

REPORT OF THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

285.1

QUESTIONABLE CONTRACTING PRACTICES
FOR THE 1976 VOTERS PAMPHLET

MARCH 1977



Joint Legislative Audit Committee

OFFICE OF THE AUDITOR GENERAL

California Legislature



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March 29, 1977

The Honorable Speaker of the Assembly
The Honorable President pro Tempore of the Senate
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Members of the Legislature:

Your Joint Legislative Audit Committee respectfully submits the Auditor General's review of contracting practices for the 1976 primary election voters pamphlet.

The state principals involved were the Secretary of State, the Director of General Services, and the State Printer. Because of prior printing commitments, the State Printer was unable to accept an order for the primary election pamphlet but did take the general election order. The low bid was submitted by a printing company in Indiana.

The Auditor General finds that the State Printer could not have taken the primary election order at less cost to the State and that the State could have realized savings by going to bid on the general election pamphlet. It is recommended that the State Printer be required to bid on future pamphlet printing. Further, that the Legislature consider giving California printers a five percent bid preference over non-California printers.

The auditors are Robert M. Neves, Audit Manager; Curt Davis; Ron Franceschi; and Don Truitt.

Respectfully submitted

MIKE CULLEN
Chairman

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SUMMARY

The 1976 primary voters pamphlet printing contract was awarded to an out-of-state firm. This report concerns why the printing was done out-of-state, rather than by the Office of State Printing or a California firm. According to officials at the Office of State Printing, the decision was made to forego the pamphlet work at the state plant because it was economically more feasible to print school textbooks, and capacity limitations at the printing plant prevented doing both. Furthermore, under a 1970 opinion of the Attorney General, the State cannot extend preference to vendors of California manufactured products. Therefore, as the lowest bidder meeting job specifications, an out-of-state firm was awarded the contract.

Our review revealed several deficiencies in the manner in which the contract was awarded. These deficiencies may have prevented the State from receiving a lower bid than the one accepted. Additionally, we found that contracting for printing work of this type may be cost beneficial to the State. Cost comparisons between private industry and the State Printer indicate that substantial savings were realized by contracting this work with a private firm.

To determine the extent of the legal restraints that prevent giving preference to California vendors, we requested the Legislative Counsel to determine if factors other than the lowest direct amount bid could be considered in determining contract awards. In an opinion

issued in February 1977, the Legislative Counsel concluded that the Legislature may provide by statute that a business firm located in California can be given a percentage credit for purposes of determining the amount of its bid. We believe that legislation to provide business preference to California firms would have a beneficial effect on the State's economy and would also provide an opportunity for California firms to better participate in the business affairs of the State of California.

INTRODUCTION

In response to a resolution of the Joint Legislative Audit Committee we have reviewed the decision to have 9.9 million 1976 primary election voters pamphlets printed by the R.R. Donnelley & Sons Company of Warsaw, Indiana, rather than by the State Printer. This examination was conducted under authority vested in the Auditor General by Section 10527 of the Government Code.

The report is in response to questions regarding (1) why the job was not filled by the State Printer, (2) why the State Printer could not do the job as quickly or as economically, and (3) why bids were not limited to California firms.

Section 14860 of the Government Code authorizes the State Printer to refuse printing orders as follows:

Whenever the Office of State Printing is not equipped to fill an order for printing or other work, the Office of State Printing shall so notify the state agency or agencies submitting the order and the State agency or agencies shall then make purchases of such printing or other work directly through the Office of Procurement of the Department [of General Services].

Under this authority the Office of State Printing and the Office of Procurement decided to request invitations to bid on the 1976 primary voters pamphlet printing work. Bid proposals were mailed to private firms, and based on bids received, the R.R. Donnelley & Sons Company was issued a purchase order as the low bidder.

The total printing and delivery cost of the pamphlets was \$1,009,000. About \$793,000 of this amount was directly related to the work done by the R.R. Donnelley & Sons Company on the English version of the pamphlet. The remaining \$216,000 accounts for printing and delivery costs associated with the Spanish and Chinese versions of the pamphlet and administrative charges assessed by the Department of General Services.

The Office of State Printing printed the general election pamphlets. The printing on the general election voters pamphlet was started approximately four months after the printing of the primary pamphlets. Total cost of printing and delivery was \$1,220,000.

This report deals only with the circumstances surrounding the printing of the voters pamphlet. A more thorough review of the State Printer's operations and related communications subjects is currently under way.

AUDIT RESULTS

INADEQUATE BIDDING PROCEDURES MAY HAVE PREVENTED THE STATE FROM OBTAINING A LOWER BID

Bidding procedures used in awarding the 1976 primary voters pamphlet printing and delivery contract were inadequate and may have prevented the State from obtaining a lower bid than the one accepted from the R.R. Donnelley & Sons Company.

Data provided by private printing firms in response to our bid process survey indicate that (1) the bid invitation was not sent to some qualified bidders, (2) the time allowed for response to the bid invitation and the time allowed between the bid response deadline and the contract start-up date were inadequate, (3) the printing specifications in the bid offering were unclear, and (4) the size of the printing order was too large for most California printing firms to manage individually.

Two of the firms that did not receive the original bid invitation supplied us with data that indicate that had they been notified of the bid order, each might have submitted a bid lower in overall cost to the State than the one accepted from R.R. Donnelley & Sons Company. Both of these firms are California-based and would have performed the printing work within the State.

In September 1975, four months before the invitation to bid was mailed, the State Printer had indications that the production capacity of the State Printing Plant might be insufficient to produce the 1976 primary voters pamphlet within the time required by the Election Code.

Between September 1975 and February 1976 the pamphlet size was uncertain and estimates of size ranged from 72 pages to 432 pages. The confusion over the size of the pamphlet was not settled until February 5, 1976, when the Secretary of State advised the State Printer that separate pamphlets for English and non-English translations would satisfy the requirements of the federal Voting Rights Act. According to the State Printer the uncertainty of size and quantity prompted the need to contract the job to private printers because it was impossible to schedule production of this work and other agency work. Although the State Printer knew that it might be impractical for him to do the work, no action was taken by either the State Printer or the Office of Procurement to inform private printers of the potential order or to ensure that a bidders list of qualified printing firms was available.

In January 1976, nearly four months after the State Printer first had indications he might be unable to produce the pamphlet, the decision was made to contract for the English version of the pamphlet. The bid invitations were prepared and mailed on January 9, 1976, 27 days before the final size of the pamphlet was determined.

Under the terms of the invitation to bid, firms were required to submit bids on a 10-million-pamphlet order to be produced within a 33-day period between March 15, 1976 and April 17, 1976. The bid was to include estimates based on 64 pages with added sizes of 8 to 144 pages. The due date of the bid response was January 19, 1976, ten days after the original mailing. A bid change order clarifying pamphlet size, delivery schedule and the method of computing the award was mailed on January 14, 1976 (five days prior to the bid due date); however, the bid response date remained unchanged.

According to the State Office of Procurement, bid proposals for the voters pamphlet were sent to 47 firms. Only three firms submitted bids, however, and one of these stated it would only be able to accept one-half the order.

Bid Survey Questionnaire

As a part of our study we sent a questionnaire to those firms on the bidder list supplied by the Office of Procurement that did not respond to the original bid invitation. These firms were asked to respond to several questions concerning bid procedures. In addition, we asked these firms to provide us with bid estimates for printing a full and partial order.

Four of the questionnaires were returned to us because of undeliverable addresses. Of the remaining firms, 17 responded to the questionnaire. A compilation of these responses indicates the procedures used in developing the bid proposals and carrying out the notification

and selection process were inadequate for a job of this magnitude. The following deficiencies in the bid process were cited by the responding firms:

- Six firms indicated they never received the original invitation to bid.
- Six firms indicated they did not receive the addendum to the original invitation.
- Six firms indicated the quantity requirements were too great.
- Seven firms indicated the time allowed to respond was inadequate.
- Two firms stated the specifications were incomplete.
- Four firms stated the time allowed for planning was inadequate.

Three of the firms supplied us with bid quotations on either partial or full orders. Two of these quotations were competitive with the contract bid price awarded to R.R. Donnelley & Sons Company. With adjustment for the reduced transportation and delivery costs associated with the work, the bids of both firms may have been under the total cost of the bid awarded to the R.R. Donnelley & Sons Company. For example, the total estimated bid cost under the Donnelley order was approximately \$731,000. The estimated bid costs under the quotations provided to us in our questionnaire by the two competitive firms were \$713,000 and \$724,000.

In drafting the job specifications, important alternatives that would have permitted more firms to bid were overlooked. Had the bid order been separated into two orders of 5 million or four orders of 2.5 million copies each, rather than the one order size for 10 million copies, four California firms indicated they would have submitted a bid. Under this procedure the State would still have been obligated to accept the lowest overall bid whether as a single bid for the entire order of 10 million copies or a combination of several smaller orders by different companies under separate bids; however, more firms would have had an opportunity to participate in the bidding process.

Two firms indicated that the specifications of the pamphlet's size were too restrictive. The 8-3/8" x 11" size required in the bid specifications greatly reduce the tolerances with which these firms prefer to work. A more flexible size enables firms to print at greater speeds at significant reduction in costs. According to these firms, tolerances of up to 1/2" are usually given for most booklet work.

CONCLUSION

Competitive bidding procedures used by the Office of Procurement were ineffective and may have prevented the State from obtaining the most economical bid for the primary voters pamphlet printing. These procedures also prevented some qualified California businesses from bidding.

RECOMENDATIONS

We recommend that the Office of Procurement:

- Develop lists of prequalified bidders, matching firm capability and interest according to the type of printing work required.
- Conduct more research on firm capability well in advance of the date for sending bid invitations.
- Develop contingency plans with the Office of State Printing in advance of bidding and printing deadlines to determine what portions of the work might be completed by the State Printer.
- Establish less restrictive bid specifications to enable more firms to participate in the competitive bidding process.
- Determine how large orders can be separated into multiple smaller orders to enable more firms to bid.
- Maintain bidders lists that include current addresses.
- Follow up on bid invitations sent to ensure that firms listed actually received them.

BENEFIT

California firms will have increased opportunity to be awarded state contracts, thereby improving the overall business climate within the State. More qualified firms competitively bidding for the work could effectively result in lower contract prices to the State.

LEGISLATION COULD EXTEND CONTRACT
PREFERENCE TO VENDORS OF CALIFORNIA
PRODUCTS

As a result of a 1970 opinion of the Attorney General (Appendix A), the State does not extend contract preference to vendors of California manufactured products. This opinion indicates that the lowest responsible bidder meeting job specifications must be awarded the contract. Accordingly, based on the lowest bid submitted, the 1976 primary voters pamphlet printing contract was awarded to the R.R. Donnelley & Sons Company of Warsaw, Indiana.

To determine the extent of the legal restraints regarding this opinion, we requested the Legislative Counsel of California to determine if factors other than the lowest direct amount bid could also be considered in determining contract awards. Specifically, we requested that the Legislative Counsel determine whether the Legislature, by statute, may provide that a business firm located in California could receive a percentage credit for purposes of determining the amount of its bid on any state contract for construction of public works or the purchase of materials for public use. In Opinion No. 987 (Appendix B), issued February 23, 1977, the Legislative Counsel concluded:

The Legislature may provide by statute that a business firm located in California shall receive a percentage credit for purposes of determining the amount of its bid on any state contract for construction of public works or the purchase of materials.

In view of this opinion, it seems that the State may ensure that its interest is best served by giving a preference to California firms in cases where the State is performing a proprietary function such as awarding contracts for its printing.

The California Legislature has facilitated small business participation in state procurement and construction contracts by providing eligible small businesses a five percent preference. Legislative intent states:

The Legislature hereby declares that it serves a public purpose, and is of benefit to the state, to promote and facilitate the fullest possible participation by all citizens in the affairs of the State of California and it is desirable to improve the economy of the State of California in every possible way. It is also essential that opportunity is provided for full participation in our free enterprise system by small business enterprises.

Legislation could also grant a percentage credit to California firms, as opposed to out-of-state firms, for purposes of determining the lowest bidder. If a California-based firm and an out-of-state firm each submitted a bid of \$100,000, a credit of five percent applied to the California-based firm bid would reduce its bid to \$95,000, although the firm would be paid \$100,000.

According to references cited by the Legislative Counsel, several state statutes that limit the administration of public business have been court-tested. In American Yearbook Co. v. Askew, the U.S. Supreme Court affirmed a District Court decision that held constitutional

certain Florida statutes that require all public printing of the state to be done within the State of Florida. The authority of this case was cited in two recent State Supreme Court decisions. The courts upheld Arizona statutes giving resident contractors a five percent preference on bids submitted for public work to be paid from public funds and Illinois statutes giving preference to residents for employment on public works.

The Florida statutes provide that public printing shall be awarded to the lowest responsible bidder, and at the same time require that all state printing shall be done in the state. Had a similar provision been in the California statutes, the 1976 primary voters pamphlet printing work would have been done in California by the second lowest bidder. In this case, after consideration of all factors involved in the job, including printing, binding, material and delivery, the additional cost to the State (applying the concepts of the Florida preference law) would have been approximately four percent, or \$29,000, higher than the contract executed with the R.R. Donnelley & Sons Company.

Although the direct cost would have been higher, the positive effect on the California economy would offset such costs. Under current procedures, accepting a bid from an out-of-state firm may result in economic losses to California. In addition to the direct loss of tax receipts to state and local governments, there is a reduction in other economic activities as a result of the loss of revenues generated from the "multiplier effect." The multiplier effect is an economic theory which accounts for the increased circulation of dollars spent within the

economy of a given area. According to estimates by the Department of Finance, Financial and Economic Research Unit, the increased dollar flow for state functions, such as printing, may range from 2.5 to 3 times the original dollar value.

CONCLUSION

The Legislature could provide California business firms with a percentage credit for purposes of comparing the amount of bids.

RECOMMENDATION

We recommend that the Legislature consider providing business preference to California firms in those cases where the State is performing a proprietary function and the interests of the State are best served.

BENEFIT

The State will provide an opportunity for California firms to better participate in the business affairs of the State of California and thereby realize gains from the multiplier effect that the program would have on the State's economy.

STATE PRINTER'S COSTS
EXCEED PRIVATE INDUSTRY

The State Printer's decision to contract to a private firm for printing the June 1976 primary voters pamphlet resulted in substantial cost savings to the State even though a lower price may have been achieved. Had the November 1976 general election voters pamphlet work also been contracted, additional cost savings would have been realized.

The cost savings realized from contracting for the primary election pamphlet printing work were twofold. First, the costs of going to bid were \$38,600 less than if the State Printer had done the work. Second, it was more economical for the State Printer to manufacture textbooks instead of voter pamphlets. During the 40-day period that would have been needed for the State Printer to print the pamphlets, the State saved approximately \$686,000 by printing textbooks at the State Plant rather than purchasing them.

Additional cost savings of approximately \$91,000 would have been realized had the State Printer contracted for the November 1976 general election pamphlet printing work.

Primary Pamphlet

The State Printer's decision to contract for the printing work on the June 1976 primary voters pamphlet was based on the determination

that it was more economical to go to bid on the voters pamphlet than on the textbooks.

Capacity limitations at the State Printing Plant prevented the State Printer from printing both the voters pamphlet and the entire textbook orders. In the case of the voters pamphlet work, the Election Code requires that the printing and delivery be completed within a specific 40-day period of each election year. This time period coincided with the State Printer's peak textbook production schedule. The time requirement that would have been necessary to print the primary voters pamphlet would have allowed him to accept only part of the textbook order. (To understand the magnitude of the job requirements for the voters pamphlet work, the State Printer required 42 days, using his two largest presses, to complete the printing on the November general election pamphlet.)

Textbook Savings

According to the State Printer's estimates, he saves the State money by printing textbooks. Savings are realized whenever the State Printer's manufacturing and royalty costs are under the publisher's selling price. During fiscal year 1975-76, for example, the State Printer manufactured 3.7 million textbooks and according to his estimates saved the State \$2.6 million. We estimate that approximately \$686,000 of this savings was realized during the 40-day period that would have been needed to print the primary voters pamphlet.

Cost Comparison

Final data on the printing and delivery of the 1976 English version of the primary voters pamphlet show a printing and delivery cost, before adjustment for surcharges, of \$792,700. Based on an estimate prepared by the State Printer this cost is approximately \$38,600 less than if he had done the work.

The following table compares actual costs with the costs estimated by the Office of State Printing.

Primary Election Pamphlet
Comparison of Printing and Delivery Costs
Office of State Printing vs. R.R. Donnelley & Sons Company

	<u>Printing and Binding</u>	<u>Paper</u>	<u>Freight and Delivery</u>	<u>Total</u>
Office of State Printing (Estimate)	\$309,900	\$458,800	\$ 62,600	\$831,300
R.R. Donnelley (Actual)	<u>251,600</u>	<u>359,400</u>	<u>181,700</u>	<u>792,700</u>
Difference	<u>\$ 58,300</u>	<u>\$ 99,400</u>	<u>\$(119,100)</u>	<u>\$ 38,600</u>

As shown above, had it not been for the additional freight and delivery charges necessitated as the result of doing the printing in Indiana rather than California, the cost savings to the State would have been \$119,100 greater.

Although we did not precisely determine why the cost of the printing from R.R. Donnelley & Sons Company was significantly less than the State Printer's estimate, indications are that the printing presses used by the State Printer are not as efficient as those used by R.R. Donnelley & Sons Company. The apparently greater machine efficiency at the R.R. Donnelley firm resulted in less paper use than if the State Printer had done the work. The labor costs for R.R. Donnelley & Sons Company may also have been lower than salaries paid in California. Since labor generally constitutes approximately one-third of printing costs, this allows certain out-of-state manufacturers to price printing below that produced by the State Printer.

General Election Pamphlet

The Office of State Printing printed the November 1976 general election pamphlet. The reported costs for paper, printing and binding of the English version of the pamphlet was \$1,113,000. Comparisons of this cost with cost estimates of private firms doing equivalent work indicate that the State Printer's costs are higher, and that substantial savings might accrue to the State if jobs of this magnitude were handled by private industry.

Two printing firms responding to our bid process survey on the June 1976 primary voters pamphlet printing work provided us with bid quotations that indicate they can perform printing and binding work at less cost than the State Printer. These firms and two of the three firms that responded to the original bid invitation on the primary

pamphlet work provided cost quotations, including profit, ranging from 4 percent to 22 percent less than the State Printer's estimate for doing the work.

The State Printer's costs to print and deliver the English version of the general election pamphlet were significantly greater than the R.R. Donnelley firm's cost to print and deliver the English version of the primary election pamphlet. After adjustment for the increased size and volume of the general election pamphlet order, we estimate that the R.R. Donnelley printing, binding and newsprint charges would have been approximately \$302,000 less than the cost incurred by the Office of State Printing. However, considerably more freight and delivery costs would have been incurred had R.R. Donnelley done the work. Even with this cost differential, however, we estimate that R.R. Donnelley & Sons' price would have been approximately \$91,000 less than the State Printer's.

CONCLUSION

Contracting the printing work on the primary election voters pamphlet resulted in a cost savings to the State. However, printing the general election voters pamphlet at the Office of State Printing may have cost the State more than private firms would have charged.

RECOMMENDATION

We recommend that for future pamphlet printing, the State Printer submit a competitive bid along with private firms. His bid would be compared against all other responsible bids

received, item for item. The Office of Procurement would award the printing contract to the State Printer only upon demonstration that he could produce the work as the lowest responsible bidder.

BENEFIT

The State will benefit economically by selecting the lowest bid price for the work. The printing industry will benefit from the increased opportunity for private firms to compete for state contracts.

UNNECESSARY CHARGES IN EXCESS OF COST
WERE MADE FOR PRINTING THE PRIMARY
VOTERS PAMPHLET

Unnecessary charges in excess of cost have been made by the Department of General Services and the Office of State Printing to the Secretary of State for services provided in printing the English version of the 1976 primary voters pamphlet. The unnecessary charges consist of separate 5 percent and 10 percent assessments levied on the direct costs associated with the printing and delivery of the pamphlets. The assessed charges are \$119,700 greater than the Department of General Services' Price Book quotation of \$2,000 for contract services.

Starting in fiscal year 1972-73 the Department of General Services initiated charges to its customers in excess of costs for supplies and services procured. The Department of General Services thereby provides additional working capital for the Service Revolving Fund. The Service Revolving Fund needs cash for the purchase of materials, supplies and equipment and for the payment of salaries, wages and other expenses until such time as it can recover its costs through collection from the client agencies. For fiscal year 1975-76 this charge was 5 percent in excess of actual costs incurred.

In addition to this charge the Office of State Printing charges its customers a 10 percent surcharge for contract services provided whenever the State Printer contracts for printing work rather than doing it himself. As near as we could determine, the justification for this

charge is based on the assistance provided by the Office of State Printing to plan and coordinate various functions related to contract services.

Neither of these surcharges is appropriate for the services performed on the voters pamphlet work by the Office of State Printing and the Department of General Services. These services included assistance in identifying potential bidders, preparing bid specifications, preparing cost estimates, ordering newsprint and various other coordinating activities. A more appropriate charge for these services is established by the Department of General Services in their publication titled "Price Book and Directory of Services." This publication states that the maximum price chargeable to customer agencies for contract services similar to that provided on the voters pamphlet is \$2,000.

In our judgment the charge for services in excess of cost to the Secretary of State for printing and delivery of the English version of the 1976 primary voters pamphlet was unnecessary and provided a wind-fall profit to the Service Revolving Fund at the expense of the Secretary of State (General Fund). The amount of overcharge was \$119,700.

RECOMMENDATIONS

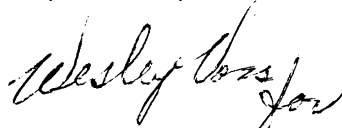
We recommend that the Department of General Services:

- Discontinue charging its customers amounts in excess

of cost for supplies and services procured for its customers from private vendors.

- Return to the Secretary of State the amount of charges in excess of cost for the printing and delivery of the 1976 primary voters pamphlet.

Respectfully submitted,



JOHN H. WILLIAMS
Auditor General

March 25, 1977

Staff: Robert M. Neves
Curt Davis
Ron Franceschi
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March Fong Eu

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Corporation Index	(916) 445-2900
Corporation Records	(916) 445-1768
Election Division	(916) 445-0820
Legal Division (Corp.)	(916) 445-0620
Notary Public Division	(916) 445-6507
State Archives	(916) 445-4293
Uniform Commercial Code	(916) 445-8061

March 23, 1977

Mr. John H. Williams
Auditor General
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Williams:

This is to acknowledge receipt of your draft report concerning the printing of the 1976 voters pamphlet. We have no problem with the report; however, we would like to share our observations with you.

1. The report seems to in part imply that the voters pamphlet should be printed by the method which would be the most cost beneficial to the state. The report also seems to suggest that California vendors be granted a percentage credit for bid-awarding purposes. We would agree that the most cost-beneficial approach should be used. However, that may not be possible in every instance if California vendors are allowed a percentage credit. We are not opposed to the percentage-credit concept. We are simply pointing out the cost of the pamphlet could be greater. It is understood that other economic considerations could be offsetting factors.
2. This office would have no basic objection to splitting the printing order between vendors if such an alternative would be more cost effective; provided, however, that the Office of State Printing would provide all of the selected vendors with preset text in the statutorily prescribed format. If this concept is to be followed, extreme care in wording the bid specifications would be required so that bids, be they for the full job or partial, could be properly evaluated.

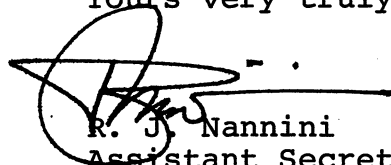
Mr. John H. Williams
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March 23, 1977

3. It would appear that some printers did not bid because the specifications for the pamphlet are too restrictive. While a more flexible size might enable firms to print at a greater speed, it should be noted that Section 88005 of the Political Reform Act of 1974 specifically provides that the pamphlet shall be not smaller than 8-1/2 x 11 inches in size. Therefore, tolerances for a larger size pamphlet may be permissible, but not for a smaller size one. It further provides for the size of the type which is to be used for different parts of the pamphlet. In other words, the restrictions set forth in Section 80000, et seq., of the Political Reform Act of 1974 cannot, in our judgment, be waived.
4. Then there are the time constraints for qualifying ballot measures and for delivery to the voters. Ballot measures can qualify up to 131 days before the election. The logistical efforts required after that date are extremely demanding and cannot be waived.

On more than one occasion the Legislature has qualified measures after the 131-day deadline by including in the measure a waiver of the 131-day requirement. This is mentioned simply for the purpose of illustrating some of the constraints that may cause some printers not to submit bids.

This office will, however, cooperate in any way possible so that the printing of the ballot pamphlet can perhaps be more efficiently accomplished.

Yours very truly,



R. J. Nannini
Assistant Secretary of State

RJN:jc

Memorandum

To : John Williams
Auditor General
925 "L" Street, Suite 750
Sacramento

Date : March 23, 1977

File No.:

From : Department of General Services

Subject: Auditor General's Report Regarding 1976 Voters Pamphlet

We are replying to your request for a response to the draft of the report titled "Questionable Contracting Practices for the 1976 Voters Pamphlet". This appears to be an odd title for a report that is to summarize findings of an investigation to determine if in fact there were questionable practices. We request that this title be revised to reflect the objectivity of your report.

Our response, prepared in the short period allowed, has been drafted to correspond with the order outlined in your table of contents.

1. Bidding Procedures --

- a. Government Code Section 14809 requires bids to go to all qualified bidders who have notified the department in writing they desire to bid on such supplies...and who have been prequalified..."shall be furnished with bids". This was done, and bids were sent to 12 additional printers who were believed to be capable of bidding.
- b. It is true that bid time and performance time were short. The uncertainty of the Secretary of State's office over the requirement for multiple language printing was the reason for this. Clearance to go to bid was given so late that the time frame was abbreviated. They were, however, adequate for two complete responses and one for a part of the requirements.
- c. The Specifications were clear enough to be understood by three competent bidders.
- d. There is no question that this was a large printing job. A split of the quantity among smaller printers could be expected to increase bid prices and would, especially in the limited time available for this bid, magnify control, responsibility and logistics problems. The possibility of accepting partial bids was considered and rejected in discussions between Procurement and State Printing. However, the bid specifically allowed joint bids, so that several small printers could have bid together, each run a part of the order, each having collective and individual responsibility for performance.

Even though the pamphlet size was not settled, according to Auditor General's draft report, until 2-5-76, the bid was opened on January 19, 1976, and ready for award before 2-5-76.

To notify printers of the possibility of a bid would be futile. Without a firm specification they could make only tentative plans and could not be expected to reserve press time on a faint possibility of winning a bid that might or might not have been issued.

The bid originally showed $8\frac{1}{2}$ x 11 trimmed minimum and 9 x 12 maximum, tolerances were thus $\frac{1}{2}$ and 1 inch. The maximum was then removed, allowing more tolerance. In addition, the size of the pamphlet is very specifically set out in the law. Tolerances in any event are well within accepted trade tolerances.

2. Legislation could extend contract preference to vendors of California products --

This issue is more appropriately discussed in the legislative environment since it would require a law change. As pointed out in your report, the only legal opinion on record is that of Attorney General Lynch and this indicates such action is unconstitutional. Under present laws, the Office of Procurement now has no authority to restrict bidding to California firms or to grant preference to them.

3. State Printer's Costs Exceed Private Industry --

In the specific instance of the June 1976 ballot pamphlet, it is true that the cost of producing that pamphlet in the time allowed was less expensive at R. R. Donnelley. I think it is important to note that in this instance the circumstances were extraordinary because of the introduction of Federal legislation requiring several language versions.

These time constraints forced us to consider pressing all available equipment into use. Some equipment was ideally suited to the job; other equipment was admittedly less efficient. It was this type of consideration that led to our decision to have this work produced elsewhere.

With regard to the difference, we do not agree that it is as great as indicated in your report, since, because of other circumstances, we could have actually delivered copies to the registered voters for less. In your consideration you have marked up paper attributed to OSP production and used raw cost for R. R. Donnelley. This situation does not exist in the real world since all printers mark up stock to recover cost of acquiring storing and handling stock. Also, your figures include no charge for the delivery of stock to the R. R. Donnelley location.

We feel a fair statement of the differential is indicated in the table as shown on Attachment A to this letter.

There appears to be no substantiation for the statement that \$91,000 could have been saved on the November, 1976, pamphlet. We believe this figure is in error since it varies broadly with our projections using the primary election pamphlet as a model.

Without an opportunity to review the basis for your statement, we must conjecture something was left out such as the composition, or the return cards for people requesting ballot pamphlets in languages other than English.

4. Unnecessary charges in excess of cost were made for printing the primary voters pamphlet --

The implication in this statement is that the only costs involved in the operation of a printing plant are direct costs and the indirect costs are ignored. Since the State Printing Office is a Service Revolving Fund type of operation, it must recover all of its costs in some manner. An assessment of 10% for indirect costs in processing an order is well below industry averages.

In the processing of the order for the Secretary of State, we were required to:

- a. Provide all the preliminary planning expertise on the design of the pamphlet in conformance with strict definitions of the Political Reform Act, in this case also taking into account Federal laws requiring bilingual presentation.
- b. Thirty-five different alternatives were considered by the Secretary of State and others involved in this project and estimates prepared on each.
- c. Presentations were prepared for and made to Department of Finance, the Governor's Office, Members of the Legislature, and the Political Reform Commission.
- d. Dummies were made up by the Art Department illustrating various approaches to bilingual presentation of the various propositions.
- e. Research on the availability cost, etc., of specialty typesetting facilities for various Chinese dialects, etc., were accomplished.
- f. Design and research were required on the preparation of the cards used for requesting other than English versions of the ballot pamphlet.
- g. State Printing paid for the processing of orders by the Office of Procurement, in this case \$2,000 for the order to R. R. Donnelley, and \$2,000 for the order to Zellerbach Paper Company for the paper.
- h. It was necessary for us to prepare a detailed package of instructions to the printer since pamphlets printed for each county had to have separate return addresses, separate mail indicia, and the return reply card had similar problems.

Items like these justify a charge that allows us to recover our indirect costs in assisting State agencies who require our specialized services in the printing area.

My staff has attempted to cooperate in every feasible manner, and if further clarification of the above is necessary we will be available. The primary election ballot pamphlet was put out to bid because it was in the best interests of the State and the bidding procedure resulted in production at the lowest possible cost.

Primary Election Pamphlet
 Comparison of Printing and Delivery Costs
 Office of State Printing Vs. R. R. Donnelley & Sons Company

	Printing And Binding Costs	Actual Paper Cost	Freight And Delivery	Subtotal	Paper 10% Markup	5% Surcharge	Total
OSP Estimate	\$323,007	\$412,305	\$ 33,096	\$768,408	\$ 41,230	\$ 40,482	\$850,120
R. R. Donnelley & Sons Actual	253,458	463,378	77,744	794,580	46,338	42,046	882,964
DIFFERENCE	<u>\$ 69,549</u>	<u>(\$ 51,073)</u>	<u>(\$ 44,648)</u>	<u>(\$ 26,172)</u>	<u>(\$ 5,108)</u>	<u>(\$ 1,564)</u>	<u>(\$ 32,844)</u>

ATTORNEY GENERAL'S OPINIONS

Opinion No. 69-253—February 11, 1970

SUBJECT: PURCHASE OF FOREIGN MATERIALS IN PUBLIC WORKS—

The California Buy American Act and the California Preference Law are unconstitutional; contracts entered into prior to determination are legal and binding.

Requested by: DEPARTMENT OF GENERAL SERVICES

Opinion by: THOMAS C. LYNCH, Attorney General
Raymond M. Momboisse, Deputy

The Department of General Services has requested an opinion on the following questions:

1. Is the California Buy American Act constitutional?
2. Is the California Preference Law constitutional?
3. If they are unconstitutional, what is the status of contracts previously entered into by the State pursuant to their mandate?
4. If they are unconstitutional, must the State now accept foreign-made items on contracts incorporating the restrictions of those laws which were entered prior to their being declared unconstitutional?
5. If they are unconstitutional may the State amend or modify a previously entered contract to allow the substitution of foreign-made items for the domestic ones specified in the contract?
6. If a modification is permissible may the State:
 - (a) Require the contractor to pay any resulting expenses incurred by the State, such as increased inspection costs, or
 - (b) Require the contractor to share any resulting economic benefit with the State?

The conclusions are:

1. The California Buy American Act is unconstitutional.
2. The California Preference Law is unconstitutional.
3. Contracts entered into by the State of California prior to the judicial determination that the California Buy American Act was unconstitutional are legal and binding on all the parties to the contract.
4. As the contracts entered into by the State of California prior to the judicial determination that the California Buy American Act was unconstitutional are

legal and binding, each party to the contract must perform according to the terms of the contract. Thus foreign goods may not be substituted where domestic items have been specified.

5. The State is empowered by section 11010.5 of the Government Code to modify contracts; but in the case of contracts entered into by the State pursuant to any statute requiring the contract to be let on the basis of competitive bids, such modification is allowed only if the contract or the law so provides.

6. In those instances where the State is authorized to modify a contract, not entered into pursuant to bids, the parties by mutual agreement establish the terms of the modifying contract. Such agreement may authorize reimbursement to the State for expenses resulting from the modification and may provide for an adjustment in prices.

In those instances where the State is authorized to modify a contract entered into pursuant to competitive bidding, the contract controls and determines what compensation the State may receive.

ANALYSIS

The California Buy American Act, sections 4300 through 4305 of the Government Code, provides generally that any public body or officer authorized to enter into contracts for the construction, alteration or repair of public works or for the purchase of materials for public use shall let such contracts only to persons who agree to use or supply materials produced in the United States or articles manufactured in the United States substantially all from materials produced in the United States, if such materials are of a class or kind which are produced in the United States.

The California Preference Law is found in sections 4330 through 4334 of the Government Code. Generally it provides that the state, counties and cities are to give a preference to California produced goods (Gov. Code § 4331).

The constitutionality of the California Buy American Act was passed upon by the Court of Appeal. In its opinion rendered on September 18, 1969, in *Bethlehem Steel Corp. v. Bd. of Commissioners*, 276 A.C.A. 266 (hearing by the California Supreme Court denied November 12, 1969), the court held that the California Buy American Act (Gov. Code §§ 4300-4305) was unconstitutional.

Public authorities in California must respect this judicial determination of the question. Thus all calls for bids and all contracts entered into by public agencies after the date of that decision must be devoid of any requirement of compliance with the California Buy American Act. The information supplied to us indicates that such has been the policy of the State since that decision was rendered.

As the California Preference Law affects foreign commerce as much as did the California Buy American Act, the reasoning of the court in the *Bethlehem* case requires that a like conclusion be reached with regard to the California Preference Law. It is unconstitutional because it constitutes "an unconstitutional intrusion into an exclusive federal domain."

The important question now is what effect does this decision have on contracts already entered into by the State in accordance with the dictates of these laws.

Or to rephrase the question, "Should the *Bethlehem* decision be applied retroactively or only prospectively?"

The United States Supreme Court in *Cipriano v. City of Houma*, 395 U.S. 701, 706, 23 L.Ed.2d 647, 89 S.Ct. 1897 (1969), held that a decision should not be given retroactive effect where it "could produce substantial inequitable results if applied retroactively . . ." Specifically the court there held that its decision invalidating a state statute giving only property taxpayers the right to vote in municipal utility bond approval elections would be applied prospectively.

"That is, we will apply it only where, under state law, the time for challenging the election result has not expired, or in cases brought within the time specified by state law for challenging the election and which are not yet final. Thus, the decision will not apply where the authorization to issue the securities is legally complete on the date of this decision. Of course, our decision will not affect the validity of securities which have been sold or issued prior to this decision and pursuant to such final authorization."

Applying this test, all contracts actually entered into by the State prior to the date of the decision in the *Bethlehem* case are valid. Naturally, the same is true of any contract that has been wholly or partially performed by that date. To hold otherwise would produce "substantial inequitable results" and a multiplicity of lawsuits.

This conclusion finds support in other decisions of both federal courts and those of our own state. *Gelpcke v. Dubuque*, 68 U.S. 175, 17 L.Ed. 520 (1863); *Cooley v. County of Calaveras*, 121 Cal. 482, 486 (1898); *Kenyon v. Welty*, 20 Cal. 637, 642 (1862); *Bank of America v. Dept. of Mental Hygiene*, 246 Cal. App. 2d 578, 586, 54 Cal. Rptr. 899 (1966).

It follows that if the decision is not given retroactive effect for the purpose of questioning the validity of the contract, it cannot be given retroactive effect for the purpose of altering the specifications spelled out in that contract. Thus the parties to the contract must strictly adhere to the terms of the contract.

A contract to which the State is a party can be modified only if such authority is granted by law. *Calif. Highway Com. v. Riley*, 192 Cal. 97, 107-108 (1923); *Paterson v. Bd. of Trustees*, 157 Cal. App. 2d 811, 818-819 (1958). Such authority is granted the State by section 11010.5 of the Government Code. That section not only confers the power to modify, but sets forth the conditions and procedures. It provides:

"Where authority is vested in any state agency to contract on behalf of the state, such authority shall include the power, by mutual consent of

the contracting parties, to terminate, amend, or modify any contract within the scope of such authorization heretofore or hereafter entered into by such state agency. The modification, amendment, or termination of any contract subject by law to the approval of the Department of General Services, Director of General Services, or other state agency, shall also be subject to such approval.

"This section does not apply to contracts entered into pursuant to any statute expressly requiring that such contracts be let or awarded on the basis of competitive bids. Contracts required to be let or awarded on the basis of competitive bids pursuant to any such statute may be terminated, amended, or modified only if such termination, amendment, or modification is so provided in the contract or is authorized under provision of law other than this section. The compensation payable if any for such amendments and modifications shall be determined as provided in the contract. The compensation payable if any in the event the contract is so terminated shall be determined as provided in the contract or applicable statutory provision providing for such termination."

Pursuant to this section a contract with the State, not let pursuant to bid, may be modified by the mutual agreement of the parties to it. Such modification may authorize the substitution of foreign items for American or California products previously required. The State as a condition of agreeing to the modification may require a price adjustment and compensation for increased costs incurred by the State which will result from the substitution.

In case of contracts entered into pursuant to a statute expressly requiring that such contracts be let on the basis of competitive bid, modification is permitted only if it "is so provided in the contract or is authorized under provision of law . . ." When modification is allowed, the compensation payable is to be determined in accordance with the provisions of the contract. Thus whether the State is to be compensated for resulting expenses or is to share any resulting economic benefit is determined by the terms of the contract or pertinent statute. The measure of such compensation is likewise determined by the terms of the contract or pertinent statute.

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Legislative Counsel of California

BION M. GREGORY

Sacramento, California
February 23, 1977

Honorable Mike Cullen
Assembly Chamber

State Contracts: Domestic Firm
Preference - #987

Dear Mr. Cullen:

QUESTION

May the Legislature provide by statute that a business firm located in California shall receive a percentage credit for purposes of determining the amount of its bid on any state contract for construction of public works or the purchase of materials for public use?

OPINION

The Legislature may provide by statute that a business firm located in California shall receive a percentage credit for purposes of determining the amount of its bid on any state contract for construction of public works or the purchase of materials.

ANALYSIS

We think most of the issues raised by the question are resolved by a United States District Court case which upheld the constitutionality of certain Florida statutes and regulations which require that all printing of the State of Florida be done in the state (American Yearbook Co. v. Askew (M.D. Fla. - 1972), 339 F. Supp. 719, affirmed (1972), 34 L.

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Ed. 2d 168). In so holding, the court ruled that the Florida legislation does not place a burden on interstate commerce in violation of the Commerce Clause of the United States Constitution (Cl. 3, Sec. 8, Art. I, U. S. Const.) and does not deny equal protection of the laws guaranteed by the Fourteenth Amendment of the United States Constitution.

In responding to the equal protection challenge, the court distinguished the exercise of proprietary power by a state from the exercise of governmental power and emphasized that each of the two types of power is limited by distinct sets of rules. The letting of public contracts, particularly those providing for internal needs of government, is clearly a proprietary function. Regarding the performance of this function by the state, the court said, at pages 722 and 723:

" . . . On the other hand, in framing specifications for its printing work, the state performs a proprietary function and stands in the shoes of a private party who is entitled in most instances to choose where and by whom his printing will be done. In that posture the state is like a trustee; the citizens are the beneficiaries. It may be necessary for the state to adopt discriminatory purchasing policies, such as those questioned here, to insure that the interest of the people is best served. In fact it is conceivable that the failure to do so would constitute a breach of the state's duty to its residents. In a case such as this, it is not for the Court to question the wisdom of the Legislature in discharging that trust obligation." (Emphasis added.)

The court used a similar argument in refuting the contention that the Florida printing statutes and regulations were a burden on interstate commerce in violation of the United States Constitution. The court flatly stated that statutes that merely specify the conditions of state purchases, in contrast to trade regulations, are not subject to Commerce Clause restrictions. The court found implicit

refutation of the contention in the case of Atkin v. Kansas (1903), 48 L. Ed. 148, where the court said "it belongs to the state, as the guardian and trustee for its people, and having control of its affairs, to prescribe the conditions upon which it will permit public work to be done on its behalf, or on behalf of its municipalities" (quoted in American Yearbook, supra, at p. 723). The Atkin case upheld a statute which imposed criminal liability upon contractors with the state who permitted or forced an employee to work longer than eight hours per day.

The court, in American Yearbook also rejected the argument that the Florida legislation compromised the fundamental right of travel implicitly guaranteed by the United States Constitution as delineated by the United States Supreme Court in Shapiro v. Thompson (1969), 22 L. Ed. 2d 600. The court simply stated that the Florida statutes and regulations "are in no wise comparable" to the laws considered by the United States Supreme Court in the Shapiro case (American Yearbook, supra, p. 723).

The authority of the American Yearbook case was followed in two recent State Supreme Court decisions. In City of Phoenix v. Superior Court (Ariz.-1973), 514 P. 2d 454, 456, the court upheld a statute which required that contractors who have paid county and state taxes for two successive years immediately prior to the making of a bid on a contract for public work to be paid from public funds receive a 5 percent preference. In People ex. rel. Holland v. Bleigh Construction Co. (Ill.-1975), 335 N.E. 2d 469, 479, the court ruled that the state can give preference to its residents for employment on public works projects.

In addition, we find that the United States Supreme Court has relied on the distinction between governmental and proprietary powers in determining whether adjudications of liability against foreign states impede the conduct of foreign relations by the United States and, therefore, are outside the jurisdiction of the courts under the doctrine of sovereign immunity (Alfred Dunhill of London, Inc. v. Cuba (1976), 48 L. Ed. 2d 301, 312-318). In the Dunhill of London case, the court concluded that the commercial and private activities of foreign states do not give rise to sovereign immunity. We think that the conclusion of the court that the adjudication of the commercial and private transactions of foreign states does not interfere with the conduct of foreign relations by the United States provides additional support for the proposition that a state's regulation of its commercial and private transactions also does not result in such interference.

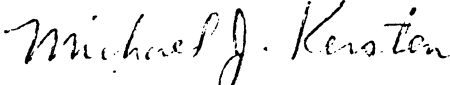
We note that in the case of Bethlehem Steel Corp. v. Board of Commissioners (1969), 276 Cal. App. 2d 221, a California court of appeal held unconstitutional the California Buy American Act (Secs.4300-4305, incl. Gov. C.). That act requires that contracts for the construction of public works or the purchase of materials for public use be awarded only to persons who agreed to use or supply materials manufactured in the United States. The court concluded that the act encroached upon the federal government's exclusive power over foreign affairs and constituted an undue interference with the United States' conduct of foreign relations (p. 224).

The Bethlehem case considered discrimination against foreign-made products, not discrimination against out-of-state and foreign contractors, which is the type of discrimination present in the proposed statute in question. In view of the holding of the American Yearbook case, its affirmance by the United States Supreme Court, its recognition by other state courts, and the decision by the United States Supreme Court in the Dunhill of London case, we think that a California court would not extend the holding of the Bethlehem case by applying its legal principles and analysis to the proposed statute. We note that the Bethlehem court failed to make any distinction between state governmental powers and state proprietary powers and treated the California Buy American Act like an international trade regulation. We think a California court would rule that the proposed statute in question is subject to United States treaties or trade agreements to no greater extent than a contract provision offered by private business.

Accordingly, we conclude that the Legislature may provide by statute that a business firm located in California shall receive a percentage credit for purposes of determining the amount of its bid on any state contract for construction of public works or the purchase of materials.

Very truly yours,

Bion M. Gregory
Legislative Counsel


By
Michael J. Kersten
Deputy Legislative Counsel

MJK:ns

Office of the Auditor General

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
Secretary of State
State Controller
State Treasurer
Legislative Analyst
Director of Finance
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
California State Department Heads
Capitol Press Corps