt to a new way of doing things and he admitted that being more "accountable" for one's time could result in greater efficiency. However, several respondents indicated that they felt "micro-managed" due to enhanced computer tracking of their activities and new driver protocols that gave them less "leeway time" when they are running late on their routes. Others suggested that the contractor's emphasis on minimizing route time and limiting overtime could compromise safety by making drivers feel pressured to complete their routes within prescribed and more rigid time limits.

Many drivers did note one demonstrable change in managerial practice that they found especially disturbing: their compensation for training. Previously, when drivers attended trainings for safety and other work-related issues, CPSD paid them at their regular hourly wage. Under First Student, even "grandfathered" employees are paid at the minimum wage when they attend such trainings. Several drivers also noted that they had previously been paid their regular wage when they performed other tasks besides driving (e.g., extra work around the facility) under CPSD management. These tasks are now paid at the minimum wage by First Student. With Oregon's minimum wage currently at $8.95 an hour, this new policy means that drivers receive anywhere from $2.50-$9.00 less per hour when they attend trainings or perform non-driver work. Many of the drivers we interviewed expressed concern over these changes, especially the lower wages associated with training, which in their view diminished its importance and suggested that cost-cutting assumed priority over job preparedness.

The other notable change in working conditions under First Student cited by drivers was the sharp rise in turnover among new hires. Although First Student has not provided systematic data on turnover among new drivers, many respondents described turnover as "huge" or "very high," which they attributed to low starting wages, limited benefits and inadequate hours. There is "no loyalty with such a low starting wage," one driver pointedly observed. Several drivers noted that while driver turnover had also occurred under CPSD management, it had not been nearly as frequent. Some suggested that because more students lack familiarity with their drivers, service has become less consistent and less secure. These observations by current First Student drivers reflect the findings of our previous studies that employee turnover tends to increase in districts that contract support services. Indeed, several drivers told us that they are poised to leave employment with First Student once better opportunities become available elsewhere. The consistent reports of new hire turnover and discontent among former school district employees now working for First Student suggest that the company's ability "to attract and retain qualified drivers as long as possible," which the school district had outlined as a "essential" objective in its RFP, may remain elusive.[8]

Implications

As outlined in greater detail in the next section of this study, we estimate that CPSD has realized a total of $726,000 in annual savings exclusively through reduced employee compensation costs. Behind these numbers, we discovered distinct personal and social costs associated with the decision to contract out. During our interviews, drivers explained how their standard of living had changed over the past eight months and its impact on their families. We also believe that these dramatic changes in job conditions have broader social implications that warrant consideration.

Personal Cost

In the graph shown below, we offer a quantitative estimate of the cost to former CPSD drivers now employed by First Student based on reduced sick, vacation and personal leave, along with the loss of employer-paid premiums for health care. We used $14.47 as an hourly wage for our estimate. $14.47 was the hourly wage paid workers with at least seven years of service under the last collective bargaining agreement between CPSD and OSEA, and seven years is the median length of service among the drivers we interviewed. We used six hours as an average work day for most bus drivers.

To be sure, the impact of contracting out has

Summary of Employee's Financial Loss of Paid Leave and Health Benefits

Description	CPSD Benefit	Annual Dollar Value to Employee
Health Insurance	Premiums up to $1,114 per month paid by CPSD	$13,368
Paid Sick Leave	10 days sick leave	$868
Paid Holiday Leave	9 paid holidays per year	$781
Personal Days	2 paid personal days	$174
Total Annual Loss to Employees	**Health care and 21 days of leave**	**$15,191**

varied from driver to driver. There are drivers that have obtained health insurance for themselves and their families through their spouses. Some were able to retire and others report they will do so soon. Nonetheless, we found clear evidence that for most drivers, the loss of school district employment has led to demonstrable deterioration in their personal and familial well-being.

One employee who had found employment elsewhere estimated suffering a $5 hourly loss in total compensation. Another observed that [some fellow employees] "had to scramble to find health care coverage" after the district contracted transportation services. Several respondents reported foregoing doctor visits due to their no longer having affordable health insurance. Workers repeatedly lamented their loss of benefits and described low morale among former CPSD drivers now working for First Student. As one worker concluded, "I don't see a future in terms of retirement and benefits." This worker also saw "no prospect of raises" and asserted that he "could use an incentive to stay." And based on the increased turnover they have witnessed among newer drivers, many of our respondents suggested that CPSD's ability to "attract and retain qualified employees" under private management will remain an ongoing challenge.

Although they did not universally praise CPSD management or the union that once represented them, most of the workers we interviewed regarded the school district as a "good employer" and appreciated the role that collective bargaining played in shaping their working lives. Indeed, CPSD officials openly acknowledged the potential impact that contracting might have on workers' standard of living, their morale and the quality of service for the school district. As CPSD superintendent Randy Gravon observed in a March 9, 2011, interview, "one of the strengths of having your own busing is you have loyalty and longevity. Noting the painful choices facing a district with a $5 million budget shortfall, Gravon acknowledged: "These are not good things to do in terms of people."[9] Our interviews confirm the superintendent's concerns and reflect the findings of our previous studies showing that school support employees tend to suffer substantial economic losses and a diminished quality of life when their jobs shift from public to private operation.

Social Costs

The contracting of bus drivers' jobs in CPSD also occurs in a broader social and community context. The CPSD is in Jackson County, located in southern Oregon near the California border. Virtually all of the drivers employed when transportation was under the aegis of CPSD lived in Jackson County communities, as do most of the drivers we interviewed who currently work for First Student. Once a regional economy based on the timber industry, Jackson County now relies on a more diverse set of occupations to provide employment, with the highest percentages of workers employed in education and health services (17 percent), retail (16 percent), leisure and hospitality industries (12 percent) and local government (10 percent). The county consistently struggles to build an economy that will provide workers, families, and communities with a decent standard of living, a struggle aggravated by the expiration of legislation providing federal payments for reduced timber logging due to environmental regulation. Indeed, encountering budget pressures similar to those faced by the CPSD, Jackson County commissioners voted in 2007 to outsource operation of the county's libraries to a private company, a move that captured national attention.[10]

Jackson County's unemployment rate (10.4 percent in June 2012) and its percentage of residents below the poverty level (14 percent according to 2010 census figures) are consistently above statewide averages, and according to an April 2011 Oregon Community Foundation study, 19.2 percent of Jackson County's residents lack health insurance. Moreover, according to the "Living Wage Calculator" developed by Amy Glasmeier of the Massachusetts Institute of Technology, two of the county's top three industries (retail and leisure/hospitality) pay less than the income required to meet basic living expenses (e.g., food, child care, medical care, transportation and housing). This brief economic snapshot of Jackson County underscores the vital importance of retaining jobs that pay wages and provide benefits sufficient to sustain a basic level of personal and family security. Although various constituencies debate appropriate strategies for attracting and retaining family-wage or family-sustaining jobs, there is a broad social consensus on their importance to local and regional economies, and Jackson County's commissioners have actively aided efforts to promote them.[11]

It is this context that suggests the broader social implications of the CPSD's decision to contract out its transportation services. Under school district operation and a collective bargaining agreement, CPSD bus drivers had jobs that provided them with living wages and family-sustaining benefits. These jobs have now been transformed under private management, lacking the elements (health insurance, retirement benefits, leave time and prospects for wage increases) that rewarded work, encouraged loyalty and longevity, and created close ties between bus drivers and the community. As one driver described it, "we had a reason to do a good job."

As CPSD board members and the superintendent repeatedly observed during the RFP process, they acted under budgetary duress and regretted the potential impact of their decision on incumbent employees. Nonetheless, there is a broader social cost that the district has perhaps unwittingly incurred. As economist and public intellectual Robert Kuttner has observed, there has been a pronounced social trend away from "regular jobs with reliable wages, benefits and terms of employment" toward a "casualization" of labor (e.g., temporary employment, contracted employment) devoid of the understandings and protections that previously allowed jobs to provide a measure of security and stability for workers. We repeat an observation from Harvard professor Christopher Jencks referenced in our 2008 study that addresses the phenomenon described by Kuttner. Noting that private and public entities continually face choices between "low road" and "high road" approaches to economic development, Jencks reflected: "Which road a firm takes depends on the social context in which managers operate. They are more likely to take the high road if they are connected to institutions, public and private, that promote such alternatives."[12]

Viewed in this context, CPSD's decision to contract out transportation services raises important questions about whether it is sound public policy to reinforce low-road approaches by downgrading good jobs in a struggling regional economy eager to attract and retain them. Based on our interviews with CPSD bus drivers, we believe these questions deserve careful consideration in the cost-benefit analysis that school districts conduct when they contemplate contracting out support services.

Assessing Privatization

School Busing in Central Point

▸ The current report focuses on Central Point School District's decision to contract out student transportation to First Student Inc., the first instance of privatization to take place under the terms of a 2009 Oregon law that requires a rigourous cost-benefit analysis before a school district can contract out any support service. The Central Point case offers a unique opportunity to examine whether school bus privatization can actually generate significant savings from sources other than wage and benefit cuts.

Background and Context

Twice over the past decade, University of Oregon faculty members associated with the UO Labor Education and Research Center (LERC) have evaluated the cost-effectiveness of contracting out school support services.[13] In those earlier reports, LERC faculty reviewed decisions to privatize the provision of transportation, food and custodial services to Oregon school districts. In each of the cases we examined, local district officials promised that contracting-out would save districts many hundreds of thousands of dollars. Our detailed analysis of contract terms and performance showed that the promised level of savings was never realized, and in some cases, the costs of contracting out exceeded the costs of keeping the services in-house.

In 2009, based partly on the evidence uncovered in those earlier reports, the Oregon Legislature adopted ORS 279B.030, which for the first time required that before contracting out any support service, school districts must conduct a rigorous cost-benefit analysis proving the district would indeed save money through privatization and that the savings would not be derived solely from lower wages and benefits for local employees.[14]

The current report focuses on the first instance of privatization to take place under the terms of the new law: the decision of the Central Point School District (CPSD) to eliminate its in-house school bus service and contract with First Student Inc. to provide this service. Given the reporting requirements mandated by the new statute, the CPSD case offers a unique opportunity to examine whether school bus privatization can actually generate significant savings from sources other than wage and benefit cuts.

The discussion that follows examines the CPSD decision in detail, starting with the procedural question of whether the district's cost-benefit analysis complies with the new state requirements, and then focusing on the substantive questions of whether CPSD is likely to save money through this decision — and, if so, whether such savings are based on wage and benefit cutbacks as opposed to other sources of innovation or efficiency.

Our analysis suggests that

the CPSD has not met the procedural requirements for a thorough and transparent cost-benefit analysis as prescribed by law.[15] More importantly, we find that a careful examination of the record shows that the district's contract with First Student clearly fails to meet the minimum standards required under the new statute. Depending on the assumptions one uses, CPSD's privatization of school busing may have resulted in a modest net gain or net loss for the district. However, there is no question that — to the extent privatization saved the District money — these savings were entirely derived from wage and benefit cuts for bus drivers.

Prior to publication, a draft copy of this report was provided to CPSD's financial services manager. The analysis below draws on multiple data sources and includes detailed financial analyses of the District's transportation operation and its contract with First Student. The entire report was therefore provided to CPSD with the request that District officials identify any facts in the report that they believed to be inaccurate.

In addition to the Central Point analysis, this report also provides a follow-up analysis of earlier decisions to privatize school transportation services in the Rainier and Lake Oswego school districts. When school districts decide to contract out transportation services, the cost-benefit analysis is usually based on costs incurred during the first contract only. However, districts may face more onerous costs in subsequent years following the first contract. For instance, districts often benefit from a one-time infusion of cash when they sell their bus fleets to a contractor; this income may be included as a benefit in the initial contract but will not be repeated in future years. In addition, school districts are in a weaker bargaining position when they prepare to negotiate a second five-year contract, since — having already sold off their fleet of buses — they have little choice but to contract with one or another of the private service providers. After spending five weeks reviewing the report, district officials did not identify a single fact they deemed incorrect — although they disagreed with the report's policy conclusions.[16]

Our analysis suggests that this weakened negotiating position, along with more lax oversight over the private operation of school buses, may result in significantly increased costs in the years following an initial contract. To be most useful to school boards and state legislators, analyses of the costs and benefits of potential bus privatization must take into account these long-term costs. Our review of the Lake Oswego and Rainier districts' experiences aims at identifying such longer-term costs so they may be properly accounted.

Misleading Presentation to the School Board

In June 2011, the Central Point School Board was presented with a cost-benefit analysis designed to help board members decide whether to retain student transportation as an in-house function or to privatize the service. To guide the board's thinking, district staff prepared a *Board Brief* that outlined four options: continue the district's current practice, outsource transportation to First Student, and two options to keep transportation in-house while purchasing upgraded bus fleets similar to that proposed by First Student. Unfortunately, the numbers presented in this brief did not provide an accurate picture of the costs and benefits of contracting out.

CPSD Business Manager Vicki Robinson told board members that contracting-out would save $380,000 in new bus purchase costs.[17] CPSD Human Resource Director Mike

Exhibit I: Central Point School District *Board Brief* (Page 1 of 3)

Board Brief
Transportation System: Service Deliver Model Selection

The Board is faced with many difficult issues and decisions. Quality decision-making requires the consideration of several pieces of information. Listed below are five questions, when applied to the issues related to student transportation in Central Point School District, may prove valuable.

Note: Timeliness of decision-making is critical, if a change in delivery model is selected.

1. What is or are the specific issue(s) or concern(s) related to the current model?
2. What are the potential answers or solutions to be considered?
3. Will the potential solutions meet the immediate needs and respond to the stated concerns?
4. Are the potential solutions sustainable (Infrastructure, costs, etc.)
5. Of the potential solutions, which one BEST meets the needs of the District and its students within the dynamics identified above.

Listed below are four scenarios related to transportation service delivery models. As noted before, no magic or ultimate advantage is attributable to any single model given that each will have both strengths and weaknesses.

Scenario #1	**Scenario #2**	**Scenario #3**	**Scenario #4**
Continue to operate system in its current configuration	**Continue to operate system in its current format but with a long-term commitment to bus replacement**	**Continue to operate system in its current format but with a long-term commitment to a reduced bus replacement**	**Outsource entire Transportation operation based on RFP requirements**
Approved Budget : $2,386,470 total cost	**Estimated Costs:** Current Budget Plus annual payment of $375,303 **1st year payment on 10 year plan	**Estimated Costs**: Current Budget PLUS annual payment of $490,359**1st year payment on 5 year plan	**Estimated Costs**: Contractor's Estimated costs:$1,734,770 with $146,221 not related to salaries.
Net Expenses: **95.3% "Approved costs" @70%** $**$906,620**	**Net Expenses:** **95.3% "Approved costs" @70%** $1,019,211	**Net Expenses:** **95.3% "Approved costs" @70%** $1,185,369	**Net Expenses:** **95.3% "Approved costs" @70%** $659,039
Strengths Familiarity Requires no additional action beyond current budget adoption Retains staff and provides least amount of employee disruption Maintains total control of operations District retains the option to change service delivery model in the future OTHERS?	**Strengths** Fleet is updated significantly with buses matching current capacities and configuration Links state support more closely to expenditure District retains employees and total control of operations. Minimizes budget spikes due to unplanned vehicle purchases Reduced vehicle maintenance costs Better, safer buses with a smaller carbon footprint and fewer emissions	**Strengths** Fleet is updated with buses matching the RFP proposal submitted District retains employees and total control of operations. Minimizes budget spikes due to unplanned vehicle purchases Reduced vehicle maintenance costs Better, safer buses with a smaller carbon footprint and fewer emissions District retains the option to change service delivery model in the future.	**Strengths** Fleet updated next year and remains updated without additional Board action Provides efficiency and safety features not implemented in current operations at no additional cost, e.g. routing technology, cameras, additional training and efficiencies of scale Provides ongoing built-in service assessments and comparative analysis of operational efficiency Potential one-time cash inflow with unlimited uses from fleet sale

Meunier similarly announced the district would enjoy a net savings of $360,000 by contracting with First Student.[18] These figures were repeated to the press and members of the public and were no doubt influential in the decision to privatize transportation, but they were highly misleading. The savings projected by Robinson and Meunier were

Exhibit I: Central Point School District *Board Brief* (Page 2 of 3)

	District retains the option to change service delivery model in the future. Maintains total control of operations OTHERS?	Maintains total control of operations OTHERS?	Avoids budget spikes due to unplanned vehicle purchases Provides cash flow from facility lease (limited use) Results in reduced liability and PD insurance expenses District retains the option to change service delivery model in the future. Removes employee issues, e.g., recruitment, hiring, testing, retention, PERS, etc. OTHERS?
Weakness Susceptibility to budget spikes for unplanned vehicle purchases and/or major repair Sustainability of current model Ever increasing vehicle maintenance costs for aging buses and availability of parts resulting in an estimated 5% additional annual expense Buses with higher emissions requiring significant retrofit or replacement Older buses do not include additional safety components now required If future sale is considered, the value of the fleet decreases each year. In five years the fleet is estimated to be worth 40% of it's current value Implications of future changes in PERS requirements Does not address any issues or questions related to current service, efficiency, operation and culture of transportation department. Unknown impact of future changes in state support OTHERS?	**Weakness** Requires additional District funds $112,591 **after** state support Requires long-term commitments Potential costs associated with bid/RFP development Possible employee conflicts over new buses Potential negative perceptions related to making bus purchases while laying off staff Possible layoffs resulting form increased vehicle reliability Implications of future changes in PERS requirements Does not address any issues or questions related to current service, efficiency, operation and culture of transportation department. Unknown impact of future changes in state support OTHERS?	**Weakness** Requires additional District funds $402,975 **after** state support Provides replacement buses with a different configuration and reduced capacity, possibly requiring additional units State bus depreciation support is not closely associated in time with expenditures Requires long-term commitments Potential costs associated with bid/RFP development Possible employee conflicts over new buses Potential negative perceptions related to making bus purchases while laying off staff Possible layoffs resulting from increased vehicle reliability Implications of future changes in PERS requirements Does not address any issues or questions related to current service, efficiency, operation and culture of transportation department. Unknown impact of future changes in state support OTHERS?	**Weakness** Preparation costs of Bids/RFPs Does not provide bus replacement with similar "new" units Employee anxiety and disruption over outsourcing operations Requires long-term commitments Possible challenges and legal costs Establishes some limits on local control based on contract Limits District's ability to return to self-op, possibly irrevocable commitment Limited use of existing funds derived from bus depreciation Requires ongoing service review schedules and procedures Unknown impact of future changes in state support OTHERS?

based on a comparison between the cost of contracting with First Student versus keeping bus service in-house, while committing to purchase a fleet similar to that proposed by the company.[19] Unfortunately, however, this calculation contains several significant problems that result in overestimating the benefits of privatization.

Exhibit I: Central Point School District *Board Brief* (Page 3 of 3)

Scenario #1	
Total Transportation Expenditure	$2,386,470
Estimated Approved Costs	$2,274,306
Imbursement rate @ 70%	$1,592,014
	$682,292
Non Approved Costs @ 4.7%	$112,164
Net Dist Expense	**$906,620**

Scenario #2	
Total Transportation Expenditure	$2,761,773
Estimated Approved Costs	$2,649,609
Imbursement rate @ 70%	$1,854,726
Non-approved costs @ 4.7%	$112,164
Net Dist Expense	$1,019,211

Scenario #3	
Total Transportation Expenditure	$2,876,829
Estimated Approved Costs	$2,576,606
Imbursement rate @ 70%	$1,803,624
Non-approved costs @ 4.7%	$112,164
Net Dist Expense	$1,185,369

Scenario #4	
Contractor Estimate	$1,734,770
Estimated Approved Costs	$1,653,236
Imbursement rate @ 70%	$1,157,265
Non-approved costs @ 4.7%	$81,534
Net Dist Expense	$659,039

June 11, 2011

First, the comparison assumes that, even if the district kept transportation in-house, it would adopt the same age limits private industry sets on buses, and thereby would commit to a dramatic increase in the rate of new bus purchases. But there is no clear rationale to support this assumption. Oregon school buses are required to undergo extensive and regular inspection to guarantee roadworthiness and safety standards. As long as buses meet these standards, they can remain in operation no matter how old they are; Central Point and many other districts regularly use buses that may be 15-20 years old, but continue to operate in a safe and efficient manner. Because private companies use buses for commercial purposes during non-school hours, and because they want to be able to sell buses at a higher price in the event a district cancels its contract, they insist on maximum age cutoffs. Thus, CPSD's contract with First Student mandates age cutoffs of 12 years for transit and conventional diesel buses, 10 years for conventional gasoline buses and 8 years for small buses or vans.[20] But there is no reason for the district to adopt these standards if it maintains student transportation as an in-house service. By falsely assuming the district would adopt the age standards of private industry — even if it kept its own fleet — district staff inflated the cost of keeping transportation in-house by $375,000, thereby providing board members with a highly skewed sense of the tradeoffs entailed in privatization.[21]

Secondly, the costs of in-house operation in the *Board Brief* were overstated by using as a baseline the district's budgeted transportation costs for the 2011-12 school year. As is the case in many public agencies, actual annual expenses for most school districts are generally less than what is budgeted at the start of the year. In 2010-11 for instance, CPSD budgeted $13.3 million for school support services, but the district actually spent only $12.2 million — 92 percent of the budgeted amount.[22] If the same pattern held true for student transportation, the real cost of in-house transportation in 2011-12 would be just under $2.2 million — $195,000 below the budgeted amount used in the *Board Brief*. Again, overestimating the cost of in-house service served to overstate the comparative benefits of privatization.

Third, the costs for contracting out were significantly underestimated because they included only those costs that would be charged by the contractor and not those the district would retain in-house. Most importantly, under the First Student contract, the District retains responsibility for purchasing fuel, which was budgeted at $300,000 for 2011-12. This cost was included in the costs for in-house transportation, but was excluded in the scenario for contracting out. This one omission distorted the cost-benefit analysis by $300,000. Similar omissions were made for administrative and other costs the district continues to bear even after contracting with First Student. District officials may have been tempted to believe, once the district contracted with First Student, district staff would no longer have to worry about transportation. However, this assumption is mistaken. As outlined in the RFP, even under the contract with First Student, the district remains responsible for a significant range of transportation management responsibilities, including identifying all students eligible for regular and Special Education bus service; reviewing regular reports and conducting regular meetings to monitor and ensure contractor performance; overseeing route planning, weather contingencies, and student behavior or bus accident problems; and providing maintenance and insurance for the bus maintenance and repair facility.[23] The costs involved in carrying out these duties are included in the estimate of in-house costs, but omitted from the cost of operating with First Student.

Finally, the *Board Brief* ignores the fact that, if transportation were kept in-house and the fleet remained district property, the district would retain a valuable asset at the end of the contract — which it would not have if it sold off the fleet. According to CPSD consultant John Fairchild, if the district had kept its fleet, by 2016 those buses would have still been worth $226,000.[24] In addition, if the district continued its past practice of purchasing two new buses per year (in order to replace aging vehicles), those new buses would likely be worth over $650,000 at the end of the five-year period.[25] Thus, combining the preexisting fleet with newly purchased buses if the district had continued in-house transportation, it would have possessed a fleet worth over $875,000 at the end of the five-year contract period. The loss of this asset must be included in any assessment of privatization; however, it was not included in the analysis district management provided to the Central Point School Board.[26]

Board members reading the *Brief* must have accepted it as a good-faith accounting. Unfortunately, to the extent board members relied on the *Brief* in evaluating the financial benefits of contracting out, they were significantly misled.

As shown in the table below, these omissions fundamentally skewed the board's ability to evaluate the proposal to contract out transportation. In their discussion of the options before the board, district staff focused on a comparison between "Scenario #2" — in which the district would continue to operate transportation as an in-house service, but would adopt "industry" cutoffs for maximum allowable bus ages, and therefore would undertake a greatly accelerated schedule of bus purchases — and "Scenario #4," in which the district would contract out the entire transportation function. It was this comparison that both the district's business manager and human resources director

Table I: Central Point School District: June 2011 *Board Brief* and Corrections

	Scenario #2 Operate system in-house but with "industry" age limits	**Scenario #4** Outsource transportation based on RFP	**Annual Projected Savings, #4 vs. #2**
Gross expenses	$2,761,773	$1,734,770	$1,027,003
Expenses net state reimbursement	$1,019,211	$659,039	$360,172
Undo assumption that district must increase schedule of bus purchases to meet "industry" age cutoffs	-$375,303		
Use actual, not budgeted, costs	-$195,000		
Include fuel costs		$300,000	
Value of fleet as remaining asset after five years		$875,000	
Adjusted gross expenses	$2,191,470	$2,209,770	-$18,300
Adjusted expenses, net state reimbursement	$808,745	$839,491	-$30,746

referred to in declaring that contracting out would save the district approximately $375,000 per year. If we adjust these figures for the omissions detailed above, we see a very different calculus. If we revise the *Board Brief's* estimate for in-house costs — by undoing the assumption of accelerated bus purchases and projecting costs based on actual rather than budgeted expenses — the gross cost of maintaining in-house transportation is reduced to $2.19 million, or just over $800,000 after state reimbursements. By comparison, if we adjust the contracting out option by adding in fuel costs and accounting for the lost value of the bus fleet as a district asset, the cost or contracting with First Student increases to $2.2 million, or almost $840,000 after state reimbursements.[27] Taken together, these corrections suggest that what was declared to be a significant net gain for the district turns out to be a slight net *loss*.

Based on this *Board Brief*, the Central Point School Board voted to terminate its in-house bus service, sell off the district's fleet and hire First Student to transport students. Tellingly, however, district managers did not rely on the *Board Brief* to prove the deal with First Student satisfied state requirements for proving cost savings from functions other than labor costs. Instead, they asked John Fairchild, the same consultant who prepared the analysis for the *Board Brief*, to prepare a separate cost-benefit analysis designed specifically to satisfy state requirements. This analysis offered a completely different set of numbers and projected more modest savings; yet these numbers were equally flawed in their own way.

Interestingly, the *Board Brief* and the Fairchild analysis provided to state authorities are, in one way, companion pieces. The two largest cost categories in school transportation are labor and bus purchases. While the *Board Brief* acknowledged the costs of increased bus purchases that would be required by adopting First Student's fleet standards, it made no pretense that the wages and benefits of bus drivers would be protected. The analysis presented to state authorities, by contrast, assumes drivers' compensation will be held harmless; but it omits entirely the cost of increased bus purchases that would result from privatization. Thus, while these analyses differ, each makes its math work by omitting one of the two major cost categories. What Mr. Fairchild and district staff were apparently unable to do was to show the district could both pay for the type of fleet demanded by First Student as well as maintain wage and benefit standards — and still save money.

Problems with the Official Cost-Benefit Analysis Provided by CPSD for the State of Oregon

According to ORS 279B.033, prior to making a decision to contract out a support service, school districts are required to perform a detailed cost-benefit analysis that includes estimates of costs for employee wages and benefits; equipment, supplies and other materials; planning and training; and miscellaneous other costs.[28]

However, CPSD never provided this level of detail. Instead, the district offered an analysis that aimed to establish the legality of privatization without providing the information required by law.[29] Indeed, the district's cost-benefit analysis does not even attempt to document the actual costs entailed in contracting out. Rather, the CPSD document starts by comparing the district's budget for in-house transportation for the 2011-12 school year with imaginary costs that might be incurred by First Student if they operated in a particularly high-road manner.

The district hypothesized that First Student would offer the same wage and benefits package currently received by district employees — while acknowledging there was no reason to believe First Student would actually maintain employees' wage and benefit standards.[30] But the district reasoned if it could show privatization would save money, even if labor costs were held equal, it would have satisfied the legal requirement of proving savings were not based solely on wage and benefit cuts.

There is reason to be concerned about the professionalism and impartiality of this analysis. The document was not produced by CPSD officials themselves, but by John Fairchild, a private consultant. By his own admission, Fairchild worked regularly through the period 2001-08 for Laidlaw, a major bus transportation company which became part of First Student in 2008. Since that time, he has worked as a paid consultant for First Student, including specifically advising the company on how to respond to the cost-benefit analysis required in ORS 279B.033.[31] Fairchild is a consultant in an industry that counts First Student as its single largest player. It is logical to anticipate he might continue to perform work for the company in the future and thus have a self-interest in not jeopardizing this relationship.

In the year leading up to privatization, CPSD Business Manager Vicki Robinson corresponded extensively with First Student, asking the company to provide the detailed cost breakdown required by law. The company repeatedly refused to provide such details, and First Student representative Tim Wulf complained to Robinson "the legislation was poorly written which is throwing a curve ball at everyone," while assuring her the law was "only a speedbump" on the path to privatization.[32] After several months of correspondence, in January 2011, Wulf emailed Robinson that "we have a better approach to the cost analysis — finally!" From the record of email exchanges, it appears likely the cost-benefit methodology employed by Mr. Fairchild — which avoids disclosing wages, benefits and other cost categories required by statute — may have originated in the offices of First Student itself.

While there is no clear evidence of illegality, the district's seeming collusion with First Student to evade reporting requirements, and the clear conflict of interest in hiring a First Student consultant to analyze the company's contract proposal, calls into question both the professionalism and the impartiality of the analyses presented to CPSD board members and to the public.

Ultimately, John Fairchild crafted an "analysis" that contained virtually none of the financial detail mandated by the new statute, but purported nevertheless to prove the contract would comply with state law. Fairchild projected it would cost $2,386,740 for the district to provide transportation services in-house in 2011-12, compared with a total of $2,280,420 to have the same service provided by First Student. Thus, Fairchild concluded contracting out would save the District $106,000 per year, even assuming employee compensation was held constant.[33]

Correcting the Fairchild/CPSD Model of Cost-Benefit Analysis

In what follows, we revisit Fairchild's cost-benefit analysis using his same methodology but correcting for some costs that were omitted from his calculations. Like Fairchild, we assume First Student will offer the same wages and benefits as employees received from CPSD and then determine whether, under those conditions, the district would

Exhibit II: Fairchild Cost Analysis for ORS 279B.033 (Page 1 of 3)

	A	B	C	D
1	**District's Estimate to Perform Services 2011 Approved Budget**		**District's Estimate to Contract the Services**	
2	District Costs to perform the services: ORS § 279B.033(1)(a) and OAR 137-047-0250(5)(b)		Estimated cost a contractor would incur: ORS § 279B.033(1)(b) and OAR 137-047-0250(5)(c)	
3	Salary or wage and benefit cost		Estimated Salaries: Current Schedule assumed to pass through as per RFP	
4	100.2551.0112.01 1001 REGULAR CLASSIFIED SALARIES	$29,812.00		$29,812.00
5	100.2551.0130.01 1.001 ADDITIONAL SALARIES	$0.00		
6	100.2551.0211.011.001 PERS	$21,491.00	$196,076.00	
7	100.2551.0220.01 1001 SOCIAL SECURITY ADMINISTRATION	$5,229.00	PERS Total	$5,229.00
8	100.2552.01 12.011.001 REGULAR CLASSIFIED SALARIES	$397,975.00		$397,975.00
9	100.2552.0130.011001 ADDITIONAL SALARIES	$10,000.00		$10,000.00
10	100.2552.0211.011001 PERS	$122,266.00		
11	100.2552.0216.011.001 OPSRP	$0.00		
12	100.2552.0220.011.001 SOCIAL SECURITY ADMINISTRATION	$36,565.00		$36,565.00
13	100.2554.0112.011.001 REGULAR CLASSIFIED SALARIES	$96,118.00		$96,118.00
14	100.2554.0211.011.001 PERS	$23,853.00		
15	100.2554.0216.011.001 OPSRP	$0.00		
16	100.2554.0220.011.001 SOCIAL SECURITY ADMINISTRATION	$5,960.00		$5,960.00
17	100.2557.0130.011.001 ADDITIONAL SALARIES	$18,000.00		$18,000.00
18	100.2557.021 1.011.001 PERS	$4,586.00		
19	100.2557.0216.011.001 OPSRP	$0.00		
20	100.2557.0220.011001 SOCIAL SECURITY ADMINISTRATION	$1,377.00		$1,377.00
21	100.2558.0112.01 1.320 REGULAR CLASSIFIED SALARIES	$93,720.00		$93,720.00
22	100.2558.021 1.011.320 PERS	$23,880.00		
23	100.2558.0216.011.320 OPSRP	$0.00		
24				
25	100.2551.0113.011.001 ADMINISTRATORS SALARIES	$54,834.00		$54,834.00
26	TOTAL	$945,666.00		$749,590.00
27	**Material costs**		**Material costs**	
28	100.2542.0322.01 1.091 REPAIR AND MAINTENANCE SERVICES	$1,250.00		
29	100.2542.0324.01 1.091 RENTALS	$3,400.00		
30	100.2542.0325.01 1.091 ELECTRICITY	$6,500.00		
31	100.2542.0326.011.091 FUEL	$4,500.00		
32	100.2542.0327.011.091 WATER AND SEWERAGE	$1,500.00		
33	100.2542.0328.01 1.091 GARBAGE	$2,100.00		
34	100.2542.0410.011.091 SUPPLIES	$1,250.00		
35	100.2543.0322.011.091 REPAIR AND MAINTENANCE SERVICES	$500.00		
36	100.2543.0410.01 1.091 SUPPLIES	$500.00		
37	100.2551.0322.01 1.001 REPAIR AND MAINTENANCE SERVICES	$800.00		
38	100.2551.0324.011.001 RENTALS	$1,000.00		
39	100.2551.0410.011.001 SUPPLIES	$3,000.00		
40	100.2552.Cd10.011.001 SUPPLIES	$1,000.00		
41	100.2552.0359.01 1.001 OTHER COMMUNICATION SERVICES	$2,400.00		
42	100.2552.0322.01 1.001 REPAIR AND MAINTENANCE SERVICES	$1,000.00		
43	100.2552.0653.011.001 PROPER INSURANCE	$55,000.00		
44	100.2552.0659.011.001 Other Insurance and Judgments	$0.00		
45	100.2557.0319.011.001 OTHER PROFESSIONAL AND TECHNICAL SERVICE	$18,000.00		
46	100.2559.0410.011.001 SUPPLIES	$80,000.00		
47	100.2559.041 1.01 1.001 GASOLINE	$300,000.00		
48	100.2559.0413.011.001 TIRES	$25,000.00		
49	100.2559.0414.01 1001 OIL	$3,000.00	Facility Rental	$72,900.00
50	100.2559.0460.011.001 NON CONSUMABLE SUPPLIES	$1,000.00	Cost Savings for this area Estimated at 10%	$572,430.00
51	100.2559.0322.011.001 REPAIR AND MAINTENANCE SERVICES	$90,000.00		
52	TOTAL	$602,700.00		$645,330.00
53				

save money by contracting out bus service. In making this calculation, however, there are five significant corrections we make to Mr. Fairchild's assumptions regarding First Student's non-labor costs.

First, and most importantly, we provide a complete accounting of bus purchase costs. Fairchild's analysis accounts for the cost of purchasing new buses for the district's in-house service, but not for the contractor. If transportation service were kept in-house, Fairchild assumed the district would pay $139,500 in 2011-12 for the purchase of new buses,[34] but he assumes there would be zero cost for bus replacement if the district contracted with First Student. This assumption is simply not plausible. A contractor, just like a school district, must replace buses when they get old. Contractors are not charities and the cost of replacing buses must inevitably be included in their charge.

In fact, we find the costs of bus replacement are significantly greater with First Student than they would have been had the District maintained transportation as an in-house service. This is because private contractors such as First Student insist on replacing buses

Exhibit II: Fairchild Cost Analysis for ORS 279B.033 (Page 2 of 3)

	A	B	C	D
1	**District's Estimate to Perform Services 2011 Approved Budget**		**District's Estimate to Contract the Services**	
2	District Costs to perform the services: ORS § 279B.033(1)(a) and OAR 137-047-0250(5)(b)		Estimated cost a contractor would incur: ORS § 279B.033(1)(b) and OAR 137-047-0250(5)(c)	
54	**Costs related to stopping and dismantling a project or operation**			
55	**Costs incurred in planning for, training for, starting up.**			
56	**Miscellaneous costs**		**Miscellaneous costs.**	
57	100.2542.0329.01 1.091 OTHER PROPERTY SERVICES	$1,200.00		
58	100.2551.0341.011 001 TRAVEL IN DISTRICT	$300.00		$1,200.00
59	100.2551.0342.011.001 TRAVEL OUT OF DISTRICT	$150.00		0
60	100.2552.0319.011.001 OTHER PROFESSIONAL AND TECHNICAL SERVICE	$4,000.00		0
61	100.2552.0342.011.001 TRAVEL OUT OF DISTRICT	$4,000.00		0
62	100.2552.0640.011.001 DUES AN FEES	$500.00		0
63	100.2559.0640.01 1001 DUES AND FEES	$500.00		0
64	100.2558.0240.01 1.320 EMPLOYEE INSURANCE	$80,477.00		$80,477.00
65	100.2558.0231.01 1.320 WORKMENS COMPENSATION	$4,624.00		$4,624.00
66	100.2558.0231.011.001 WORKMENS COMPENSATION	$0.00		
67	100.2558.0220.011.320 SOCIAL SECURITY ADMINISTRATION	$7,706.00		$7,706.00
68	100.2558.0220.01 1.001 SOCIAL SECURITY ADMINISTRATION	$0.00		0
69	100.2557.0240.011.001 EMPLOYEE INSURANCE	$0.00		0
70	100.2557.0231.011.001 WORKMENS COMPENSATION	$785.00		$785.00
71	100.2554.0240.011.001 EMPLOYEE INSURANCE	$26,975.00		$26,975.00
72	100.2554.0231.011.001 WORKMENS COMPENSATION	$4,195.00		$4,195.00
73	100.2552.0240.011.001 EMPLOYEE INSURANCE	$308,436.75		$308,436.75
74	100.2552.0231.011001 WORKMENS COMPENSATION	$22,650.00	These numbers are simply "pass thru" and not substantiated by proposer	$22,650.00
75	100.2551.0240.01 1001 Employee Insurance	$28,758.00		$28,758.00
76	100.2551.0231.01 1.001 WORKMENS COMPENSATION	$1,618.00		$1,618.00
77	TOTAL	$496,874.75		$487,424.75
78				
79	**Anything not included in the above:**			
80	Gross Annual Payment: Bus Replacement			0
81	100.2558.0122.01 1.001 TEMPORARY CLASSIFIED SALARIES	$5,000.00		$5,000.00
82	100.2558.0122.01 1.320 TEMPORARY CLASSIFIED SALARIES	$7,000.00		$7,000.00
83	100.2554.0122.01 1.001 TEMPORARY CLASSIFIED SALARIES	$0.00		
84	100.2552.0122.01 1.001 TEMPORARY CLASSIFIED SALARIES	$70,000.00		$70,000.00
85	100.5200.0710.01 1001 FUND MODIFICATIONS	$139,500.00		
86				
87				
88	100.2541.320 SPED pupil transportation	$120,000.00		$120,000.00
89			Equalization Calculation for PERS	$196,076.00
90	Total	$341,500.00		$398,076.00
95		$2,386,740.75		$2,280,420.75
96				
97			Estimated Savings to the District AFTER including PERS Equalization Factor	$106,320.00
98	**Estimated District Expense**	$2,386,740.75		

much more frequently than school districts normally require. Contractors have strong incentives to insist on newer buses. The buses are the private property of the contractor (even if fully paid for by the district), who is free to use them for transporting gamblers to casinos, fans to sporting events or any other type of customer during non-school hours. In CPSD, First Student has already begun advertising the fleet's availability for "weddings, field trips, corporate transportation, and other group outings."[35] In addition, since contracts last a maximum of five years, contractors may want to ensure they're not left owning a fleet of older, low-value buses when a contract is terminated.

As explained above, there is no age limit for district-owned buses and many remain roadworthy and in operation for 20 years

Exhibit II: Fairchild Cost Analysis for ORS 279B.033 (Page 3 of 3)

	A	B	C	D
1	**District's Estimate to Perform Services 2011 Approved Budget**		**District's Estimate to Contract the Services**	
2	District Costs to perform the services: ORS § 279B.033(1)(a) and OAR 137-047-0250(5)(b)		Estimated cost a contractor would incur: ORS § 279B.033(1)(b) and OAR 137-047-0250(5)(c)	
99	After comparing the difference between the costs estimated for the Contracting Agency to perform the Services and the estimated costs a potential Contractor would incur in performing the Services under section the Contracting Agency may proceed with the Procurement only if the Contracting Agency would incur more cost in performing the Services with the agency's own personnel and resources than it would incur in procuring the Services from a Contractor.			
100				
101	Exception Based on Salaries or Wages and Benefits. If the sole reason that the costs estimated for the Contracting Agency to perform the Services under section (5)(b) exceed the estimated costs a potential Contractor would incur in performing the Services under section (5)(c) is because the average or actual salary or wage and benefit costs for Contractors and their employees estimated under subsection (5)(c)(A) are lower than the salary or wage and benefit costs for employees of the Contracting Agency under subsection (5)(b)(A), then the Contracting Agency may not proceed with the Procurement.			
102				
103				
104				
105	**Amount listed above is mitigated by sale of both new and old buses**			
106	**Actual Annual Payments:**			
107	**Before State Support for Depreciation**	**$490,359**		
108	**After State Support**	**$402,975**		
109				

or more. But private operators insist on replacing all buses on a much stricter timetable, regardless of the bus' condition or roadworthiness. In CPSD, the decision to contract out included adopting strict "industry standard" age limits, as identified in the district's RFP:[37]

- Conventional gas buses: 10 years
- Conventional diesel buses: 12 years
- District approved heavy-duty transit buses: 15 years
- All other transit buses: 12 years.
- Conventional small bus or van: eight years

Imposition of these age limits leads to a dramatic increase in the number of buses the district must purchase. Historically, CPSD replaced its fleet of 35 route buses at a rate of approximately two buses per year. The average age of CPSD buses at the time of contracting with First Student was 14 years, with 24 buses more than 12 years old. Despite their age, the district's route buses passed annual state inspection and were considered operationally sound.

Because the impact of industry age limits may not be fully realized in one five-year contract, we compared in-house and contracted-out bus replacement costs over a 15-year period. If CPSD retained transportation in-house, the district could have continued purchasing two buses per year, plus one additional bus during that 15-year period in order to comply with the Oregon regulations mandating the replacement of diesel buses with lower-emission engines by the year 2025.[38] Over this 15-year period, the district would need to purchase a total of 31 buses, at an annual cost of $153,089 in 2012 dollars.[39]

By contrast, First Student's bid indicates that it will purchase 25 buses in the first year of the contract, to complement the 16 buses it retained from the district's old fleet. In addition, First Student pledged to purchase nine new buses during the life of the five-year contract.[40] Finally, of the 41 used buses that will be servicing the district in 2011-12 (combining holdovers from the CPSD fleet with First Student additions), 10 will reach their maximum allowable age and will need to be replaced within the life of the five-year contract. First Student has pledged to replace all of these with new vehicles.[41] Where the district would have purchased 10 new buses

Exhibit III: CPSD In-House Fleet Replacement Model

Central Point School District, Bus Purchases 2001-10

Year	Purchased	S/R/	Capacity	Type	Fuel
2001	2001	Spare	84	Transit	D
1987	2001	R	71	Conventional	D
1987	2001	R	71	Conventional	D
1988	2001	R	71	Conventional	D
1988	2001	R	71	Conventional	D
1988	2001	OOS	71	Conventional	D
1989	2001	R	71	Conventional	D
2002	2001	R	18	Handi-	D
2002	2002	R	84	Transit	D
2003	2003	R	24	Cutaway	D
2004	2003	R	22	Cutaway	D
2005	2004	R	83	Transit	D
1999	2004	Spare	14	Cutaway	G
2006	2005	R	84	Transit	D
2006	2005	R	34	SPED	D
2007	2006	R	71	Transit	D
2000	2006	R	14	Cutaway	G
2010	2009	R	84	Transit	D

Based on fleet inventory from:
ODE Form 581-2256, Aug. 28, 2010; ODE Form 581-3171, June 30, 2010

between 2011-16, First Student will purchase 25 used buses and 19 new buses, for a total of 44. Again, to capture the impact of industry age limits over time, we calculated First Students' bus replacement needs not just for the first five-year contract, but over the coming 15 years. Assuming the fleet maintains its current size, and each bus is replaced with a new vehicle when it reaches its maximum allowable age — as is mandated by the First Student contract — we project that where the district would buy 31 new buses over the next fifteen years, First Student will purchase 87 new buses. The cost of this greatly increased schedule of new bus purchases totals $371,887 per year in 2012 dollars, or more than twice the cost of maintaining an in-house fleet.[42] Thus, the first step we take in adjusting the Fairchild analysis is to account for this cost.

Secondly, it appears First Student charges the full cost of bus purchases over a five-year period.[43] By contrast, Oregon law mandates the district-owned buses be depreciated over a 10-year period. Faster depreciation costs both the district and the State of Oregon money. Moving up the schedule of payments means foregoing interest earnings on those funds, or paying interest to borrow money that would otherwise still be available. All told, assuming modest interest rates, the cost of paying for First Student's accelerated depreciation schedule — separate from the increased schedule of bus purchases itself — amounts to $42,017 per year.[44]

Thirdly, Fairchild's estimate also exaggerates the savings from privatization by assuming contracting with First Student would save the district 10 percent on material costs. This projection entails two assumptions: first, First Student's size will enable it to purchase materials more cheaply; and second, the company will pass these cost savings on to the district rather than absorbing them as profit. Neither Fairchild, First Student nor CPSD has ever provided evidence supporting these assumptions. In deposition, Fairchild conceded he had no data to support the assumption.[45] In May 2012, CPSD Financial Services Manager Spencer Davenport confirmed he too was unaware of any supporting evidence nor did he possess any evidence that First Student had, in fact, produced such savings in the months since it took over CPSD transportation.[46]

The budget line item for CPSD material costs for 2011-12 (excluding fuel) totals $302,700. Fairchild's assumption artificially reduced the estimate for material costs under the First Student contract by 10 percent, or $30,270. Adding this amount back in helps produce a more realistic assessment of the costs of contracting out.

Fourth, First Student's contract includes mandatory annual price increases of 2.5 percent per year, significantly higher than the rate of increase that the district would likely face if it kept transportation in-house. At first glance, First Student's charge may seem reasonable: the rate of inflation has averaged 2.4 percent over the past decade and the Federal Reserve Bank projects it will average 2.3 percent in the coming decade.[49] However, standard inflation rates overstate the level of cost increases faced by First Student. By far the biggest driver of inflation in recent years has been the price of oil. In 2010-11, for instance, the overall national inflation rate was 3.2 percent, but the price of gasoline during this year rose 26.4 percent. When energy costs are omitted, the rate of inflation for the past decade falls from 2.4 percent to 2.05 percent.[50] Yet under the terms of the contract, the CPSD is responsible for purchasing bus fuel directly and these costs are not included in First Student's per-mile rates.[51] Thus, the inflation rate associated with First Student's operation should be based on the adjusted inflation rate that excludes energy costs. Indeed, this measure — CPI excluding energy — is used in other school transportation contracts. First Student's own contract with the Lake Oswego School District, for instance, provides for annual rate increases based on the CPI excluding energy costs.[52] In CPSD, however, the company has negotiated an annual price increase based on an inflation rate that includes the cost of fuel and thus results in price increases in non-fuel costs above those the district would face if it kept transportation in-house.

Looking again at the coming 15 years, we estimate real inflation in the costs associated with student transportation (excluding fuel) will average 1.95 percent.[53] Thus, First Student's prices will go up slightly more than one-half of one percentage point faster than the price increases the district would otherwise face. This additional cost amounts to an annual total of $17,195 per year in 2012 dollars.[54]

Fifth and finally, the decision to contract-out entails the district forfeiting the asset represented by its bus fleet. Although First Student paid the district to purchase the fleet, the district is repaying the entire cost of that purchase price over the life of its five-year contract.[55] In financial terms, the purchase and pay-back cancel each other out. But by giving up its fleet, the district suffers a net loss equal to the amount its fleet would be worth at the end of the five-year contract. As detailed previously, we estimate this value as approximately $875,000.

When Fairchild's analysis is corrected in just these five simple ways — accounting for First Student's bus purchases and the loss of the district's fleet, including the cost of accelerated depreciation and higher-than-inflation rate increases and eliminating the unfounded assumption regarding savings on material costs — it becomes clear that, if employee compensation standards were maintained, the choice to contract-out transportation would result in a large net loss to the public.[56] Even if the only adjustment made to the Fairchild numbers was to include the costs of First Student's bus purchases, this by itself would show that rather than saving $106,000, the impact of contracting out would be a loss of $265,000. When we include all five of the above the corrections, we see that, if labor costs were held constant, privatization of CPSD's student transportation service would result in a net loss of just over $530,000 per year, or $2.6 million over the life of the five-year contract.

Table II: Corrections to Fairchild Cost-Benefit Analysis

	Annual	Five Year
Privatization cost savings projected by Fairchild analysis	**$106,000**	**$530,000**
Corrections		
First Student bus purchase costs	-$371,887	-$1,859,435
Material costs — no basis for assumed 10 percent savings	-$30,270	-$151,350
Accelerated (five-year) depreciation cost to State of Oregon	-$42,018	-$210,090
Contractor 2.5 percent annual price increase vs. 1.95 percent CPI	-$17,195	-$85,975
Forfeiture of bus fleet	-$175,000	-$875,000
Net result of privatization, holding labor costs constant	**-$530,370**	**-$2,651,850**

Thus, if we follow the methodology that CPSD proposed to state authorities — assuming employee compensation is held harmless — it is clear privatization fails the first test set by Oregon law: it would result in a large net loss to the taxpayers.

Conducting a Fact-Based Cost-Benefit Analysis in Keeping with Oregon Statute

Having followed the district's novel methodology, and discovering that privatization would result in a net economic loss if labor costs were held constant, we now offer a cost-benefit analysis that more faithfully follows the dictates of Oregon law — one that estimates separately the costs for each major category of transportation expenses, both in-house and contracted out, in order to determine whether privatization produces savings, and whether such savings derive from wage and benefit cuts.

First, for the district's in-house costs, we begin with the school district's 2011-12 approved budget, just as Mr. Fairchild did.[57] But we incorporate two important adjustments in order to make the numbers more accurate.

First, we place costs in the appropriate categories so we can clearly distinguish between labor and non-labor costs. Mr. Fairchild's analysis inexplicably categorizes $400,000 of bus drivers' and mechanics' health benefits as "miscellaneous costs."[58] This doesn't affect the ultimate comparison between the overall costs of operating in-house and contracting out, but it does impact the extent to which savings are understood to derive from wage and benefit cutbacks. As will be shown below, First Student provides little or no insurance benefits to its bus drivers and mechanics. Under Oregon law, this $400,000 savings must clearly be accounted for as labor cost savings. By wrongly classifying health insurance as a "miscellaneous" expense, Fairchild's analysis disguises the extent to which cuts in wages and benefits lay at the heart of First Student's business model. Thus, we adjust Fairchild's analysis to put the full cost of employee benefits in the category of labor costs.

Secondly, we use our own estimate of bus replacement costs. As described earlier, we estimate the district's annual bus replacement costs for the five-year contract to average just over $153,000 per year.

Other than those two changes, our estimate of in-house costs for providing transportation is identical to those of Mr. Fairchild.

In estimating the comparable costs of contracting with First Student, we use data from First Student's bid, statements provided by First Student and CPSD representatives in court proceedings related to the contract and evidence gathered in interviews with First Student drivers. Based on these sources, we are able to derive independent estimates for the most important cost categories, including labor and bus purchases. Where we lack independent data for certain smaller cost categories, we follow Mr. Fairchild and use the district's 2011-12 budgeted costs as approximations for First Student's likely costs.

As described above, First Student's insistence on strict age limits for its bus fleets results in dramatically increased costs for bus purchases. We estimate that during the first five-year contract, the choice to privatize transportation is likely to result in total bus purchase costs of $2,383,077, or almost three times as great as the five-year cost of $855,538 if the district had kept the service in-house.[59] Averaged over a longer-term 15-year period, the annual cost for bus replacement under the First Student contract is estimated at $371,887, more than double the cost for maintaining an in-house fleet.[60] As described above, First Student's practice of depreciating its buses over a five-year schedule, rather than a 10-year schedule, makes these purchases yet more expensive for the district by adding approximately $42,018 per year to the cost of the contract, or an additional $210,090 over the life of the five-year contract.[61]

We assume that First Student's material and miscellaneous costs are largely identical to those of the district operation.[62] Like Mr. Fairchild, we note that First Student will be paying $72,900 per year to rent the district's bus shed and repair facility.[63] Unlike Fairchild, we do not assume contracting out results in lower material costs. However, we do project First Student may realize a 5 percent savings in maintenance and repair costs due to the newer condition of its fleet. All told, including bus purchases, we project material costs under

Table III: Bus Purchase Schedules, 2011-16

New Buses Purchased

	CPSD	First Student
Year 1	2	1
Year 2	2	11
Year 3	2	3
Year 4	2	4
Year 5	2	0
Total new	**10**	**19**

Used Buses Purchased

	CPSD	First Student
Year 1		25
Year 2		
Year 3		
Year 4		
Year 5		
Total used	**0**	**25**
TOTAL	**10**	**44**

the First Student contract to be $1,042,809, an increase of more than one-third above the district's total costs of $755,789.[64]

Our estimate of First Student's labor costs is based both on company documents and on interviews with current employees. According to reports from drivers, First Student appears to be providing no funding whatsoever toward health insurance or pension benefits for its drivers. First Student pays 77 percent of the health insurance cost of management, administrative and maintenance personnel.[65] But other than those job titles, employees report that, while the company formally offers a health insurance option, the plan requires that employees pay the full cost of their premiums; as a result, not a single bus driver reported having health insurance through First Student. Likewise, the company offers a 401(k) plan in lieu of a pension plan, with a maximum annual employer match of $250. None of the employees we interviewed report participating in the plan, apparently leaving the company with no financial obligation for retirement benefits.[66] Thus, the best available evidence suggests that First Student has effectively eliminated pension and health insurance benefits for its drivers.

In addition, there is evidence that the company pays significantly lower wages than those offered by the district. Some savings result from reduced average per-hour wages since First Student is currently employing many entry-level drivers who are paid at reduced wage rates. While drivers who transferred to First Student from the district are grandfathered in at their previous wage rates, new hires are reported to be earning lower wages, approximately $10-$11 per hour. It is not known how many new drivers the company has hired, but several employees report there is "huge" turnover among the workforce. In addition, even those higher-wage employees formerly employed by the district, whose hourly rates were grandfathered in by First Student, nevertheless have seen their earnings reduced. They report that First Student's operation includes less regular pre-trip inspections. Not only does this raise safety concerns among some drivers, but it also results in reduced working hours. Wage losses have also occurred in cases where First Student has shortened routes, leaving some drivers with fewer hours on the job. Also, First Student has sharply curtailed the number paid holidays employees receive. Finally, employees report that no matter what their official wage rate, they are paid minimum wage when they attend trainings — a steep cut from the district's practice of paying employees their regular wage rate for all hours they are required to work, including training.[67]

All told, we estimate First Student is saving $726,000 per year — or a total of $3.6 million over the five-year contract — by cutting the wages, health insurance and pensions of employees. This represents a 48 percent reduction in labor costs compared with the compensation received by in-house employees. By cutting compensation almost in half, First Student has created dramatic hardship for bus drivers and equally dramatic economic gain for the company.

Beyond the major cost categories of bus purchases and employee compensation, there are several additional areas where privatization has resulted in additional costs for the district, and we include these in our analysis. As described above, First Student's contract includes annual price increases that rise faster than the costs of an in-house operation. Averaged over the coming 15 years, we estimate these higher price increases amount to a cost difference of approximately $17,195 per year.[68] Finally, the choice to contract with First Student entails the district's giving up its bus fleet. As discussed earlier, we estimate at the end of five years the district's fleet would be worth approximately $875,000. Thus, the decision to contract out includes the cost of forfeiting this asset, estimated at $175,000 per year over the life of this five-year contract.

Taking all of these costs into account, a reasonable cost-benefit analysis demonstrates the privatization of bus services in CPSD fails the second test set by Oregon law. Our calculations (see Table IV) estimate that contracting out will result in a cost savings of $205,339 per year, or just over $1 million over the life of the five-year contract. These savings come entirely from steep cuts in wage and benefit compensation — slashed by $726,573 per year, or $3.6 million over the five-year contract. Indeed, apart from labor, the First Student contract is more expensive than in-house transportation in every other cost category. If we exclude First Students' savings due to wage and benefit cutbacks, privatization would result in a net loss of $521,234 per year, or just over $2.6 million over the duration of the five-year contract.

How do First Student's Actual Invoiced Costs to Date Compare with Our Estimate of the Cost-Benefit Analysis?

As discussed above, our budget-based analysis projected the costs of operating transportation under the First Student contract would total $2,194,990 per year. Based on the first seven months of First Student's operation, we believe this estimate is reasonable and perhaps even conservative. Indeed, First Student's track record suggests its cost to the district is likely to significantly exceed our projection. Table V below shows the charges First Student has invoiced to the CPSD from September 2011 through March 2012. From September through January, these charges averaged $132.639 per month.[69] However, in February the company assumed responsibility for two Special Education bus routes, previously operated by a neighboring school district under contract to CPSD.[70] This led to a dramatic increase in monthly charges for Special Education (SPED) transportation.[71] Assuming that the final five months of the 2011-12 school year will follow the pattern of February and March, we project First Student's per-mile charges will total $1.56

Table IV: Cost to Taxpayers for Transportation Services

	In-House	First Student	One-Year Savings/ Loss due to Privatization	Five-Year Savings/ Loss due to Privatization
Salaries, Wages & Benefits	$1,513,891	$787,318	$726,573	$3,632,864
Material Costs	$755,789	$1,042,810	-$287,021	-$1,435,103
Bus Replacement	*$153,089*	*$371,887*	*-$218,798*	*-$1,093,990*
Miscellaneous Costs	$130,650	$189,863	-$59,213	-$296,065
Contractor Accelerated Depreciation	*$0*	*$42,018*	*-$42,018*	*-$210,090*
Contractor 2.5 percent annual rate increase, versus 1.95 percent CPI	*$0*	*$17,195*	*-$17,195*	*-$85,975*
Forfeiture of Asset of Bus Fleet	$0	$175,000	-$175,000	-$875,000
Total	**$2,400,330**	**$2,194,990**	**$205,339**	**$1,026,697**
Savings/Loss for all Categories But Labor			*-$521,234*	*-$2,606,168*

million for the 2011-12 school year. However, this year will still be less costly than successive years. Since First Student is expected to continue operating these routes in future years, charges for every month of 2012-13 and the remaining years of the contract will be similar to those recorded in February and March of the past year.[72] Thus, in 2012-13 and successive years, the company's charges are expected to total just over $1.78 million per year.

This figure remains $240,000 below our projection of First Student's costs. But the invoices submitted to the district do not capture the complete range of transportation costs associated with the First Student Contract. Most importantly, they do not include the price of fuel, which is purchased independently by the district and was budgeted at $300,000 for the 2011-12 school year.[73] In addition, there may be further costs First Student charges the district beyond those captured in the monthly per-mile charges, including shop labor for repair and maintenance of buses. So too, these charges do not include the district's administrative expense for determining the number of students eligible for bus service each year, planning routes, responding to parent complaints and overseeing the First Student contract itself.[74] Finally, First Student's higher-than-inflation annual rate increases impose additional costs beginning in the second year of the contract that do not appear in the first year's invoices but are included in our estimate. Averaged across the five-year contract, First Student's price increases represent an additional cost of approximately $17,195 per year.

Once we account for the full range of costs, the evidence suggests the cost of contracting with First Student is likely at least $2.1 million per year. Since we have no data for maintenance, repair and district administrative costs, it is impossible to estimate a final total; but it is clear the record of First Student's charges to date points to total expenses that are generally in line with our own estimates described earlier.

Table V: First Student Invoiced Expenses to CPSD, 2011-12

Per-mile rate charges	September	October	November	December	January	February	March	Avg. Sept-Jan	Avg. Feb-March	Avg. 2011-12 blended
Regular transp. routes	$80,028.86	$108,767.02	$102,011.88	$78,464.94	$73,804.82	$105,870.83	$120,313.36	$88,616	$113,092	$100,854
SPED transp. routes	$27,818.63	$36,723.58	$34,424.44	$30,086.44	$29,064.60	$53,957.49	$58,158.12	$31,624	$56,058	$43,841
Addition for min. mileage	$5,767.52		$4,307.56	$4,054.44	$2,510.86	$71.19	$131.08	$3,328	$101	$1,715
Other										
Extracurricular	$5,921.74	$9,728.62	$10,448.99	$7,860.08	$5,696.91	$6,003.45	$6,033.31	$7,931	$6,018	$6,975
Monitors	$633.33	$990.90	$849.29	$820.02	$648.00	$1,701.53	$1,325.70	$788	$1,514	$1,151
Optional color camera					$515.66	$788.24	$809.48	$103	$799	$451
Optional second camera										
Optional computer-assisted routing system										
Fuel	$141.21	$643.64	$410.60	$48.95						
Credit for TIC	-$5,210.48									
Credit for rent	-$6,075.00	-$6,075.00	-$6,075.00	-$6,075.00	-$6,075.00	-$6,075.00	-$6,075.00	-$6,075	-$6,075	-$6,075
Maintenance of district equipment										
Maintenance labor										
Parts										
Outside repairs										
Total	$109,025.81	$150,778.76	$146,377.76	$115,259.87	$106,165.85	$162,317.73	$180,696.05	$125,522	$171,507	$148,514
Total before credits	$120,311.29	$156,853.76	$152,452.76	$121,334.87	$112,240.85	$168,392.73	$186,771.05	$132,639	$177,582	$155,110
10-month total	$1,090,258.10	$1,507,787.60	$1,463,777.60	$1,152,598.70	$1,061,658.50	$1,623,177.30	$1,806,960.50	$1,255,216.10	$1,715,068.90	$1,485,142.50
10-mo. total before credits	$1,203,112.90	$1,568,537.60	$1,524,527.60	$1,213,348.70	$1,122,408.50	$1,683,927.30	$1,867,710.50	$1,326,387.06	$1,775,818.90	$1,551,102.98
Est. July-Aug. avg. charges	$4,089	$4,089	$4,089	$4,089	$4,089	$4,089	$4,089	$4,089	$4,089	$4,089
Annual total	$1,086,286	$1,503,816	$1,459,806	$1,148,627	$1,057,687	$1,619,205	$1,802,989	$1,251,244	$1,711,097	$1,481,171
Annual total before credits	$1,211,291	$1,576,716	$1,532,706	$1,221,527	$1,130,587	$1,692,105	$1,875,889	$1,334,565	$1,783,997	$1,559,281

Summary: Four Approaches to Cost-Benefit Analysis

This report provides four approaches to comparing the costs and benefits of CPSD's maintaining transportation in-house or contracting with First Student: the *Board Brief* presented to CPSD's decision makers; CPSD consultant John Fairchild's analysis provided to state authorities to document compliance with Oregon statute; LERC's own analysis of comparative costs; and the actual track record of First Student's charges over the past school year. Together, these four avenues for assessing the benefits of contracting out in CPSD reach a common conclusion. When all costs are considered, we estimate the net impact of contracting out for the school district ranges between annual savings of $205,000 and a slight net loss of $18,000 per year.[75] It appears the slight net loss may be the most realistic figure, since it alone calculates in-house costs based on actual, rather than budgeted, expenses. However, in the absence of more detailed information from the district and First Student, all these numbers remain estimates, and therefore we simply conclude the ultimate bottom line of privatization lies somewhere in this range.[76] It is critical, however, that both the numbers presented by CPSD consultant John Fairchild — when properly corrected — and LERC's own budget-based analysis show any savings from privatization are entirely due to steep cuts in the wages and benefits of bus drivers. Essentially, privatization in CPSD has meant turning family-wage jobs into low-wage jobs in order to pay for new buses that First Student use to operate commercial services during non-school hours. Furthermore, this assessment fits with the real-time data available from First Student expenses recorded over the 2011-12 school year. No matter how one approaches the question, the answer appears to be the same, namely that CPSD's contract with First Student fails to meet the test established by Oregon statute.

Table VI: Range of Estimated Annual Savings from Privatization of Student Transportation

	Estimated Costs Associated with First Student Contract	
Estimated Costs of In-House Operation	*Board Brief* $2,209,770	LERC budget-based analysis $2,194,990
Board Brief $2,191,470	**-$18,300**	**-$3,520**
Fairchild analysis for State of Oregon $2,386,740	**$176,970**	**$191,750**
LERC budget-based analysis $2,400,300	**$190,530**	**$205,310**

Notes:

Savings estimates are based on total public costs, including state and local expenses.

Board Brief *estimates are based on "Scenario 2" for in-house costs and "Scenario #4" for contracting out, with corrections described above in the text of this report.*

Fairchild analysis for State of Oregon estimates for in-house costs include corrections described above in the text of this report. Contracted out costs are not used since they assume First Student's labor costs would be the same as were budgeted for in-house operation.

LERC budget-based analysis is described in detail in the text of this report.

Beyond the First Contract: Long-term Concerns with Bus Privatization

The analysis so far shows privatization of bus service may cost more than it saves, and that to the extent it does generate savings, these are entirely made up of wage and benefit cuts to local employees. These conclusions are based on analyses of costs and benefits associated with CPSD's initial five-year contract with First Student. However, there is reason to believe the costs of contracting out will grow even more burdensome in future years beyond the first contract.

Once a school district has sold off its bus fleet, the cost of reestablishing transportation service as an in-house function may be prohibitively expensive. For this reason, when districts prepare to negotiate a second contract, they do so from a position of weakened bargaining leverage since — having already sold off their fleet of buses — they have little choice but to contract with one or another of the private service providers. As Lake Oswego Business Manager Stuart Ketzler observed in 2006 on the occasion of the district's initial decision to privatize bus service, in future contract negotiations:

> "*Our options will of necessity consider what it would cost us or one of Laidlaw's competitors to finance a whole fleet of buses if we decide to not exercise our extension option. I am sure Laidlaw and all of their competitors are mindful of our options as they prepare their rates.*" [77]

This problem is compounded by the fact that the market for school transportation is extremely concentrated. As shown in Table VII and Exhibit 4, just two companies — First Student and Mid-Columbia — control 90 percent of the private market for student transportation in Oregon.

In the case of Lake Oswego (LOSD), the district has seen transportation costs increase at a rate well above inflation in the years since privatization. Over the past nine years, transportation costs in the district have increased an average of 4.8 percent for a 46 percent total increase over the period, or more than double the increase in the local inflation rate.[78]

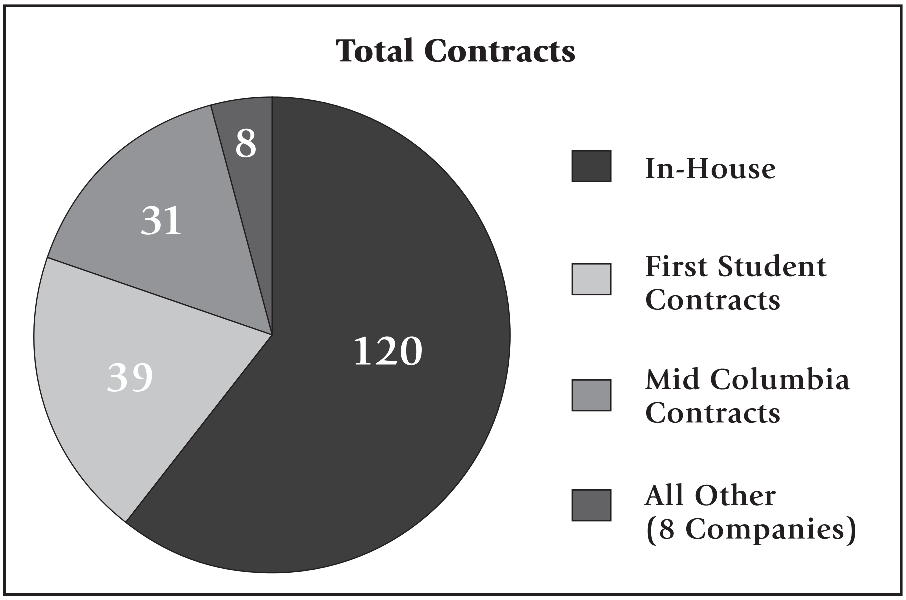
One of the sources of long-term costs is higher-than-inflation annual rate increases. As described above, First Student's excessive rate increases are estimated to cost the CPSD just over $17,000 per year during the initial five-year contract. But the impacts of overcharging become much more burdensome over the long term. Due to the effect of compounding interest, even a modest overcharge — such as the difference between First Student's 2.5 percent annual price increase and the estimated long-term inflation rate of 1.95 percent — amounts to an increasingly heavy burden over time. For instance, if CPSD renews its contract for just two more five-year periods, by 2025 the cumulative impact of

Table VII: Oregon School District Transportation Contracts

	Total	Percentage
In-House	120	61%
First Student	39	20%
Mid Columbia	31	16%
All Other (8 Companies)	8	4%
Total Contracts	78	39%
Total Districts	198	100%

Source: *Oregon Department of Education, Pupil Transportation, www.ode.state.or.us/search/page/?=1149*

Exhibit IV: Student Transportation in Oregon



Source: *Oregon Department of Education, Pupil Transportation www.ode.state.or.us/search/page/?=1149*

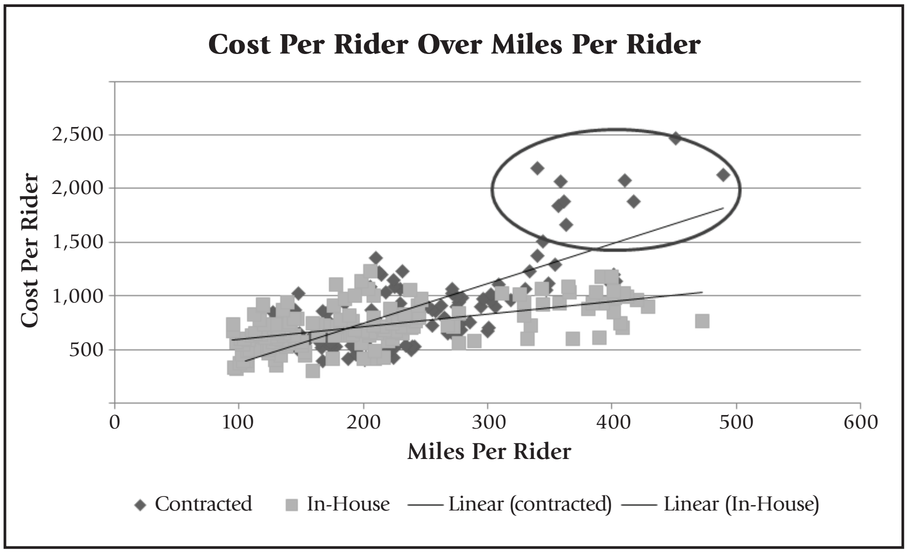
First Student's rate increases will amount to an increased cost of $166,000 per year. Averaged over the entire 15-year period, the cost difference will average $74,500 per year.[79]

In LOSD, one of the factors driving up long-term costs is the contractor's failure to abide by inflation controls written into the contract itself. As described earlier, since the district is responsible for all fuel costs over a fixed minimum, LOSD's contract with First Student stipulates that annual fee increases will be based on a rate of inflation defined as the Consumer Price Index (CPI) excluding out energy costs.[80] In reality, however, First Student has instituted annual increases based on the overall CPI — including energy costs — resulting in significantly steeper price increases. The contractor openly informed the district that its price increases were based on this higher-than-contracted rate, but it appears that district staff were unable to provide sufficient oversight to catch this violation. [81] In the years since 2005, we estimate that First Student's overbilling amounts to a total of $230,000 in charges to the school district, with 70 percent of this amount, or $161,000, being reimbursed by state taxpayers. First Student's charges appear to constitute a clear violation of the contract terms, yet district staff have been unable to effectively police the contract language. When informed of this discrepancy by the authors of this report, Lake Oswego Finance Director Stuart Ketzler suggested that the district had no choice but to accept rate increases based on the higher inflation factor because the lower rate is based on "an [inflation] index that is no longer tabulated." But this is simply not true: the federal government publishes the inflation rate for all items except energy — specifically for the Portland-Salem metropolitan area — every year on a website that is freely available to the public.[82]

Without more detailed information, it's impossible to tell how much of LOSD's overall cost increase is due to rate increases or other transportation costs. It is clear, however, that the district's costs have increased significantly above the rate of inflation — even while the number of riders served and miles driven have decreased.

Beyond rate increases, private contractors may seek to increase long-term charges in myriad aspects of the transportation system, including design of the bus routes themselves. When school districts operate their own fleets, they have an interest to constantly seek opportunities for plotting

Exhibit V: Tri-County Portland Metro School Districts



the shortest possible routes in order to minimize gas, wear-and-tear and labor costs. Contractors, however, do not typically absorb the costs of gas, and their fee from the district increases with every mile driven. Thus they have no incentive to economize on route length and every reason to allow or encourage routes to lengthen beyond what is strictly necessary. The track record of private contractors suggests that, over time, routes are indeed designed in ways that produce significantly higher mileage than would be the case for in-house operations.

Using 10 years of Oregon DOE transportation data gathered for 26 districts in the Tri-County (Multnomah, Clackamas and Washington) area, we conducted a regression analysis comparing costs per rider trend against miles per rider.[83] Exhibit 5 shows the results of this analysis. The

Table VIII: First Student Charges Back Full Price of Bus Purchase Over Five-Year Contract

	Estimates based on: Minimum Guaranteed Mileage	Estimates based on: RFP route sheets
Regular route rate per mile, no bus purchase	$2.09	$2.09
Regular route rate per mile, with bus purchase	$2.26	$2.26
Bus purchase add-on, per mile of regular routes	$0.17	$0.17
SPED route rate per mile, no bus purchase	$2.22	$2.22
SPED route rate per mile, with bus purchase	$2.41	$2.41
Bus purchase add-on, per mile of SPED routes	$0.19	$0.19
Total regular miles per year, estimated	446,646	491,259
Total SPED miles per year, estimated	156,930	172,605
Total add-on premiums per year	$105,746	$116,309
Total, five-year contract	$555,838	$611,358

Notes:

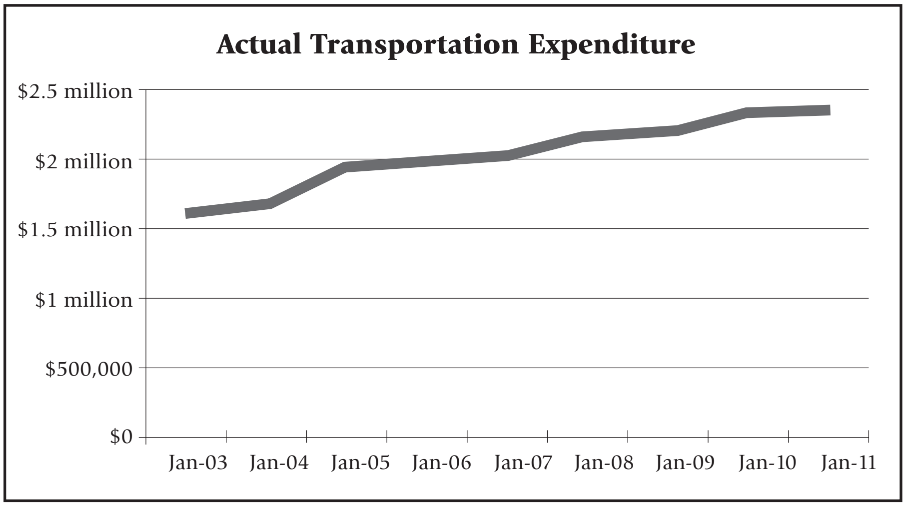
RFP route sheets were discussed in email between Meunier and Fairchild, May 23, 2011, noting they showed 663,864 miles of CPSD pupil transportation in 2009-10. The estimate here uses that total and assumes 26 percent of those miles were SPED, as was true for the first five months of the 2011-12 school year.

Minimum guaranteed miles, according to the contract, are 3,449 miles per day. Although only 170 days are guaranteed, RFP states schools normally run 175-176 days per year. Figure here is for 175 days at 3,449 miles and assuming 26 percent of miles are SPED, as was true before the addition of February 2012 routes.

Projected Based on Miles as of February 2012 includes the addition of two SPED routes in February 2012 that dramatically increased SPED mileage. Totals here assume that change will remain in effect from February 2012 through the end of the five-year contract.

Five-year total cost includes accounting for 2.5 percent annual inflation in per-mile charges.

Exhibit VI: Lake Oswego School District Transportation Expenditures, 2003-11



lightly-shaded data points represent in-house transportation service; the darker-shaded points are contracted out. The X axis shows miles per rider; the further right one goes, the more rural the district, with greater distance between riders. As the distance between riders increases, we would normally expect to see the cost per rider increase as well, as the cost of transporting students increases with greater distance. Indeed, the cost per rider does increase as districts get more rural, even for in-house operations. However, where bus service is contracted out, the cost per rider increases at a significantly higher rate. Rural districts that have contracted out their bus service pay significantly more per rider than otherwise similar districts that retain in-house transportation. This suggests that smaller rural districts may lack the ability to effectively oversee their transportation contractors, and contractors may use their control over route planning to chart unnecessarily lengthy bus routes in order to maximize per-mile charges. Based on this 10-year data set, we estimate that contracted transportation costs approximately eight cents more per mile and $64 more per annual student than in-house transportation.

Thus, in route planning, higher-than-inflation charges and generally weaker negotiating position, districts face significant long-term costs that may not appear in the first five-year contract. While it may be difficult to quantify the impact of such concerns, they must be taken into account when a district is determining whether or not to contract out its transportation service.

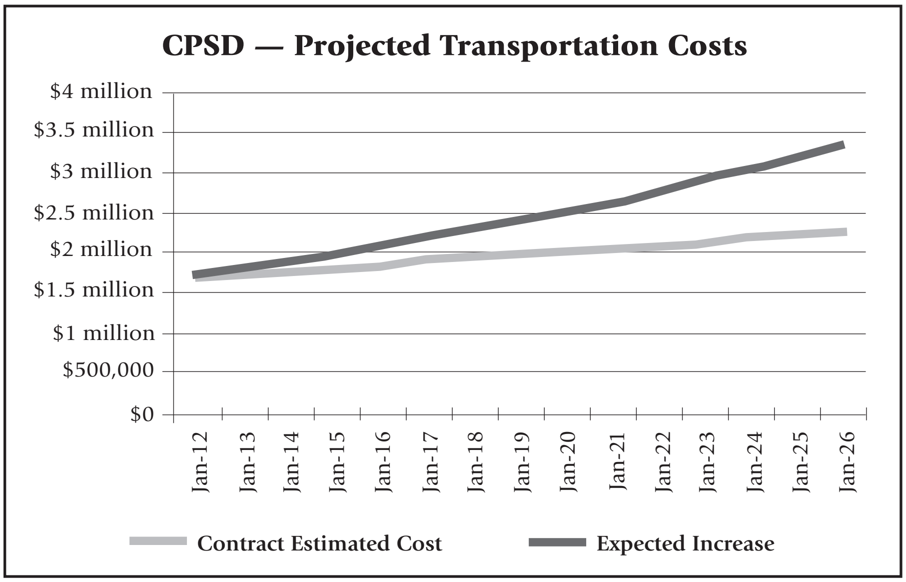
In the case of LOSD, it's not possible to identify exactly which factors were most responsible for driving the cost increases, and therefore we cannot know whether a similar pattern should be expected in other districts. Nonetheless, the LOSD experience raises a concern regarding the potential for privatization to entail significant costs that become apparent only over the long term.

Exhibit VII projects the anticipated cost of CPSD's contract with First Student over the next 15 years. If costs increase only in accord with the inflation rate, the increases will be modest. However, if CPSD faces cost escalations in line with those experienced by LOSD (the "Expected Increase" line in Exhibit VII), the increase may be much more dramatic.[84]

Legal and Ethical Questions Regarding CPSD Privatization

The report thus far has focused on the economics of bus privatization. But the terms of transportation contracts in CPSD and elsewhere also raise potentially troubling legal and ethical concerns. Many of the most troubling questions revolve around the sale of district bus fleets and the subsequent operation of a privately-owned bus fleet paid for by public dollars.

Exhibit VII: Central Point School District
Projected Transportation Costs Based on Lake Oswego Experience



Estimated cost is based on actual contract value and negotiated rate increases. Expected increase is based on Lake Oswego's rate of increase since privatization.

In CPSD, one of the most glaring irregularities concerns the fact that First Student appears to have charged the district for the entire cost of First Student's purchasing the district's bus fleet — a transaction that amounts to First Student taking possession of the fleet for free. This directly undermines one of the central rationales for privatization. The district claims "we have invested the proceeds from the sale of our bus fleet into our classrooms and schools… each dollar saved … adds value to the educational opportunities provided to our students."[85] But the evidence suggests that this is demonstrably false: all the funds received from the sale of the fleet were repaid to First Student in higher per-mile charges; indeed, the district has never challenged the facts of the repayment schedule. While neither the company nor the district openly acknowledges the complete terms of this transaction, it is made clear in the small print of the contract and in the record of discussions leading up to the parties' agreeing on final terms.

When First Student bid to provide transportation service for CPSD, the company submitted two different rate sheets — one assuming the company would purchase the district's bus fleet and the other assuming it would not. In the bid that included purchasing the fleet, First Student increased its per-mile rate by 17 cents for regular bus routes and 19 cents for Special Education (SPED) routes.[86]

In examining the data available to First Student at the time it submitted this bid, it appears the per-mile premium the company charged for purchasing the CPSD fleet was intended to recoup the entire $565,000 purchase price of the fleet over the life of the five-year contract.

The contract stipulates First Student is guaranteed a minimum of 3,449 miles per day, and the district's RFP states contractors should expect to operate 175 or 176 days per year.[87] Assuming a 175-day school year, and conservatively assuming 26 percent of the miles are SPED, the bus-purchase premium for the five-year contract would total $555,838, just $10,000 shy of the total purchase price.[88]

Alternately, an early version of the RFP that was shared with First Student included "route sheets" showing CPSD operated a total of 663,864 miles of pupil transportation in the 2009-10 school year. Prior to the addition of the two new SPED routes in early 2012, SPED accounted for approximately 26 percent of annual miles. If First Student assumed the district would require the same mileage in 2011-12, its per-mile premiums would total $611,358 over the life of the five-year contract, or $45,000 above the purchase price.[89]

Exhibit IX: First Student, Used Buses Purchased to Service Central Point School District

VIN	Type	Manufactured	Passengers	Yellow Book Current Value
208745	Conventional	2005	72	$27,200
208735	Conventional	2005	72	$27,200
208795	Conventional	2005	72	$27,200
202035	Conventional	2005	72	$27,200
208715	Conventional	2005	72	$27,200
208755	Conventional	2005	72	$27,200
208725	Conventional	2005	72	$27,200
208775	Conventional	2005	72	$27,200
227812	Van	2002	21	$9,100
213904	Van	2004	33	$15,100
242556	Van	2006	20	$22,500
218551	Conventional	2001	72	$10,900
218531	Conventional	2001	72	$10,900
213026	Conventional	2006	72	$33,800
215557	Conventional	2007	72	$39,200
208577	Conventional	2007	72	$39,200
215587	Conventional	2007	72	$39,200
215577	Conventional	2007	72	$39,200
215567	Conventional	2007	72	$39,200
208587	Conventional	2007	72	$39,200
205597	Van	2007	20	$25,500
234232	Van	2002	17	$9,100
208458	Transit	2008	84	$64,600
50726	Van	2006	24	$22,500
50727	Van	2008	24	$28,800

In either case, it seems clear First Student calculated its per-mile premiums in order to charge the district over a five-year period for the entire purchase price of its fleet. Indeed, this logic is confirmed by an email from CPSD Personnel Manager Mike Meunier who, in preparing the terms of the contract, noted "the contractors" wanted to know whether "the District want[s] the appraised value of the 16 [current CPSD] vehicles included in the rates; which also means the District would receive a check for that amount."[90] Thus, both bid calculations and internal district communications point to a one-to-one transaction in which First Student charged back the entire cost of purchasing the district's fleet.

This transaction raises several potential legal questions.

First, both the district and the state appear to be, in part, paying for something they've already bought. Under state statute, buses are depreciated on a straight 10-year schedule. After 10 years, though the buses retain value as an asset, they have been completely paid for. In the case of CPSD's fleet, at the time of privatization, the share of the fleet's purchase price that had not yet been depreciated stood at $486,687.[91] In other words, once the district and state paid this amount, they would have paid for the entire purchase price of the fleet. However, under the contract with First Student, the district and state will jointly pay $565,000 to First Student to cover the company's cost of purchasing this fleet. The difference between these two figures — nearly $80,000 — represents taxpayers paying for something they have already purchased.

Second, and more fundamentally, the logic of the district selling First Student its fleet, and then paying the company to cover the purchase price, violates basic norms of commerce. If we sell a car, we give up the asset of my car and get cash in return. No one sells a car, turns over ownership of the vehicle, and then also repays the buyer for the cost of the purchase. It appears that the district has paid twice in this transaction — it has given up the asset of its bus fleet, and it has also paid First Student for the entire cost of buying its fleet. Having paid the full purchase price, the district should logically retain ownership of the fleet at the end of the five-year contract — an asset we estimate will be worth $226,000. But under the terms of the contract, this asset becomes the property of First Student.

Thirdly, First Student's practice of charging the full cost of bus purchases over five years raises additional questions. If we assume this is standard company practice for all bus purchases, we should expect that per-mile rates are calculated in order to capture the full cost of all bus purchases over a five-year time horizon. But since per-mile rates have never been known to be reduced after buses are paid off, this raises a concern regarding potential double-billing.

In the simplest of cases, if a school district purchases an entire fleet of new buses from First Student — with the purchase cost built into the per-mile rates — these costs will be fully paid for within five years. In the second five-year contract, however, these buses will continue to be in operation, not yet having reached their allowable age limit. If First Student does not reduce its per-mile rates by the amount designated for bus purchase (and there is no evidence that contractors ever reduce rates in this manner), the district may be effectively paying twice over — or, in the case of a bus with a 12-year age limit, 2.4 times over — for the same asset.

A slightly more complicated but likely more common problem concerns the sale of used buses. To understand this problem, suppose that CPSD's contract includes the purchase of a new bus, and that after five years First Student decides to sell that bus to a different school district within the state of Oregon. The company will presumably charge the new district for the current value of the used bus. But if First Student has already charged CPSD the full purchase price over the course of its five-year contract, this bus will already have been 100 percent paid for. In this case, the second school district is paying for something that has already been completely paid off. And the State of Oregon — which funds 70 percent of both districts' transportation costs — will be paying a second time on an asset it already purchased.

This question arises regarding the 25 used buses First Student has brought to the CPSD fleet. We assume that, as with the sale of the district's own fleet, First Student has built the full purchase price of these buses into the per-mile rates charged. But where did these buses come from? Have any of them come from other Oregon school districts, or districts in other states with similar practices, where they may have already been entirely paid off? We do not know the origin of these buses and thus can't answer this question. But we believe the prospect of such double-payments — particularly involving buses sold from one Oregon school district to another — poses a concern that may be worthy of legislative attention.

Fourth, contracts may have an incentive to overpay for the purchase of district fleets — to the ultimate detriment of taxpayers. Indeed, this may have been the case in CPSD. First Student's own records show the "fair market value" of the CPSD fleet as $469,560.[92] Yet the company purchased the fleet for $565,000. According to the official Yellow Book values for buses contained in the CPSD fleet, it appears First Student may have overpaid by an average of 16 percent per bus.

This generosity may be reminiscent of First Student's overpayment to LOSD at the time that district first contracted out its transportation services in 2003. At the time,

Table X: Lake Oswego School District Transportation Costs, 2003-11

Year End	Total Transp. Cost	% Increase	Inflation	Total Riders	Total Miles
June 2003	$1,608,600	0.0%	0.0%	2,526	401,428
June 2004	$1,676,500	4.2%	0.8%	3,615	381,368
June 2005	$1,948,087	16.2%	1.4%	2,085	385,875
June 2006	$1,982,367	1.8%	2.6%	1,899	412,852
June 2007	$2,027,296	2.3%	2.6%	1,898	435,449
June 2008	$2,159,267	6.5%	2.6%	1,756	405,804
June 2009	$2,199,679	1.9%	3.7%	1,797	381,839
June 2010	$2,340,485	6.4%	3.3%	1,724	361,467
June 2011	$2,348,809	0.4%	0.1%		
Total		**46.0%**	**18.2%**		

First Student stated explicitly in its contract that LOSD's fleet was only worth $650,000, but First Student would purchase the fleet at the inflated price of $1 million, on the condition that the district paid First Student back the difference — $400,000, including interest — over the life of the five-year contract. This payback was built into First Student's per-mile charges and submitted to the state as a reimbursable "transportation" expense; these facts are uncontested by district officials.

Because the State of Oregon routinely reimburses 70 percent of "all contracted transportation," contractors may have an incentive to overpay for bus fleets as a way of sweetening a contract and solidifying districts' decision to privatize transportation.[93] Such agreements may represent a win-win accord for the district and the contractor, but one that is carried out at the expense of state taxpayers. For the contractor, the overpayment may help seal the deal, and in any case will be paid back by the district over the life of the contract. For the district, the overpayment is a welcome additional infusion of cash at the time of privatization. And most critically, while the district gets 100 percent of the overpayment up front, it will only have to repay 30 percent of it over the course of the contract; the rest will be paid by the state.

For instance, assuming, as may have been the case, that First Student paid CPSD approximately $100,000 more than the true value of its fleet — the district gets a check for $100,000, and has to repay $33,000 of this amount over five years. The rest — from the district's point of view — is pure profit. But this comfortable arrangement is carried out at the expense of state taxpayers.

Furthermore, the impact of these overpayments continues to be felt for many years. Since the repayment of these overpayments is built into the contractor's per-mile charge, and since these charges only increase over time, the district and state will repeat the overpayments many times over, assuming the contract is extended beyond its initial term.

For example, in LOSD the district repaid First Student $400,000 over its first five-year contract to compensate the contractor for overvaluing the fleet. In theory, when the first five-year contract was concluded, First Student's hourly charge should have been reduced by the amount designated for repayment of this $400,000 loan. Instead, when First Student's contract was renewed in 2008, its per-hour charges were increased by the rate of inflation. Thus, in its current 2008-13 contract, the district and the State of Oregon are once again repaying this $400,000 loan from First Student.[94] For a contractor, any temporary cost that increases initial per-mile charges is fortunate because, while the cost will pass in time, the charge will continue to be paid and repaid indefinitely.

Finally, the CPSD contract points to another common problem, which is the prospect of public funds being used to pay for private commercial activities. The buses used to transport CPSD students are the private property of First Student, and the company has the right to use them for any purpose it chooses when they are not required for student transportation. Across Oregon, school buses are used for a variety of private, for-profit purposes during evening and weekend hours — including transporting fans to sporting events, customers to fairs and amusement parks and gamblers to casinos.

CPSD's contract with First Student requires the district's bus shed and maintenance and repair facility be reserved "for the exclusive use of providing pupil transportation services to the district" unless otherwise agreed to by district

Table XI: Yellow Book Value and First Student Purchase Price for Central Point School Buses

Bus Type	Year Built	Passengers	Miles	VIN	Yellow Book Value	FS Purchase Price	Difference	% Diff.
Transit	2000	77	228,868	115115	$6,100	$9,200	$3,100	50.8%
Transit	2000	77	246,562	115113	$6,100	$9,200	$3,100	50.8%
Transit	2001	84	166,693	115133	$9,900	$16,700	$6,800	68.7%
Transit	2002	84	146,685	115095	$16,000	$22,800	$6,800	42.5%
Transit	2005	83	117,475	115118	$34,000	$40,500	$6,500	19.1%
Transit	2006	84	98,703	115119	$45,700	$50,800	$5,100	11.2%
Conv	2007	71	110,246	115107	$33,800	$36,500	$2,700	8.0%
Transit	2010	84	39,061	115108	$85,200	$89,500	$4,300	5.0%
Transit	2010	84	26,338	115110	$86,200	$89,500	$3,300	3.8%
Transit	2010	84	40,693	115116	$84,200	$89,500	$5,300	6.3%
Transit	1992	90	289,934	115097	$500	$800	$300	60.0%
Van	2004	22	163,474	115126	$13,100	$22,500	$9,400	71.8%
Conv	2006	34	132,535	115124	$24,500	$38,000	$13,500	55.1%
Total, Buses Retained in Service					**$445,300**	**$515,500**	**$70,200**	**15.8%**

Notes:

Data is from 2012 Yellow Book. Because we aimed to identify 2011 values, we treated each bus as if it was one year younger than it is, and used the 2012 value for that bus. E.g. to estimate the value of a 2007 bus in 2011, we looked at what a 2008 bus of the same type was worth in 2012. This way we had an accurate estimate for a four-year-old bus as of 2012. If anything, our Yellow Book estimates may therefore be slightly high, since they don't account for price inflation from 2011 to 2012. If that is true, the overpayment is also slightly greater than that shown here.

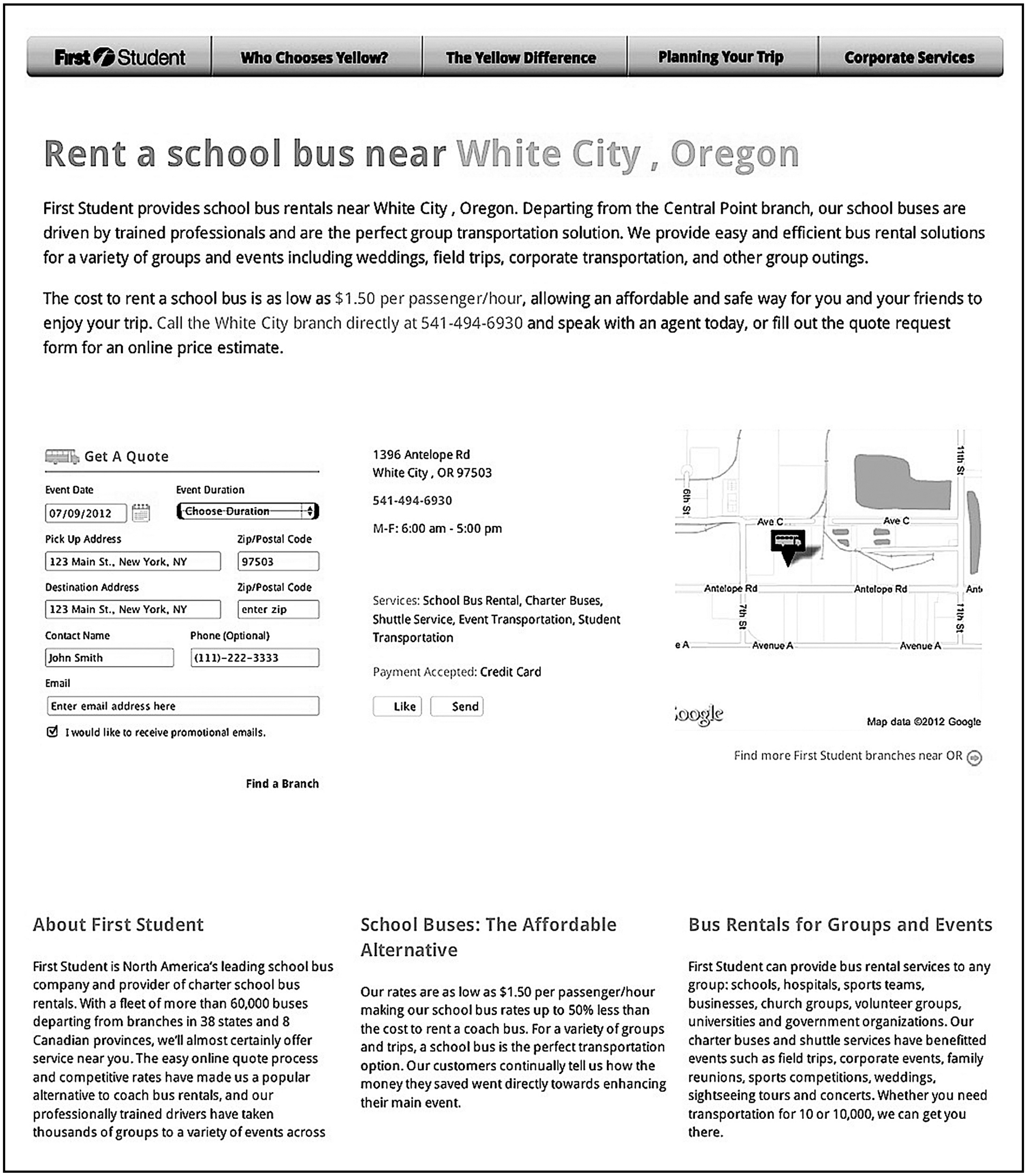
staff. In addition, the contract mandates bus fuel will be provided by the county "only for certified pupil transportation," and that "procedures will be developed, implemented, and linked to daily bus reports" so that district managers can ensure the public is not buying gasoline for private commercial transportation.[95]

Yet it appears these safeguards have never been put in place. The district has never granted permission for First Student to operate a private bus service out of its facility, yet the company is doing so, advertising "easy and efficient bus rental solutions for ... weddings, field trips, corporate transportation, and other group outings" that run out of the district's facility.[96] More strikingly, CPSD Financial Manager Spencer Davenport and Personnel Manager Mike Menuier report the district has no mechanism in place for knowing whether buses that service district students are being used for non-educational purposes during off hours, nor any means of knowing whether public funds are being used to pay for maintenance, repair or depreciation costs resulting from private commercial use of the fleet. Nor does the district have any controls in place regarding the use of publicly-purchased gasoline for private commercial purposes. First Student receives fuel through Jackson County, and thus enjoys reduced federal and state fuel taxes.[97] The company is required to report the extent to which such fuel has been used for purposes other than student transportation, and to reimburse the exempted taxes associated with that mileage. For the company to use district-bought gasoline for its private ventures would not only violate the terms of its contract with CPSD, but if not reported, it might also constitute federal and state tax evasion. Despite the seriousness of this potential contract violation, District staff report "we wouldn't know" whether First Student is using district-supplied gasoline to transport commercial customers out of the CPSD facility. [98]

If First Student uses these buses for private purposes, they will wear out faster, require more intensive maintenance and need to be replaced sooner than otherwise necessary. These added costs should not be borne by the taxpayers, but it appears they are. CPSD has no means of knowing how much mileage may have been put on a bus due to private commercial activities. But, assuming the district is paying 100 percent of the purchase price of the vehicle, it is effectively paying for all wear-and-tear on the vehicle, including that which results from private travel. Similarly, if a First Student bus hits a pothole while taking customers to a casino, does the company take the bus into CPSD's maintenance shed and have personnel do the repair work there at district expense? It is hard to imagine the company would maintain an entirely separate shed and maintenance facility in the area; thus it appears likely repairs due to commercial activity are done at public expense. Finally, since First Student's charges to commercial customers are even higher than to the school district, it is likely that these charges include some number of cents-per-mile designated to offset the purchase price of the vehicle — even though the district is simultaneously being charged for the full purchase price.[99] In that event, one of the parties would, once again, be paying for something that has already been paid for.

Unfortunately, a similar pattern appears to be occurring in LOSD. There, too, the district's contract with First Student mandates the bus facility may only be used for student transportation unless the district provides prior written approval. The contract further requires "any school bus or other vehicle used under the contract serving the Lake Oswego School District which was used on behalf of any other district, or for any other purpose or party, must be broken out separately from the main fuel invoice and the documentation for the time and cost of fuel associated specific to the District must be provided."[100] As in CPSD, First Student advertises a full-service commercial rental facility operating out of the LOSD transportation facility.[101] Yet the district reports that it has "no records in [our] possession" regarding any private use of school buses.[102] Thus, First Student appears to be operating a private commercial business — using district facilities — without the required permission, and potentially to be charging the public for fuel, maintenance, repairs and depreciation costs associated with its private business. This suggestion was not contested by district authorities given a preview copy of this report.

Exhibit VIII: First Student Advertisement for Private Bus Rentals, Central Point



These cases raise the specter not only of unethical and possibly illegal billing, but also of potentially defrauding the State of Oregon. While the state is legally committed to reimbursing 70 percent of "all contracted expenses" for school transportation, several of the transactions described above arguably include charges that do not constitute legitimate pupil transportation expenses, and therefore are not legally reimbursable. If such practices have been widespread across Oregon, it is possible contractors have defrauded the state of significant sums of money.

Possible Legislative Concerns

The subject of privatization has long been a topic of concern for Oregon lawmakers. We believe the evidence presented in this report suggests the need for further legislative or regulatory attention to the issue.

First, it seems clear that neither CPSD nor First Student has conducted the rigorous cost-benefit analysis intended by the Legislature. To avoid replication of this problem, legislators may want to consider clarifying that the law requires contractors to identify the component costs that make up their per-mile charges, including specifically accounting for actual wage and benefit payments; for the costs of bus purchase and replacement; and for any purely financial transactions between the contractor and district, including voluntary overpayment for fleet purchases.

In order to protect the public interest, legislators may also want to consider mandating greater contractor transparency. We have no hard evidence of illegal charges in the CPSD contract, but our evaluation of the available information strongly suggests the possibility of wrongdoing. Our inability to obtain documentation for First Student's costs and depreciation practices points to a larger problem: the lack of transparency where public funds are involved. First Student's claim that identifying the components of its per-mile charge would reveal a "trade secret" violates the central purpose of the law. Both local Central Point property tax dollars and Oregon income tax funds are used to pay First Student's bill. Therefore, citizens in Central Point and throughout the State of Oregon deserve greater transparency and accountability.

More specifically, legislators should insist that any cost-benefit analysis must take into account costs imposed on Oregon taxpayers through the state Department of Education, and not solely local district costs. Contracts that save the district money, but amount to a net loss when accounting for the full cost to Oregon taxpayers, cannot be deemed beneficial. Legislators may want to mandate that cost-benefit analyses be done on the basis of 15-year projections, which more accurately capture the impacts of bus purchase schedules, accelerated depreciation and inflated rate increases.

To further safeguard tax dollars, legislators may also want to require that all buses used for pupil transportation be tracked in a central database recording the date of purchase, value of the bus charged to the district and the history of previous ownership. Without such a mandatory database, it is impossible for the State of Oregon to tell whether it is paying for the purchase of buses that have already been paid for by other Oregon school districts or other parties.

We believe legislators should also consider adopting procedures to ensure school districts' effective policing of contract terms in the event they decide to contract out support services. First Student's practice of overcharging for annual rate increases in violation of its LOSD contract is a clear example of how taxpayer dollars may be wasted through insufficient oversight. There could easily be similar such cases that have yet to come to light, and it might be useful to establish procedures for guaranteeing more thorough stewardship of tax dollars in the enforcement of contract terms.

As part of effective contract oversight, legislators should also mandate districts establish a mechanism for monitoring the extent to which buses used to service students are being used for private commercial purposes in off-hours, including the ability to screen out maintenance, repair, fuel and depreciation costs related to private activities, and to guarantee such expenses are not be borne by Oregon taxpayers.

A Template for Accurate Cost/Benefit Analyses

In order to ensure schools receive quality service, and that taxpayer dollars are not squandered, it is critical that district managers carefully assess the costs and benefits of privatization and, in the event the district does decide to privatize a given service, maintain thorough oversight over services once they are contracted out. In previous reports, we have outlined recommended steps that school boards may take in order to safeguard taxpayer dollars when contemplating privatization of school services. We direct interested readers to the recommended due diligence procedures outlined in our previous report.[103] In addition, based on current Oregon law and lessons drawn from the recent experience of Central Point School District, we offer a template in order to assist school districts in providing board members and the public at large with an accurate assessment of the potential costs and benefits of contracting out school bus service.

Exhibit IX: Template for Cost-Benefit Analysis

ORS 279B.033 Cost Analysis Template	**District's In-House Cost**	**Cost to District of Contractor**	**District Savings or Loss**
Salary or Wage and Benefit Costs			
Salaries			
PERS			
Social Security			
Other Retirement Benefits			
Employee Health Insurance			
Workmen's Compensation			
Other Salary or Wage and Benefit Costs			
TOTAL Salary or Wage and Benefit			
Material Costs			
Bus Replacement			
Bus Garage			
Bus Repair and Maintenance			
Other Repair and Maintenance			
Utilities			
Liability Insurance			
Vehicle Fuel			
Parts and Service Supplies (e.g., oil, tires, replacement parts, etc.)			
Other Supplies			
Other Materials Costs			
TOTAL Material			
Operation Stopping and Dismantling Costs			
Value of Option to Reacquire Transportation Service			
Other Stopping/Dismantling Costs			
TOTAL Stopping/Dismantling			
Planning, Training, and Starting Up Costs			
Administrative Time for RFP Preparation and Bid Evaluation			
Other Planning/Training/Starting Up Costs			
TOTAL Planning/Training/Starting Up			
Miscellaneous Costs			
Travel			
Dues and Fees			
Professional and Technical Services			
Other Miscellaneous Costs			
Contractor Profit			
TOTAL Miscellaneous			
TOTAL			

Conclusion

The 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.

▸ 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.

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.

Appendix: *Sources*

[1] "Q&A: First Student's Burtwistle on Outlook, Acquisitions," January 2011, Kelly Roher, "Many Fleets Have Steady Growth," July 2011, both in *School Bus Fleet*, www.schoolbusfleet.com, Oregon Department of Education, Pupil Transportation, www.ode.state.or.us/search/page?=1149, accessed online, June 5, 2012.

[2] "*Board Brief*, Transportation System: Service Deliver Model Selection," Central Point School District (CPSD), June 11, 2011, Hannah Guzik, "Central Point Decides to Put School Bus Service Out to Bid," *Mail Tribune* (Medford, OR), June 16, 2011 (online version).

[3] At the July 30, 2012, CPSD school board meeting, First Student transportation manager Susan Quaintance reported that 28 of 30 drivers employed by the school district had stayed on with the contractor.

[4] "Required Supplemental Information," submitted as part of First Student RFP to Central Point School District, May 23, 2011, 134/140.

[5] Required Supplemental Information," 134/140, "Central Point RFP," Pupil Transportation version, May 13, 2011, p. 42.

[6] Tim Wulf to Mike Munier, et. al, June 10, 2011, "Benefit Schedule," First American Benefit Choices, October 1, 2011, Collective Bargaining Agreement Between Central Point School District and OSEA Chapter 47, July 1, 2006-June 30, 2009.

On June 8, 2010, the school district and the union agreed on a memorandum of understanding that largely extended the terms of this agreement. The district did agree to increase its insurance contribution by 6.5 percent for the 2009-10 school year.

[7] For a good overview of the phenomenon of presenteeism, see Jodie Levin-Epstein, "Presenteeism and Paid Sick Days," Center for Law and Social Policy, Feb. 28, 2005, accessed at http://www.clasp.org/admin/site/publications/files/0212.pdf, July 6, 2012.

[8] In her report to the CPSD school board on July 30, 2012, First Student transportation manager Susan Quaintance reported "low" driver turnover in the first year under private management, and also contended that turnover in Central Point was "normal" by industry standards.

[9] Paris Achen, "Central Point District Considers Changing Bus Service," *Mail Tribune*, March 9, 2011, online version.

[10] William Yardley, "Timber (and Its Revenues) Decline, and Libraries Suffer," *New York Times*, May 5, 2007, Akito Yoshikane, "Public Libraries for Profit," *In These Times*, Nov. 27, 2007, Guy Tauer, "Rogue Valley: Quarterly Census of Employment and Wages 2011 Recently Released," Oregon Labor Market Information System (OLMIS), May 30, 2012, accessed online, July 23, 2012.

[11] Oregon Community Foundation, "Southern Oregon Regional Profile," April 2011, accessed online, July 22, 2012, US Census Quick Facts, Jackson County (OR), June 2012, accessed online, July 10, 2012, Jackson County (OR) Website, "Poverty in America/Living Wage Calculator, "Jackson County, Oregon," accessed at http://livingwage.mit.edu/ ", July 10, 2012, County Participating in "Sustainable Valley" to Create Family Wage Jobs, accessed online, July 10, 2012. Although dated, a useful review of Jackson County's economic challenges can be found in "Shifting to Good Jobs: Rethinking Economic Development in Jackson County," A Report by Oregon Action, December 1999.

[12] Robert Kuttner, "Decent Work," *The American Prospect*, October 2009, Christopher Jencks, "The Low Wage Puzzle," *The American Prospect*, January 1, 2004, accessed online, July 12, 2012.

[13] Gordon Lafer and Robert Bussel, *All Costs Considered: A Report on the Contracting Out of School Support Services in Oregon*, University of Oregon, 2004; Lafer and Bussel, *All Costs Considered: A NEW Analysis on the Contracting Out of School Support Services in Oregon*, University of Oregon, 2008.

[14] http://www.leg.state.or.us/ors/279b.html

[15] Central Point School District officials insist that the decision was carried out in keeping with state law. A legal challenge to the privatization of Central Point's school bus system was rejected by a Circuit Court judge and is now pending appeal in state court.

[16] Spencer Davenport, email communication to Gordon Lafer, October 26, 2012. The full text of Mr. Davenport's email is as follows: "Mr. Lafer: Good afternoon. Thank you for sharing this report with us. We generally disagree with this report and its findings. The focus of our school district is to provide the best educational opportunities for our students given the tools and resources available. Contracting for our pupil transportation services aligns with this and has allowed us to focus available resources on our classrooms and schools. We calculate our cost savings for the last school year alone to be $456,000. Ignoring $120,000 in unemployment benefits paid to transportation employees would drive these savings from operations even higher. In addition to these operational savings we have invested the proceeds from the sale of our bus fleet into our classrooms and schools. With these savings and investments being more focused on classrooms and schools each dollar saved and/or invested adds value to the educational opportunities provided to our students. The report you provided fails to recognize this value added to our students both in the short and long terms. Furthermore, we disagree, as does the court, with the claim that the district and its advisers did not follow the law with regards to the cost benefit analysis. As you are aware this claim was denied in the Circuit Court of Jackson County on March 19, 2012. Best, Spencer Davenport." The $456,000 claimed savings is a figure that the district has never before suggested, whether in public discussions, board hearings, or court records. In response to this email, we asked Mr. Davenport if he could share the data used to calculate this savings level, but none was forthcoming.

[17] Quoted in Paris Achen, "Central Point district considers changing bus service," Mail Tribune, March 9, 2011.

[18] Quoted in Hannah Guzik, "Central Point decides to put school bus service out to bid," *Mail Tribune*, June 16, 2011. Meunier's figure is based on a comparison of the *Board Brief*'s "scenario #2," which takes the approved CPSD 2011-12 transportation budget and adds $375,303 as a first-year payment on accelerated bus replacements, and compares that with the Brief's "scenario #4," which lists "contractor's estimated costs," excluding ongoing district costs such as fuel. After assumed state reimbursement payments, the difference between these two scenarios is $360,172.

[19] These are scenarios #2 and #4 in the *Board Brief*. The Brief is attached as an Appendix to this report. Scenario #2 envisions keeping transportation in-house but having the district commit to upgrading its fleet in order to meet "industry" standards of maximum bus ages, rather than continuing to operate older buses even if they meet state safety standards. By contrast, Scenario #3 envisions not only upgrading to "industry" standards, but committing to purchase the full complement of buses that First Student proposed to purchase over life of the five-year contract.

[20] CPSD *Request for Proposals*, May 13, 2011, p. 23.

[21] Indeed, these costs were inflated even above the actual cost of matching First Student's bus purchase plan, since the *Board Brief* assumed the district would have to purchase all new buses, whereas First Student actually purchased a large number of used buses to service Central Point students.

[22] Central Point School District, audited financial statement for 2010-11 school year.

[23] RFP, pp. 26-41.

[24] John Fairchild, "Scenario #1 Data," spreadsheet prepared for CPSD.

[25] This is an estimate, projecting that the district might purchase two small buses each in years 1 and 4 and two large conventional buses in years 2, 3 and 5. Based on purchase price estimates recorded by Fairchild, we estimate the cost of small buses at $60,000 and large buses at $120,000. The values are depreciated on a straight 10-year schedule, as mandated by Oregon law. The estimate for the value remaining on these buses at the end of the five-year contract is calculated as the remaining undepreciated value under this state formula.

[26] It may be argued that the forfeiture of the fleet as a district asset should not be counted in the cost-benefit analysis since it is offset by First Student's payment to the district when it purchased the fleet for $565,000. This argument is mistaken for two reasons. First, the per-mile fees First Student is charging the district serve to recoup the entire cost of the fleet purchase; thus, the loss of the fleet as an asset — represented as the projected value of the buses in 2016 — is a net loss to the district after accounting for First Student's purchase of the fleet and its charge-back in per-mile fees. Secondly, the baseline assumption for in-house operating costs includes the cost of continuing to purchase approximately two buses per year; this value of over $650,000 is foregone in privatization and is not offset by any payment or other compensation from the contractor.

[27] The value of the fleet after five years, $875,000, is divided by five to estimate the value of this loss as an annual cost item.

[28] http://www.leg.state.or.us/ors/279b.html

[29] It appears that CPSD officials may have prepared their cost-benefit analysis even before the terms of the contract with First Student were established. A record of extensive communication between First Student and CPSD officials suggests the two offices engaged in ongoing discussions regarding how to shape the cost-benefit analysis beginning long before the Board of Education approved the decision to privatize transportation service. In the case of *Stephanie Hicks vs. Central Point School District and First Student Inc.*, the defense submitted two cost-benefit analyses as evidence of compliance with ORS 279B.030. The first analysis, conducted by then-CPSD Business Manager Vicki Robinson, was completed in January 2011. In communication with the author of this report, Central Point Finance Director Mr. Spencer Davenport insisted the district's cost-benefit analysis conformed to the requirements of Oregon state law, and noted that a challenge to the legality of CPSD's privatization of transportation was rejected in Circuit Court. Mr. Davenport wrote "we disagree, as does the court, with the claim that the District and its advisers did not follow the law with regards to the cost benefit analysis. As you are aware this claim was denied in the Circuit Court of Jackson County on March 19, 2012." Spencer Davenport, email communication to Gordon Lafer, Oct. 26, 2012. However, this decision has been appealed and is pending a hearing by the state Court of Appeals.

[30] John Fairchild, the consultant hired by CPSD to conduct the cost-benefit analysis, did not use any actual, historic or budget cost information to estimate the contractor's labor costs. Instead, Fairchild's analysis explains that "these [contractor estimate] numbers are simply "pass thru" and not substantiated by proposer." John Fairchild, Cost-benefit analysis to show compliance with ORS 279B.033

[31] Deposition of John Fairchild, *Stephanie Hicks vs. Central Point School District and First Student Inc.* Jackson County Circuit Court. Nov. 17, 2011. Pp. 11-17.

[32] Email correspondence between Vicki Robinson and Tim Wulf. Nov. 23, 2010 to April 28, 2011. CPSD Case Records. "CPSD 1-106 Emails Vicki and Tim." Pp. 14-78.

[33] For reasons that remain unclear, CPSD Human Resources Director Mike Meunier told the local press the district would save $360,000 per year, more than triple the savings estimated by the district's own consultant. Quoted in Hannah Guzik, "Central Point decides to put school bus service out to bid," *Mail Tribune*, June 16, 2011.

[34] Conversation with Spencer Davenport, May 1, 2012. Davenport reported these funds came from state reimbursements for previous bus purchases; the $139,500 does not represent local tax levy money.

[35] "First Student Charter Bus Rental/White City, Oregon," http://www.firstcharterbus.com/branch/12630/whitecity-oregon, accessed May 21, 2012.

[36] The conflicting interests of school districts and private contractors on this issue became apparent in 2003 when the Lake Oswego School District determined to contract its bus service to Laidlaw, a company subsequently taken over by First Student. When the school district first issued its RFP, it stated buses used by the contractor must simply "meet or exceed the State of Oregon minimum standards," noting that "the district

recognizes that the existing bus fleet has an average useful life beyond that recommended by normal industry standards." However, Laidlaw and other contractors preparing to bid on the RFP successfully lobbied the district to revise this language, adding a new requirement that the fleet "meet the current recognized industry standards" for maximum age limits. The 2003 Lake Oswego RFP and revisions are described in Gordon Lafer and Bob Bussel, *All Costs Considered: A New Analysis on the Contracting Out of School Support Services in Oregon*, University of Oregon, February 2008, p. 34.

[37] RFP, p. 23, incorporated into the First Student contract by reference.

[38] ORS 468A.796(2) mandates that all diesel engine buses must be replaced with school buses manufactured after Jan. 1, 2007, by Jan. 1, 2025.

[39] For the purpose of our model, we took the 2011 price of each of the three major bus types (as listed in the Yellow Book) and projected these costs out to each year of the period. For future bus purchases, we estimated an inflation rate of 1.95 percent, which is roughly accurate for the past 10 years. Finally, we applied a discount rate to future bus purchase costs in order to measure the impact of future expenditures in present terms. In choosing a discount rate, we believe it is most appropriate to use CPSD's cost of capital. That is to say that the value of deferring a capital expenditure from 2011 to a point in the future is equal to the interest rate that the district would pay on a loan in order to make such a purchase in 2011. Based on current economic conditions and the likely creditworthiness of the district as a special tax collection district, we have chosen a 4.6 percent discount rate. The estimated annual cost of $153,089 is the net present value of annual bus purchase costs for the 15-year period. Note that our model projects a slightly higher cost for district bus purchases than the $139,500 estimated by John Fairchild.

[40] First Student's commitment to purchase new buses was included in its contract with the district, and confirmed by CPSD Business Manager Stuart Davenport, in telephone conversation with the authors, May 1, 2012. According to First Student's bid, the company will add 23 buses to the CPSD fleet, with an average age of 5 years.

[41] First Student's commitment to purchase new buses was included in its contract with the district, and confirmed by CPSD Business Manager Stuart Davenport, in telephone conversation with the authors, May 1, 2012. According to First Student's bid, the company will add 23 buses to the CPSD fleet, with an average age of 5 years.

[42] As with the cost estimate for in-house bus replacement purchases by the district, bus costs are based on published values for the three major types of buses, and costs for future years are projected using a 1.95 percent annual inflation rate and a 4.6 percent discount rate; thus, the $386,389 figure represents the net present value in 2012 of annual bus replacement costs over the duration of the 15-year period. These projections are subject to certain assumptions — most notably, we assume that for the 25 buses First Student brought into CPSD, the district was charged the used value of the buses; we assume that the nine new buses First Student has pledged to purchase are additions to the fleet rather than replacements for other buses (this seems likely at least for the one bus and five 20-passenger vans slated to be bought in 2011-12, though it is less clear for the two buses and one van to be bought in 2013-14); and we assume that First Student either does not enjoy any ability to purchase buses at a discount rate, or if it does, it does not pass this savings on to the district (the prices it paid for the district's own buses certainly do not suggest First Student is a discount buyer). If these assumptions are varied, the net present value of annual bus replacement costs over the 15-year period could be as low as $312,554 (if one assumes that First Student gets a 10 percent discount below Yellow Book value on bus purchases, and passes the full value of the discount on to the district; that none of the nine new buses purchased in the first five-year contract are additions to the fleet; and that the district was charged used-bus rates for the 25 buses First Student added to its fleet in 2011) or as high as $487,949 (assuming the district was charged new-bus prices for the 25 buses added to its fleet; that the nine new buses are additions, and that First Student either gets no discount on bus purchases or keeps that savings for itself rather than passing it on to the district). Note that the *Board Brief* prepared by Mr. Fairchild projected first-year costs of $490,000 for the schedule of bus purchases proposed by First Student, with that cost

increasing over the life of the five-year contract. Those projections assumed all newly acquired buses would be new, whereas First Student's actual practice has been to purchase a substantial number of used buses. Our projected cost of bus purchases here is based on the actual First Student practice, and therefore is lower than the $490,000 figure projected in the *Board Brief*.

[43] First Student's bid sheet, when read together with the CPSD RFP and related documents, shows First Student charged the district for the full cost of purchasing the district's fleet, with the entire cost to be recovered over the course of the five-year contract. In addition, the spreadsheets used by John Fairchild to calculate the four scenarios presented in the CPSD *Board Brief* show the district would be charged the full cost of new bus purchases over the course of a five-year contract. In calculating the costs of the scenario in which the district would purchase buses to match the fleet First Student proposed to create, Fairchild estimated the district would need to spend $490,000 in the first year of the contract. His spreadsheets note this "assumes buses purchased on 5 year lease plans with five equal payments beginning the first year." This assumption is also in keeping with communication from First Student to the district, described in email from CPSD Human Resources Director Mike Meunier. Given First Student's refusal to provide any alternative information regarding the terms on which bus purchase costs are built into the company's per-mile fee, we assume all bus purchases follow the principle embodied in the charge for purchasing the CPSD fleet.

[44] Based on the projected cost of bus purchases as announced by First Student for the five-year contract. We calculated the cost of paying for those purchases over five years versus 10 years and converted this into 2012 dollars using a discount rate of 4.6 percent.

[45] Deposition of John Fairchild, *Stephanie Hicks vs. Central Point School District and First Student Inc.*, Jackson County Circuit Court. Nov. 17, 2011. Pp. 43-44. Fairchild apparently adopted this assumption from an earlier document put together by then-CPSD Business Manager Vicki Robinson, who in turn reported First Student told her the district would save "five to 10 percent" in material costs by contracting out its bus service. Robinson is quoted in Paris Achen, "Central Point district considers changing bus service," *Mail Tribune*, March 9, 2011. On Robinson's communication with First Student, see also email correspondence between Vicki Robinson and Tim Wulf. Nov. 23, 2010 to April 28, 2011. CPSD Case Records. "CPSD 1-106 Emails Vicki and Tim." Pp. 14-78.

[46] Spencer Davenport, phone conversation with Gordon Lafer and Jaxon Love, May 1, 2012.

[47] Fairchild Cost Analysis - Exhibit 4, P. 2. Sum of rows 28 — 46, 48-51.

[48] 2.5 percent annual fee escalator clause is included in the Executive Summary of the RFP, as confirmed by CPSD Financial Services Manager Spencer Davenport in email to Gordon Lafer, June 14, 2012.

[49] U.S. Bureau of Labor Statistics, CPI-U, Change in Annual Averages, ftp://ftp.bls.gov/pub/special.requests/cpi/cpiai.txt. Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters*, October 2011. http://www.phil.frb.org/research-and-data/real-time-center/survey-of-professional-forecasters/spf-documentation.pdf

[50] CPI-U, Annual Averages for All Items and for All Items Except Energy, 2002-11.

[51] CPSD, Request for Proposal, May 13, 2011, Section III, part 1, p. 41.

[52] Contract for Pupil Transportation Services, Lake Oswego School District and Laidlaw Transit Inc., 2003, p. 21.

[53] Our assumption is based on the average difference over the decade 2002-11 between national CPI-U for all items and national CPI-U for all items excluding energy, which was 84.7 percent of the all-items rate. We kept this same ratio and estimated that the forecast long-term inflation rate of 2.3 percent for CPI-U overall should be adjusted to 84.7 percent of that rate in order to exclude energy costs, resulting in a non-energy inflation forecast of 1.948 percent per year.

[54] This is derived from calculating the difference between 1.95 percent and 2.5 percent inflation, assuming a starting contract cost of $1.73 million per year, and assuming a 4.6 percent discount rate.

The difference over a five-year contract is almost $86,000 in 2012 dollars, or a bit over $17,000 per year. The $1.73 million starting contract cost is a conservative estimate of First Student's likely charges to the district (our estimate of likely First Student annual charges is higher), taken from the *Board Brief* presented to CPSD board members in June 2011.

[55] As described elsewhere, the entire purchase price of the CPSD fleet is being charged back to the district, built into the rate-per-mile charged by First Student.

[56] We do not correct Fairchild's baseline in-house transportation budget for the difference between budgeted and actual expenses, as we did in the analysis of the *Board Brief*. Because the Fairchild analysis used to show compliance with state law assumed the same $2.386 million baseline budget for both in-house and First Student operations, the cost-benefit analysis is not affected by the difference between approved budget and actual expenditure figures.

[57] Adopted Budget 2011-12 Central Point School District No. 6. pp. 68-71. (Hard copy only.) Although the adopted budget most likely overstates the district's actual costs (as explained in the discussion above concerning the *Board Brief*), our analysis continues to use this budget as a baseline for estimating both in-house and First Student costs since this is the only document that provides breakdowns for each cost category. Therefore, it provides the most useful structure for analyzing the cost categories required under Oregon statute. Since we use the same baseline for in-house and contracted out costs, this should not impact the overall cost-benefit analysis.

[58] Fairchild Cost Analysis — Exhibit 4, p. 2. Rows 64, 69, and 73 correspond to employee insurance for special education; vehicle purchasing, service and maintenance; and vehicle operation services respectively.

[59] Both these figures are net present values in 2012 dollars and are based on the assumptions of 1.95 percent CPI (excluding fuel) and 4.6 percent discount rate.

[60] All figures net present value in 2012 dollars.

[61] This figure is based on the assumption that First Student charges the district only the used-bus value for the 25 buses that it brought to service the district at the start of its contract. If those buses were charged at the new-bus rate, the cost of accelerated depreciation would be significantly higher than that cited here.

[62] Fairchild assumed First Student could do without the roughly $10,000 that the district spent on its managers paying professional dues or attending meetings outside the School District. There is no supporting evidence for this assumption, and it seems unlikely that any multinational corporation would operate in this way; thus we have assumed First Student will continue to bear these costs.

[63] Central Point School District No. 6, Request for Proposal For Pupil Transportation Services, May 13, 2011. Sec. III, 1, "Contractor Facilities," incorporated by reference into the contract between CPSD and First Student. We have followed Fairchild's methodology in treating this as a cost of contracting out. The district is foregoing use of the maintenance facility (or the right to rent it out to other potential tenants) but is benefiting from the rental payment; thus, conceptually one might think this transaction has no net financial impact. It is possible, however, First Student has built the cost of this rental fee into its per-mile charges to the district — as it has with the cost of purchasing the district's fleet — and this would result in the rent being a net cost, as Fairchild suggests. Since Fairchild had greater access than we do to the internal financial deliberations of both First Student and the district, we have chosen to follow his methodology on this point and treat the facility rental as a cost of contracting out.

[64] We follow Fairchild in treating the $72,900 annual rent paid by First Student for use of the district's bus repair and maintenance facility as a net expense of contracting out. The district is foregoing use of the maintenance facility (or the right to rent it out to other potential tenants) but is benefiting from the rental payment; thus, conceptually one might think this transaction has no net financial impact. It is possible, however, that First Student has built the cost of this rental fee into its per-mile charges to the District — as

it has with the cost of purchasing the district's fleet — and this would result in the rent being a net cost, as Fairchild suggests. Since Fairchild had greater access than we do to the internal financial deliberations of both First Student and the district, we have chosen to follow his methodology on this point and treat the facility rental as a cost of contracting out.

[65] "CPSD 438-463 — Emails Fairchild Meunier Wulf". Email from Tim Wulf to Mike Meunier. June 10, 2011. P. CPSD 448.

[66] First Student's 401(k) plan, including a maximum annual employer match capped at $250, is described in a June 10, 2011, email from First Student Business Development Director Tim Wulf to CPSD Human Resources Director Mike Meunier.

[67] Information on First Student's driver turnover, reduced driver hours for particular routes and minimum wage compensation for training sessions was extrapolated from interviews with former CPSD transportation employees who currently are employed by First Student. See "Survey Log - CPSD Transportation — Merged.xls."

[68] Our assumption is based on the average difference over the decade 2002-11 between national CPI-U for all items and national CPI-U for all items excluding energy, which was 84.7 percent of the all-items rate. We kept this same ratio, and estimated the forecast long-term inflation rate of 2.3 percent for CPI-U overall should be adjusted to 84.7 percent of that rate in order to exclude energy costs, resulting in a non-energy inflation forecast of 1.948 percent per year.

[69] As shown in the table, these charges do not account for the "credits" for facility rental and a "tech in charge" personnel charge for September. First Student has chosen to pay its facility rental fee by crediting the district on its annual invoices, but we treat these costs separately, totaling up the contractor's charges to the district and then accounting for the rental payment under the category of "material costs."

[70] Communication from Mike Meunier, CPSD Transportation Director, to Jaxon Love, May 2012.

[71] District staff report there are more days of school per month in the second half of the year than in the first half, and this partly explains the increase in charges in February and March. However, in comparing October 2011 with February 2012, district staff concede that there were fewer days of bus service in February, and yet First Student's SPED charge was more than $17,000 higher that month, primarily due to the addition of these two routes. CPSD Business Manager Davenport and Personnel Manager Mike Meunier, telephone conversation with G. Lafer, Aug. 7, 2012.

[72] Our estimate assumes these high monthly charges — similar to February and March 2012 — only for the 10 months of the school year, with much lower mileage projected for the summer months.

[73] The fuel charges included in the invoices shown represent the rare occasions in which a bus runs out of fuel unexpectedly or on a long-distance trip. All regular fueling is done with fuel purchased directly by the district.

[74] The district has not provided detailed breakdowns for these costs, so we do not have a firm estimate for them. But they are clearly included in the estimates for in-house costs, so they should be taken into account as continuing expenses associated with contracting out.

[75] After reviewing a pre-publication version of this report, CPSD Business Manager Spencer Davenport replied that "we calculate our cost savings for the last school year alone to be $456,000." Yet Mr. Davenport did not point to a single number in the report that he contested was false. When asked for detail to explain the basis for the claimed $456,000 savings, he did not provide any. Spencer Davenport, email communication to Gordon Lafer, Oct. 26, 2012.

[76] Our analysis of the *Board Brief* estimates in-house costs based on actual district expenses rather than the higher amount in the approved budget; the difference is about $195,000. By contrast, the Fairchild analysis and LERC's own analysis take the approved budget as a starting point. The $195,000 difference in these models accounts for the *Board Brief's* projecting that privatization would result in a slight net loss, while the other analyses project it would yield a savings of approximately $200,000 per year. In the absence of more detailed

information from the district and First Student, the Fairchild framework provided a useful means of comparing the costs of in-house and contracted-out service. We believe the actual costs — which show privatization resulting in a small net loss — are likely closer to the truth; but these too are an estimate. Therefore, we report a range in this report that includes the possibility of privatization causing a slight net loss or modest net savings to the district.

[77] Stuart Ketzler, email to G. Lafer, July 26, 2006. Quoted on p. 39 of Lafer and Bussel, *All Costs Considered: A New Analysis on the Contracting-Out of School Support Services in Oregon*, Labor Education and Research Center, February 2008.

[78] Lake Oswego School District's finance manager argues that transportation costs might have risen faster than the general inflation rate even if the district had retained transportation as an in-house service, particularly if employee health insurance and pension costs were to increase significantly. This is, of course, possible — but it's not relevant to understanding cost trends in the district's ongoing contractual relationship with First Student. The first question at hand is whether there are additional costs to privatization that appear only in later years, and that, therefore, should be taken into account in the cost-benefit analysis conducted in order to make the decision about whether or not to contract out a given service. The second question at hand is whether, once districts have sold off their fleets and therefore are in a weak bargaining position vis-à-vis transportation contractors, contractors take advantage of this relationship to unnecessarily increase charges in later years. (Stuart Ketzer, Executive Director of Finance, Lake Oswego School District, email communication to G. Lafer, Sept. 24, 2012.)

[79] Due to the function of compounded interest, even a modest difference in inflation rates, such as that between 1.95 percent and 2.5 percent, generates very large dollar differences in later years, as each year's increase is based not only on the percent difference for that year's costs, but also the cost basis that has been built up over previous years due to excessive fee increases. Lake Oswego Finance Director Stuart Ketzler suggests costs have increased partly because the district is purchasing a large number of buses for First Student. But the cost of these bus purchases were built into the contract terms from the start; the question of why the annual charges are rising faster than inflation cannot be traced to bus purchases. (Stuart Ketzler, Executive Director of Finance, Lake Oswego School District, email communication to G. Lafer, Sept. 24, 2012).

[80] Lake Oswego School District and First Student, Contract for Pupil Transportation Services, Section XXVII, subsections 3 and 4.

[81] Documents provided to Gordon Lafer by Lake Oswego School District Executive Director of Finance Stuart Ketzler, June 27, 2012.

[82] Stuart Ketzler, Executive Director of Finance, Lake Oswego School District, email communication to G. Lafer, Sept. 24, 2012. The U.S. Bureau of Labor Statistics, Current Population Survey, annually publishes the Consumer Price Index for all items except energy, specifically for the Portland-Salem metropolitan area. The data is available to the public at ftp://ftp.bls.gov/pub/special.requests/sanfrancisco/cpiport_table.txt.

[83] All data provided by Oregon Department of Education.

[84] The "contract estimated cost" line in this chart takes First Student's estimated charges for 2011-12 and assumes they will increase by the projected inflation rate of 1.95 percent; the "expected increase" line projects an annual increase of 4.84 percent, the rate experienced by Lake Oswego in the years since privatization.

[85] CPSD Business Manager Stuart Davenport, email communication to Gordon Lafer, Oct. 26, 2012.

[86] "Ex. 2 — First Student Bid." Pp. 3-6. The first two pages are the non-fleet purchase rate sheet. This rate contains a regular transportation per-mile rate of $2.09 and a special education rate of $2.22. The last two pages are the fleet purchase rate sheet, which specifies a purchase price of $565,060 for the CPSD fleet. The per-mile rates for regular and special education transportation are $2.26 and $2.41, respectively.

[87] P. 23 of the RFP (Ex. 1) includes the "GENERAL SCOPE. Contractor shall during the period hereinafter set forth, provide and maintain

the required number of school buses and bus drivers to transport conveniently, safely and reliably, all students designated by the District to be served under the provisions of the contract. Such transportation shall be provided for regular home-to-school and special education (including school-to-school) transportation service for each and every day that the school is convened and, in addition, Contractor shall during the period of this agreement provide transportation for all students or other authorized personnel as may be required by the District for field trips, excursions, athletic activities, extended school year, summer school, or any other purpose designated by the District. The current school year is based generally on 175 or 176 days of school in which transportation is required."

[88] SPED amounted to 26 percent of total mileage in the first five months of the 2011-12 school year, before the addition of the two new SPED routes.

[89] Five-year total costs include accounting for First Student's annual 2.5 percent increase in per-mile charges.

[90] Email communication from CPSD Personnel Director Mike Meunier to CPSD consultant John Fairchild, May 22, 2011.

[91] This figure is from John Fairchild's calculation in preparation for the *Board Brief*, June 2011.

[92] The fair market value of the fleet was noted on the Bill of Sale executed by First Student, June 25, 2011. First Student's purchase price was based on the average of three appraisals provided by Western Bus, Inc., each using a different methodology. Although the fleet's fair market value was recorded as $469,000, each of these methodologies resulted in a significantly higher value. The first approach used Yellow Book values for each bus, but then adjusted them upward to "cover the cost for equivalent replacement pre-owned units that would meet all Oregon state school bus specifications." The second methodology used current prices for new equivalent buses, depreciated based on the RFPs age requirements, assuming 10 percent value remaining at the end of that period. By backloading depreciation, this methodology significantly inflates the current estimated value of the fleet. Finally, the third methodology started with the 10-year straight line depreciation of buses as mandated by Oregon statute and then determined "this results in a significantly undervaluing of [the] fleet by at least 30 percent," and thus inflated the price by 30 percent. These three methodologies yielded appraised values that together averaged $565,060, or nearly $100,000 above the fair market value for the buses. Letter to Central Point School District Superintendent Randy Gravon from Mollie Blagg, President, Western Bus Sales, Inc., May 3, 2011. Provided to the authors by CPSD.

[93] OAR 581-023-0040(5)(c) allows for reimbursement of "all contracted transportation."

[94] Indeed, because First Student's hourly rates increase with inflation, we estimate the district will end up paying First Student a total of nearly $430,000 over the five-year 2008-13 contract as a second repayment of the bus-purchase overpayment. Nearly $300,000 of this amount will be paid by the State of Oregon. These facts have not been contested by district officials who were provided a preview copy of this report.

[95] RFP, Section III, Part 1, "Contractor Facilities," incorporated by reference into the contract. Interestingly, in the version of the RFP submitted as part of the district's court case, it is clear the original text of the RFP reserved use of the facilities exclusively for student transportation uses; the text was later amended — perhaps at the urging of First Student — to also allow other uses "as agreed upon by the district."

[96] Advertisement is at http://www.firstcharterbus.com/branch/12630/whitecity-oregon. CPSD Business Manager Spencer Davenport and Personnel Manager Mike Meunier reported they have never granted First Student permission to operate private bus services out of district facilities, telephone conversation with Gordon Lafer, Aug. 7, 2012.

[97] School buses receive a tax waiver for diesel fuel. See Oregon Department of Transportation, *Fuels Tax Compliance Guide for Use Fuel Users*, http://cms.oregon.gov/ODOT/CS/FTG/docs/UserPDFs/UFU_Compliance_Guide.pdf. Both the county and First Student are required to file Schedule A reports with ODOT showing the mileage and fuel used for student transportation and other purposes and reimbursing the unpaid taxes for

the non-student-transportation mileage. On school districts' exemption from federal fuel taxes, see "School bus fuel tax exemption preserved," *School Bus Fleet* magazine, Feb. 23, 2012. http://www.schoolbusfleet.com/Channel/Contractors/News/2012/02/23/School-bus-fuel-tax-exemption-preserved.aspx. ORS 825.017(1) also specifies "vehicles used by, or under contract with, any elementary or secondary school district are exempt from the payment of weight-mile taxes when engaged exclusively in transporting students to or from school or authorized school activities or those activities sponsored by the State Board of Higher Education." If First Student uses buses for mixed purposes, it would not be entitled to this exemption.

[98] CPSD Financial Manager Spencer Davenport and Personnel Manager Mike Meunier, telephone conversation with Gordon Lafer, Aug. 7, 2012. Through several rounds of questioning on this topic, Mr. Meunier stated "we wouldn't know necessarily on gas," explaining that "I'm not sure there would be a check for the gas" and, therefore, that "I don't know how we would know" if First Student was using district-supplied gas for private ventures.

[99] As of August 2012, First Student charged private customers seeking transportation out of its Central Point facility $2.79 per mile for large buses and $2.47 per mile for small vans. By comparison, the school's charge for the 2012-13 school year is $2.47 for large buses and $2.31 for vans. Communication from Susan Quaintance, First Student Location Manager, White City, Oregon, Aug. 7, 2012.

[100] Article 1, Section 1.2; Section XVII, Clause 7.

[101] http://www.firstcharterbus.com/branch/22034/lakeoswego-oregon/

[102] Letter to Gordon Lafer from LOSD Executive Director of Finance Stuart Ketzler, June 27, 2012.

[103] Lafer and Bussel, *All Costs Considered*, 2004, "Recommended Procedures for Due Diligence," pp. 49-52.

Published by

Oregon School Employees Association
4735 Liberty Rd S, Salem, OR 97302

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