

## CHAPTER 5

# PRIVATIZATION, OUTSOURCING, AND SUBCONTRACTING

## I. UNITED STATES EXPERIENCE: A MANAGEMENT VIEWPOINT

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In the United States and elsewhere there has been widespread interest and activity in transferring functions and work from the public sector to the private sector. The new buzzword for this movement is privatization. This trend towards privatization is fueled by a variety of pragmatic and philosophical considerations, including the following:

- The “belief that new arrangements between the government and the private sector might improve efficiency while offering new opportunities and greater satisfaction for the people served.”<sup>1</sup>
- The belief that government “has become too large, too expensive, and too intrusive in our lives.”<sup>2</sup>

Moreover, substantial cutbacks in federal funding and excessive reliance on property taxes have forced many financially strapped state and local public employers in the United States to look for new ways to get more bang for the taxpayer’s buck. It is often in this context that privatization is considered.

### Forms of Privatization

Where privatization occurs, it usually takes one of three forms.<sup>3</sup> The first is the outright sale of government assets. This

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<sup>1</sup>Report of the President’s Commission on Privatization, *Privatization: Toward More Effective Government* (Washington: 1988), 1 (hereinafter cited as *Privatization*). See generally *Privatization 1987: Second Annual Report on Privatization* (Santa Monica: The Reason Found., 1987). Wellington and Winter commented that “[p]ublic employee unionism . . . is a force restraining expansion of the role of government” and that “[o]ther considerations being equal, it is a force requiring government to decline new functions or to shed those it already has.” Wellington and Winter, *The Unions and the Cities* (Washington: Brookings Inst., 1971), 65 (emphasis in original).

<sup>2</sup>*Privatization*, *supra* note 1, at 1.

<sup>3</sup>*Id.* at 1–2. The President’s Commission on Privatization observed that deregulation of industry is a form of privatization and “has been one of the most important forms of curbing government in relying more heavily on the private sector.” *Id.* at 2.

has been the prime vehicle for privatization in many countries outside the United States. For example, the British government has sold numerous commercial entities owned by the government, including British Petroleum, British Aerospace, British Airways, and Rolls Royce.<sup>4</sup> The Japanese government has partially privatized Japanese National Railroads (JNR) and plans are underway to sell part of Nippon Telegraph and Telephone.<sup>5</sup> The Canadian government has announced plans to sell 45 percent of Air Canada to private investors<sup>6</sup> and has privatized some Crown corporations.<sup>7</sup>

While the sale of assets has been the most prominent method of privatization in many other countries, it is not the primary vehicle in the United States. The sale of Conrail is the only significant example.<sup>8</sup> This should come as no major surprise since substantially all commercial activity in the United States is already in the private domain.

There has been a countertrend in the United States. Passage of the Urban Mass Transportation Act of 1964,<sup>9</sup> as one court observed, "put inexorable forces in motion whereby, at an accelerated pace, transportation companies changed hands from the private sector to the public sector."<sup>10</sup> As a result, publicly owned transit systems now account for over 90 percent "of total vehicle miles operated."<sup>11</sup> The State of New York has agreed to assume ownership of the Long Island Lighting Company's Shoreham nuclear plant after exploring the possibility of a state takeover of the entire utility.<sup>12</sup> While the trend towards privatization is clear, the mass transit and LILCO examples in the United States demonstrate that "governmentalization," if I may coin a phrase, is continuing to occur.

The second form of privatization "is the use of vouchers, under which the government distributes purchasing power to eligible consumers, who then must spend the funds received on

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<sup>4</sup>*Id.* at 4.

<sup>5</sup>*Id.*

<sup>6</sup>The Christian Science Monitor (December 22, 1987), 11.

<sup>7</sup>Northern Ontario Business, Vol. 8, No. 2, Sec. 1, (November 1987), 3.

<sup>8</sup>Privatization, *supra* note 1, at 1. The President's Commission on Privatization has recommended further federal asset sales, including the sale of Amtrak and the Naval Petroleum Reserves. *Id.* at 162-187.

<sup>9</sup>49 U.S.C. §§1601 *et seq.*

<sup>10</sup>*Kramer v. New Castle Area Transit Auth.*, 677 F.2d 308, 309, 25 WH Cases 581, 582 (3d Cir. 1982), *cert. denied*, 459 U.S. 1146, 25 WH Cases 1139 (1983).

<sup>11</sup>*Id.*

<sup>12</sup>New York Times, Sec. 1 (May 29, 1988), 30.

designated goods and services.”<sup>13</sup> Food stamps and housing vouchers are two examples.

The third technique for privatizing the delivery of services is contracting out, that is, the government contracts with firms in the private sector to provide goods and services rather than employing government employees to do such work. Whereas the sale of government assets has been the primary privatization device in countries such as Britain and France, contracting out is the primary privatization technique in the United States. As the President’s Commission on Privatization observed, “contracting out is widespread and increasing in popularity at the state and local levels.”<sup>14</sup> A report prepared by Touche Ross, entitled *Privatization in America* and co-sponsored by the Privatization Council and the International City Management Association, reported that the contracting out of services is the most popular form of privatization, with 99 percent of the survey respondents stating that their jurisdictions contracted for services during the past five years.<sup>15</sup>

### Subcontracting

Since subcontracting is the privatization technique of choice for public employers in the United States and since subcontracting frequently results in disputes between public employers and unions representing public employees, the principal focus of my comments is to analyze how arbitrators have handled public sector subcontracting disputes.

Following the lead of the National Labor Relations Board (NLRB) in *Town and Country*<sup>16</sup> and the Supreme Court in *Fibreboard*,<sup>17</sup> most public sector boards and courts have held that subcontracting is a mandatory subject of bargaining.<sup>18</sup> With the

<sup>13</sup>Privatization, *supra* note 1, at 2.

<sup>14</sup>*Id.*

<sup>15</sup>Touche Ross, *Privatization in America* (1987), 3 (hereinafter *Privatization in America*).

<sup>16</sup>*Town & Country Mfg. Co.*, 136 NLRB 1022, 49 LRRM 1918 (1962), *enforcement granted*, 316 F.2d 846, 53 LRRM 2054 (5th Cir. 1963). For a more recent decision in which the NLRB reaffirmed that subcontracting of bargaining unit work is a mandatory subject of bargaining under the NLRA, see *Century Air Freight*, 284 NLRB No. 85, 125 LRRM 1237 (1987).

<sup>17</sup>*Fibreboard Paper Prods. Corp. v. NLRB*, 379 U.S. 203, 57 LRRM 2609 (1964).

<sup>18</sup>*Communications Workers Local 4501 v. Ohio State Univ.*, 24 Ohio St.3d 191, 494 N.E.2d 1082 (1986); *City of Poughkeepsie v. Newman*, 95 A.D.2d 101, 466 N.Y.S.2d 752 (1983); *Carbondale Community High School Dist. No. 165*, 2 PERI §1067 (Ill. ELRB 1986), *aff’d*, 153 Ill. App.3d 744, 505 N.E.2d 418 (1987); *Unified School Dist. No. 1 v. WERC*, 81 Wis.2d 89 (1977); *Norwalk Bd. of Educ.*, Decision No. 2177 (Conn. SLRB 1983); *Heraldsburg Union*

exception of teacher negotiations, the issue of subcontracting is a common topic for negotiations in the United States public sector. In first contract negotiations it is typical for the union to propose a complete ban on the subcontracting of work performed by bargaining unit employees and for the employer to propose that the contract contain, either specifically or generically, contract language which authorizes the contracting out of bargaining unit work.<sup>19</sup> In terms of negotiated outcomes, public employers have been more successful in obtaining contractual provisions authorizing the right to subcontract or contractual silence on the issue than unions have been in prohibiting subcontracting during the term of the agreement.<sup>20</sup> Many contracts permit subcontracting but contain restrictions or limitations. A common subcontracting clause in Illinois public sector contracts provides that the public employer may subcontract bargaining unit work as long as no bargaining unit employees are laid off as a direct result of subcontracting.<sup>21</sup> Such clauses authorize sub-

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*High School Dist.*, Decision No. 132 (Cal. PERB 1980); *Van Buren Public Schools*, 1973 MERC Lab. Op. 714 (Mich.), *aff'd*, 61 Mich. App. 6, 232 N.W.2d 278 (1975); *PLRB v. Storo-Rox School Bd.*, 9 PPER ¶9065 (Pa. LRB 1978). *Contra IFPTE Local 195 v. State*, 176 N.J. Super. 85 (1980), *aff'd in relevant part*, 88 N.J. 393, 443 A.2d 187 (1982); *AFSCME Local 1116 v. Adams County*, Case No. 494 (Neb. Comm. Indus. Rel. 1982); *AFSCME Dist. Council 37 & City of New York*, Decision No. B-1-74 (N.Y.C. OCB 1974). Even in those few jurisdictions where subcontracting is not a mandatory subject of bargaining, the normal rule is, as the New York Office of Collective Bargaining stated, "that the practical impact of the decision to subcontract on the terms and conditions of employment of the affected employees must be bargained over." *AFSCME Dist. Council 37, supra*. *Accord IFPTE Local 195 v. State, supra*, 443 A.2d at 195-196.

While subcontracting is typically held to constitute a mandatory subject of bargaining, a public employer's decision to no longer provide a given service has not been similarly viewed. In *Chippewa County*, Decision No. 25003 (Wis. ERC 1987), the Wisconsin Employment Relations Commission (WERC) held that a union proposal which provided that the employer would not "contract, lease or sell [its health care center] or any of its property or physical plant to be used for the same purpose or for a similar purpose to that for which it is being used presently" was not a mandatory subject of bargaining. After noting that "the issue is one of determining the level of services provided by or through the municipal employer rather than whether services will be provided to citizens by any entity," WERC held that "[w]here a municipal employer decides to get out of the health care service business, it need not bargain that choice with the union even though another entity may continue to provide such services to the citizens."

<sup>19</sup>Employers typically propose, as part of a management rights clause, that they retain the right to contract out work or services. Occasionally this reservation of right is stated generically, that is, the employer reserves the right to decide whether work or services are to be purchased or provided by employees covered by the collective bargaining agreement.

<sup>20</sup>*See, e.g.*, the 1987-1989 agreement between the Metropolitan Sanitary District of Greater Chicago and the Operating Engineers Local 399, which contains the following clause: "The right of contracting and subcontracting is vested with the District."

<sup>21</sup>*See, e.g.*, the 1988-1990 agreement between the City of Elgin and the Fire Fighters Local 439, which contains the following subcontracting clause: "The City reserves the right to contract out any work it deems necessary in the interest of efficiency and economy, and in emergency situations. No employee shall be laid off as a result of any

contracting of bargaining unit work as long as the loss of work is absorbed by attrition rather than by laying off bargaining unit employees.

Although subcontracting is frequently dealt with at public sector bargaining tables, the arbitration of subcontracting disputes does not occur as frequently in the public sector as in the private sector. While the Supreme Court in *Warrior & Gulf* observed that subcontracting disputes are "grist in the mills of the arbitrators,"<sup>22</sup> the same observation does not appear to be true in the public sector.

In reviewing all the reported, full-text, public sector arbitration decisions concerning subcontracting published by The Bureau of National Affairs, Inc. (BNA) from 1945 to date, by Commerce Clearing House (CCH) from 1961 to date, and by Labor Arbitration Information System (LAIS) from 1982 to date, I was able to find less than two dozen decisions published by these three major services.<sup>23</sup> Despite the paucity of reported public sector cases, it is not difficult to anticipate an increase in such cases as a result of governmental privatization initiatives which will increasingly result in the contracting out of work or services, especially since approximately 50 percent of the public sector work force is covered by collective bargaining agreements.<sup>24</sup>

### Arbitral Handling of Subcontracting Cases

Subcontracting and labor arbitrators are no strangers. This issue has been one of the most studied, analyzed, and written-about topics in labor arbitration. From the early studies authored by Crawford,<sup>25</sup> Dash,<sup>26</sup> Greenbaum,<sup>27</sup> and Wallen,<sup>28</sup> to Sinicropi's presentation at the 1980 Annual Meeting of the

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decision by the City to subcontract any work performed by employees covered by this Agreement."

<sup>22</sup>*Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 584, 46 LRRM 2416, 2420 (1960).

<sup>23</sup>These cases appear in the Addendum at the end of this paper.

<sup>24</sup>The same situation appears to be true in Canada. A Canadian management attorney, Brian Gatien, said that subcontracting disputes have been at the heart of recent Canadian public sector labor disputes. Northern Ontario Business, *supra* note 7.

<sup>25</sup>Crawford, *The Arbitration of Disputes Over Subcontracting*, in Challenges to Arbitration, Proceedings of the 13th Annual Meeting, National Academy of Arbitrators, ed. Jean T. McKelvey (Washington: BNA Books, 1960).

<sup>26</sup>Dash, *Arbitration of Subcontracting Disputes*, 16 Indus. & Lab. Rel. Rev. 210 (1963).

<sup>27</sup>Greenbaum, *Arbitration of Subcontracting Disputes*, 16 Indus. & Lab. Rel. Rev. 223 (1963).

<sup>28</sup>Wallen, *How Issues of Subcontracting and Plant Removal Are Handled by Arbitrators*, 19 Indus. & Lab. Rel. Rev. 265 (1966).

National Academy of Arbitrators,<sup>29</sup> subcontracting has been, and continues to be, a topic receiving extensive scrutiny. However, arbitral treatment of public sector subcontracting disputes has not been subjected to detailed analysis, although Sinicropi's paper did touch on the subject.<sup>30</sup>

My review of the published public sector subcontracting decisions shows that arbitrators approach public sector subcontracting disputes in much the same way that they approach private sector subcontracting disputes. Several arbitrators have quoted or paraphrased Elkouri & Elkouri to the effect that where the contract is silent on the issue of subcontracting, the employer has the right to subcontract bargaining unit work as long as it is done in good faith, is reasonable, and does not significantly undermine the bargaining unit.<sup>31</sup> The reported public sector decisions reflect both the expansive and the narrow views of arbitral authority in deciding subcontracting disputes where the contract is silent on the issue.

For example, in *County of Koochiching*<sup>32</sup> the arbitrator held that although the contract did not contain any limitation on the right to subcontract, the subcontracting of janitorial services affecting one bargaining position violated the contract in that it was "contrary to the spirit of the contract as a whole with its broad related clauses," such as normal work hours and seniority.<sup>33</sup> The arbitrator ruled that the contract as a whole "contained the inherent premise that the basic bargaining unit work would remain, to the extent such work is available and needed."<sup>34</sup>

However, in *Transit Authority of River City* another arbitrator held that the subcontracting of janitorial services did not violate a contract which did not place any limits on subcontracting, observing that "it has become, in general, a recognized retained right of management to subcontract in the absence of language

<sup>29</sup>Sinicropi, *Revisiting an Old Battleground: The Subcontracting Dispute*, in *Arbitration of Subcontracting and Wage Incentive Disputes*, Proceedings of the 32nd Annual Meeting, National Academy of Arbitrators, eds. James L. Stern and Barbara D. Dennis (Washington: BNA Books, 1980), 125.

<sup>30</sup>Although Sinicropi did devote several pages to the public sector in his 1980 paper, he did not analyze any of the reported public sector arbitration decisions concerning subcontracting. Sinicropi, *supra* note 29, at 152-155. He did, however, discuss "examples of the anomalies found in the public sector." *Id.* at 155.

<sup>31</sup>See, e.g., *Transit Auth. of River City*, 74 LA 616, 619 (Chapman, 1980); *Central Ohio Transit Auth.*, 71 LA 9, 15 (Handsaker, 1978). See generally Elkouri and Elkouri, *How Arbitration Works*, 4th ed. (Washington: BNA Books, 1985), 537-547.

<sup>32</sup>10 LAIS 2011 (Jacobowski, 1982).

<sup>33</sup>*Id.*

<sup>34</sup>*Id.*

in the contract placing restrictions on subcontracting.”<sup>35</sup> In holding that the subcontracting passed muster under the reasonableness standard, he rejected the union’s contention that “the provisions of the Recognition clause, the Seniority clause, and the Layoff and Recall clause would be rendered a nullity if . . . subcontracting were to be permitted.”<sup>36</sup> As in the private sector, this latter approach represents the majority view.

Since a review of the reported public sector subcontracting decisions reveals essentially the same gamut of opinions that can be found in the private sector,<sup>37</sup> it is legitimate to ask whether there are any additional considerations which arbitrators should take into account in ruling on public sector subcontracting disputes. In my judgment, there are at least three additional factors that arbitrators should consider in deciding public sector subcontracting disputes.

### **Difference Between Private and Public Sector Cases**

First, the decision by a public employer to contract out work is not driven by the profit motive that is operative in the private sector. While subcontracting decisions in the private sector are economic decisions, such decisions in the public sector are essentially political decisions. As the New Jersey Supreme Court observed:

The issue of subcontracting does not merely concern the proper technical means for implementing social and political goals. The choice of how policies are implemented, and by whom, can be as important a feature of governmental choice as the selection of ultimate goals.<sup>38</sup>

Since the decision to subcontract is usually made by politically accountable public officials, an arbitrator, in the absence of clear contractual limitations or restrictions, should be reluctant to overturn a public employer’s decision to contract out bargaining unit work. For an arbitrator to reverse a public employer’s

<sup>35</sup>74 LA 616 (Chapman, 1980). See also *Ohio Ass’n of School Employees v. Sylvania City School Dist.*, C.A. No. L-86-129 (Ohio Ct. App. 1987) (court rejected union’s contention that contracting out custodial work constituted an invidious erosion of the bargaining unit, noting that there was no provision in the collective bargaining agreement “which specifically prohibits the contracting out of custodial services.”).

<sup>36</sup>74 LA at 619.

<sup>37</sup>Sinicropi commented that “the arbitration of subcontracting issues are handled similarly in private- and public-sector cases.” Sinicropi, *supra* note 29, at 155.

<sup>38</sup>*IFPTE Local 195 v. State*, *supra* note 18.

decision in these circumstances means that the arbitrator is substituting his or her judgment for that of the legislative body as to the wisdom of the decision to subcontract the work.<sup>39</sup>

Second, unlike the private sector, unions in the public sector have the ability to influence a public employer's decision to contract out services through their involvement in the political process. As David Stanley noted, "[w]ith or without . . . [anti-subcontracting] provisions unions bring pressure to retain government work for government employees."<sup>40</sup> Stanley noted that the Service Employees International Union (SEIU) in Boston "prevented management from contracting out janitorial service for a new city hall, while AFSCME succeeded in getting the city to take over the work of one private garbage collection contractor."<sup>41</sup> He observed further that such successful union efforts mean that "governments have agreed to retain work for employees even though there may be otherwise sound management reasons for having the work done by outsiders," thereby assuring that such work is done "in such a way as to protect the jobs of certain groups of citizens."<sup>42</sup> The Touche Ross survey identified union or employee resistance as the most significant impediment to contracting out government services.<sup>43</sup>

When a union does not succeed in blocking a public employer from subcontracting bargaining unit work through political means, it may try to accomplish the same result through arbitration. While I do not deny a union's right to grieve subcontracting decisions and to take such issues to arbitration,<sup>44</sup> I think that arbitrators should recognize that in most cases the union probably has already lost in its efforts to influence politically the policy decision to subcontract the work.

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<sup>39</sup>*Cf. Dougherty v. Department of Health*, Pa. Commw. Ct. LEXIS 295 (1988) (agency's decision to subcontract work previously performed by six civil service employees upheld where the agency's good faith and increased efficiency were demonstrated by amount of time that was freed up for the individuals who had supervised the laid-off employees and by savings of \$80,000 which "could be redirected to research crucial to the long-range goals of the Appointing Authority's Program").

<sup>40</sup>Stanley, *Managing Local Government Under Union Pressure* (Washington: Brookings Inst., 1972), 92.

<sup>41</sup>*Id.*

<sup>42</sup>*Id.* at 93.

<sup>43</sup>Privatization in America, *supra* note 15 at 6.

<sup>44</sup>Of course, if the contract specifically or implicitly excludes the submission of subcontracting disputes from the grievance and arbitration procedure, such disputes are not arbitrable and the arbitrator has no authority to rule on subcontracting disputes. *See, e.g., Pacific Missile Test Center*, 926 GERR 43 (Rule, 1981) (contract made "it quite clear contracting out was to be at Management's discretion and thus not subject to grievance and arbitration").



Third, subcontracting in the public sector is frequently motivated by cost savings. Contrary to the holdings of some arbitrators, the fact that the public employer can demonstrate that there are cost savings (including a subcontractor's lower wage rates or lower benefit costs) should substantiate the reasonableness of the public employer's decision rather than constitute evidence of bad faith and unreasonableness. This is especially true when the public employer is required by competitive bidding statutes to award the work to the lowest responsible bidder. If a public employer can save \$100,000 by contracting out custodial work, the \$100,000 in savings can be used to cut a budgetary deficit, to provide additional services to the public at no additional expense,<sup>45</sup> or to reduce taxes. As Arbitrator Morrison Handsaker observed in *Central Ohio Transit Authority*, a public employer "has an obligation to operate as efficiently as possible in the interest of the taxpayer. . . ."<sup>46</sup> In short, demonstrated savings as a result of a decision to contract out work should constitute evidence of reasonableness rather than the contrary.

### **Effect of Size of Bargaining Unit on Determination of Reasonableness**

To what extent should the size of the bargaining unit influence an arbitrator's judgment as to the reasonableness of an employer's decision to subcontract when the labor contract is silent on the issue? Assume two different fact patterns. First, assume a broad bargaining unit of 400 blue-collar employees represented by the union, of whom four are custodians. Second, assume the same 400 blue collar employees, but with the four custodians represented in a separate bargaining unit. Assume further that under both hypothetical situations the employer justifies subcontracting custodial work by the following:

- cost savings of \$30,000, attributable to economies of scale which the contractor is able to achieve and to overall lower

<sup>45</sup>Cf. *Department of Public Welfare v. Magrath*, 14 Pa. Commw. Ct. 257, 321 A.2d 403, 405 (1974) (in upholding agency's decision to make different arrangements for the delivery of services which resulted in the layoff of civil service employee, court noted that "the law committed to the responsible officials of Haverford State Hospital, not to the Civil Service Commission or to this Court, decisions as to what best promotes the efficiency of its services to the public").

<sup>46</sup>71 LA 9, 17 (Handsaker, 1978).

compensation and benefits paid by the contractor to its employees;

- elimination of need to purchase and maintain the equipment utilized by the custodians; and
- freeing up of management and supervisory time which would otherwise be spent managing the custodial operation.

Under the first hypothetical most arbitrators would view the employer's decision to subcontract the work of only four employees in a bargaining unit of 400 to be reasonable since the employer's decision did not seriously undermine the union.<sup>47</sup> Under the second hypothetical, however, I suspect that many arbitrators would consider the elimination of the bargaining unit, albeit a unit composed of only four custodians, to be determinative and would hold that the employer's action was not reasonable. But is that a correct result? I think not.

The reasonableness of the employer's decision to subcontract work or services, assuming reasonableness is the applicable standard, should be viewed in the context of the overall size of the employer's work force and not just the size of the bargaining unit affected by the subcontracting decision. Where the employees affected by the subcontracting decision are in a small, fragmented bargaining unit, the fact that the entire bargaining unit is affected should not mean that the public employer acted unreasonably. If it is reasonable for the employer to subcontract

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<sup>47</sup>While the published public sector subcontracting decisions I reviewed included only one case in which a number of employees were laid off as a result of the decision to subcontract, arbitrators have frequently dealt with this issue in the private sector. Among the cases in which arbitrators have upheld subcontracting as reasonable, even though some bargaining unit personnel were laid off, are the following: *Westinghouse Elec. Supply Co.*, 86-2 ARB §8606 (Aronin, 1986) (contracting out of delivery work and elimination of entire bargaining unit upheld in the absence of any specific contractual prohibition; the parties "contracted for the Union's right to represent a unit of employees" and "did not contract for that right to exist in perpetuity or foreclose the Employer from eliminating that function when dictated by business considerations"); *Linde Co.*, 30 LA 998 (Shister, 1958) (contracting out operation of plant cafeteria in order to reduce or eliminate operating loss upheld even though six full-time employees were displaced); *Park, Davis & Co.*, 26 LA 438 (Haughton, 1956) (subcontracting of printing department and resultant layoff of 18 employees upheld where contract was silent on issue of subcontracting; the arbitrator ruled that the union had "not sustained the burden which it carries to show bad faith"). See also *Roper Corp.*, 80 LA 760 (Rezler, 1983) (contracting out field service work and resultant layoff of bargaining unit employee upheld where contract was silent on issue of subcontracting and where employer asserted that contractual arrangement would result in a 50% savings in its costs). In the one public sector case, *City of Detroit*, 79 LA 1273 (Mittenthal, 1982), the arbitrator held that the city violated implied limitations on subcontracting when it subcontracted building trades work resulting in a 10% reduction in the size of the bargaining unit. He based his decision primarily on the fact that the city's decision to contract out the work had been "triggered by the Union's rejection of wage concessions." *Id.* at 1277.

the work of four custodians when they are part of a 400 employee bargaining unit, the fact that the four custodians are in a unit limited to custodians should not produce a different result.<sup>48</sup>

### Effect of Statutory Civil Service Provisions

An additional issue not present in private sector subcontracting disputes occasionally surfaces when a public employer subcontracts services typically performed by civil service employees pursuant to constitutional or statutory civil service provisions. In several jurisdictions unions representing civil service employees have filed lawsuits contesting the subcontracting of services that have been or could be performed by employees in civil service classifications on the ground that such services may not be subcontracted. It is usually asserted that subcontracting work normally performed by civil service employees undermines the civil service system and could lead to a return of the spoils system. While these legal challenges have produced mixed results, depending on the jurisdiction and the particular wording of the constitutional or statutory provisions governing civil service, the majority view is that it is not contrary to civil service law for a public employer to subcontract such work.

In *Communications Workers of America Local 4501 v. Ohio State University*, the Ohio Supreme Court held "that in the absence of proof that a public employer was motivated by political considerations or a desire to set up a spoils system," the public employer has the legal right to subcontract services which could be performed by civil service employees "so long as such practice is not violative of either the affected employees' collective bargaining agreement" or the employees' rights under the Ohio

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<sup>48</sup>While the prevailing view in the public sector is that bargaining units should be as broad as reasonably practicable and should include all employees who share a broad community of interest, many small, fragmented bargaining units exist in the United States. Some statutory provisions protect historical units or mandate the establishment of small units. For example, §9(b) of the Illinois Public Labor Relations Act provides that where there is "an historical pattern of recognition," the Illinois State Labor Relations Board "must find the employees in the unit then represented by the union pursuant to the recognition to be the appropriate unit." This section further provides that "where the majority of public employees of a craft so decide, the Board shall designate such craft as a unit appropriate for the purposes of collective bargaining." Ill. Rev. Stat., ch. 48, §1609(b) (1985).

public sector collective bargaining law.<sup>49</sup> The court specifically observed that since subcontracting is a mandatory subject of bargaining, civil service employees are "thus in a position to 'protect' the civil service system at the bargaining table . . . ."<sup>50</sup> Finally, the court noted that disputes over the propriety of subcontracting civil service work "should be resolved, whenever possible, through arbitration."<sup>51</sup>

In line with the reasoning of *Ohio State University*, if a union challenges the legality of a public employer's decision to subcontract bargaining unit work that has been or could be performed by civil service employees and raises this issue before an arbitrator, the arbitrator should ordinarily limit the decision to interpreting the applicable provisions of the collective bargaining agreement and not entertain broad general arguments that the subcontracting violates the state's civil service law. Since subcontracting is a mandatory subject of bargaining in most jurisdictions<sup>52</sup> and since the courts have usually held, in the absence of explicit statutory provisions to the contrary, that the provisions of a collective bargaining agreement supersede civil service provisions,<sup>53</sup> the arbitrator normally should consider

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<sup>49</sup>*Communications Workers Local 4501 v. Ohio State Univ.*, *supra* note 18. *Accord Ohio Ass'n of Public School Employees v. Sylvania City School Dist.*, *supra* note 35 (in absence of proof of intent to thwart purposes of civil service system, "it is clear that the board may lawfully contract to have an independent contractor perform services which might also be performed by civil service employees"); *Michigan State Employees Ass'n v. Civil Serv. Comm'n*, 141 Mich. App. 288, 367 N.W.2d 850 (1985) (work that could be performed by civil service employees may be contracted out "for reasons of efficiency and economy," there being "no requirement that all who provide services for the state must be in a civil service position"); *IFPTE Local 195 v. State*, *supra* note 18 (civil service laws "do not prevent the State from subcontracting where appropriate"); *Department of Public Welfare v. Magrath*, *supra* note 45 (contracting out services can create valid lack of work and does not violate Civil Service Act). *Contra Washington Fed'n of State Employees v. Spokane Community College*, 90 Wash.2d 698, 585 P.2d 474 (1978) (college "has no authority to enter a contract for new services of a type which have regularly and historically been provided, and continue to be provided, by civil service staff employees").

<sup>50</sup>*Communications Workers Local 4501 v. Ohio State Univ.*, *supra* note 18, at 1086.

<sup>51</sup>*Id.* at 1087. *See Houghton v. Schuler*, 61 A.D.2d 1104, 403 N.Y.S.2d 366 (1978) (lawsuit brought by adversely affected civil service employees challenging legality of contracting out dismissed for failure to exhaust contractual grievance and arbitration procedures where contract contained a job security clause).

<sup>52</sup>*Supra* note 18.

<sup>53</sup>*Civil Serv. Comm'n v. Wayne County Bd. of Supervisors*, 384 Mich. 363, 184 N.W.2d 201, 77 LRRM 2034 (1971). Some public sector bargaining laws specifically give pre-emptive effect to provisions contained in collective bargaining agreements if there is any conflict with other statutory provisions. For example, §15(a) of the Illinois Public Labor Relations Act provides that "[i]n case of any conflict between the provisions of this Act and any other law, executive order or administrative regulation relating to wages, hours, and conditions of employment and employment relations, the provisions of this Act or any collective bargaining agreement negotiated thereunder shall prevail and control." Ill. Rev. Stat., ch. 48, §1615(a) (1985) (emphasis supplied).

only whether the subcontracting violates the collective bargaining agreement.

Under some collective bargaining agreements, however, an arbitrator may have no choice but to consider applicable law in ruling on a subcontracting dispute. For example, in *Southern Illinois University at Edwardsville*,<sup>54</sup> Arbitrator John Dunsford ruled that he had to consider a union's contention that a university's subcontracting of guard work violated state law since the contract specifically provided that the employer's exercise of its contractual management rights was subject to arbitral review if it was "so exercised as to violate an expressed provision of this Agreement and/or applicable law."<sup>55</sup> Referring to this contract language, he held that it "apparently requires the arbitrator in interpreting and applying the contract to consider arguments alleging that managerial action is in violation of state law."<sup>56</sup>

On the merits, Professor Dunsford rejected the union's argument that the statutory provision authorizing the establishment of a police department required "that whenever possible the University use the police force to perform every function which might be described as involving security work."<sup>57</sup> He noted that "there is nothing in the language of the statute which restricts the University from contracting out guard work in order to supplement the police protection already achieved by the appointment of Police Officers and the creation of a department,"<sup>58</sup> and observed:

The legislative authorization of the Board of Trustees to create a police department does not limit its discretion to decide that some types of security protection are more efficiently and properly performed by contracting with outside agencies for guards. It would be ironic, and improper, to interpret the broad grant of authority to the Board of Trustees to create a police department as a restriction on its power and discretion to decide when the members of that department are needed to provide police protection.<sup>59</sup>

The need for arbitrators to consider applicable law in ruling on subcontracting disputes is especially acute in cases involving the federal government. Although the Civil Service Reform Act

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<sup>54</sup>*Southern Ill. Univ. at Edwardsville*, AAA Case No. 51 390 0171 87 S (unpublished) (Dunsford, 1987).

<sup>55</sup>*Id.* at 11.

<sup>56</sup>*Id.* at 16.

<sup>57</sup>*Id.* at 17-18.

<sup>58</sup>*Id.* at 18.

<sup>59</sup>*Id.*

of 1978 specifically provides that nothing therein "shall affect the authority of any management official of any agency . . . to make determinations with respect to contracting out,"<sup>60</sup> the Federal Labor Relations Authority (FLRA) has held that a union proposal that would require the agency to comply with the Office of Management and Budget (OMB) Circular A-76<sup>61</sup> in contracting out work and services is a mandatory subject of bargaining.<sup>62</sup> The federal courts of appeals have split on whether such a proposal constitutes a mandatory subject of bargaining,<sup>63</sup> but the Federal Service Impasses Panel (FSIP) in one case adopted a union's proposal that would permit the union to grieve alleged violations of OMB Circular A-76 when the agency contracted out bargaining unit work.<sup>64</sup>

Arbitrators have grappled with the issue of whether a federal agency has complied with OMB Circular A-76 in contracting out work. Arbitrator Donald Rothchild determined that the United States Naval Academy did not violate the Circular when it contracted out janitorial work, even though he acknowledged that there were some irregularities in awarding the contract.<sup>65</sup> He ruled that the union had not met its burden of showing that the Naval Academy's decision to contract out the work in question was not in accordance with applicable laws, rules, and regula-

<sup>60</sup>5 U.S.C. §7106(a)(2)(B).

<sup>61</sup>As the District of Columbia Court of Appeals noted in *EEOC v. FLRA*, 744 F.2d 842, 845 n.3, 117 LRRM 2625 (D.C. Cir. 1984), *cert. denied*, 476 U.S. 19, 122 LRRM 2081 (1986): "OMB Circular A-76 (the Circular) prescribes guidelines for determining whether the goods and services needed by the federal government shall be acquired from the private sector or obtained 'in-house' with government facilities and personnel. . . . The Circular specifies that the government generally should acquire its goods and services from private enterprise if it is cost-effective. The Circular contains a Cost Comparison Handbook outlining procedures to be followed in determining whether contracting-out is most cost-effective."

<sup>62</sup>*Equal Employment Opportunity Comm'n*, 10 FLRA 3 (1982), *aff'd*, 744 F.2d 842, 117 LRRM 2625 (D.C. Cir. 1984), *cert. denied*, 476 U.S. 19, 122 LRRM 2081 (1986).

<sup>63</sup>The District of Columbia Court of Appeals has held that such a proposal is a mandatory subject of bargaining. *EEOC v. FLRA*, *supra* note 61. However, the Fourth and the Ninth Circuits have held that such a proposal is not a mandatory subject of bargaining. *Department of Health & Human Servs. v. FLRA*, 128 LRRM 2150 (4th Cir. 1988) (en banc); *Defense Language Inst. v. FLRA*, 767 F.2d 1398, 120 LRRM 2013 (9th Cir. 1985), *cert. denied*, 106 S.Ct. 2004 (1986). The Fourth Circuit noted that, while OMB Circular A-76 "seems, at first blush, to provide a purely mandatory rule, it provides an opportunity for arbitrators to second-guess managerial decisions." *Department of Health & Human Servs. v. FLRA*, *supra*, at 2155. The Fourth Circuit further noted that "[w]ere the internal management directives of the executive branch held to give rise to enforceable third party rights, the obvious result would be chaos" and "[t]he President would be forced to compete with arbitrators over the interpretation of executive branch policy." *Id.* at 2157.

<sup>64</sup>*U.S. Military Academy Preparatory School, Ft. Monmouth, N.J.*, Case No. 87 FSIP 11, 25 GERR 919 (1987).

<sup>65</sup>*United States Naval Academy*, 21 GERR 2165 (Rothchild, 1983).

tions governing subcontracting, noting that his role was limited "to determining whether there was a violation of 'applicable laws,'" regardless of "what [his] views may be about management's determination about contracting out."<sup>66</sup>

### Some Problems of Definition

Whether a given situation calls into play specific or implied contractual restrictions on subcontracting seems to surface as an issue more frequently in the public than in the private sector. Three published public sector subcontracting decisions involved this issue.

In the first case the public employer, responding to a disaster situation which caused employees to work many overtime hours, agreed to permit the Army Corps of Engineers to perform the same work that bargaining unit employees had been doing.<sup>67</sup> In rejecting the union's contention that this arrangement amounted to subcontracting in violation of the collective bargaining agreement, the arbitrator noted:

the relationship . . . [of the Army Corps of Engineers and the County] is nothing more than that created by the acceptance of an offer of help from the federal government. . . . Certainly the parties never intended that the employer should be required to turn down offers of such assistance regularly and traditionally offered in cases of disaster and emergency simply because such could potentially deprive employees of an earning opportunity.<sup>68</sup>

In the second case the arbitrator was asked to determine whether a contract prohibiting subcontracting work normally performed by bargaining unit employees barred a school district from using students for custodial and janitorial work when the funds for their employment came from a job training grant.<sup>69</sup> Although the arbitrator acknowledged that the students were doing work normally performed by bargaining unit employees, he held that the use of students pursuant to the job training grant was not the kind of subcontracting that was prohibited by the contract.

<sup>66</sup>*Id.*

<sup>67</sup>*Lenawee County Rd. Comm'n*, 72 LA 249 (Daniel, 1979).

<sup>68</sup>*Id.* at 250. See also *Keeton v. Department of Social & Health Servs.*, 34 Wash. App. 353, 661 P.2d 982 (decision to lay off two bakers and to purchase baked goods on the open market does not come "within the technical meaning of 'contracting out work' as used in the area of labor relations").

<sup>69</sup>*Tracy School Dists.*, 76 LA 883 (Bogue, 1981).

The preceding holding should be contrasted with that in the remaining case, in which a union challenged a university's decision to enter into a contract whereby social service recipients did bargaining unit work and were paid by an outside agency. In reaching the opposite conclusion, the arbitrator stated "that a subcontracting relationship does exist between the University and the Department of Social Services in the Work Relief Program."<sup>70</sup> The arbitrator ruled, however, that the subcontracting, under a contract silent on the issue, was reasonable and, therefore, did not violate the contract.

The decisions in the first two cases are more reasonable since they recognize that intergovernmental cooperation in funding and delivering public services normally does not constitute subcontracting.<sup>71</sup>

### Conclusion

The goal of the worldwide privatization movement is to reduce the overall size of government and to establish more efficient and economical ways to provide public services.<sup>72</sup> As the privatization movement gains momentum, more public employers will utilize subcontracting, the privatization technique of choice in the United States. Since approximately one half the public sector work force is covered by collective bargaining agreements, the number of arbitration cases involving subcontracting will increase significantly. In public sector cases involving an assessment of the reasonableness of the employer's decision to subcontract (either because the contract is silent or because it gives the arbitrator the authority to make such a judgment), arbitrators should be reluctant to substitute their judgment for the essentially political decision the public employer has made. The fact that the savings achieved by subcontracting are the result of lower wages and benefits paid by the subcontractor or the fact that subcontracting may cause the layoff of some bargaining unit employees (including the elimination of an entire small bargaining unit), ordinarily should not

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<sup>70</sup>*Michigan State Univ.*, 82-2 ARB §8507 (Borland, 1982).

<sup>71</sup>A different question is presented if the applicable contract specifically provides that no bargaining unit work may be performed by anyone not covered by the contract.

<sup>72</sup>Futurist John Naisbitt, author of *Megatrends*, recently forecast that one of the "new megatrends" is increasing "global privatization," which he said may bring an end to the welfare state. *Chicago Sun-Times* (October 27, 1987), 11.



be viewed as grounds for arbitral reversal of the employer's decision. As one arbitrator observed, public employers have "an obligation to operate as efficiently as possible in the interest of the taxpayer."<sup>73</sup>

### Addendum

Reported public sector arbitration decisions concerning subcontracting:

*West Muskingum Bd. of Educ.*, 87-2 ARB §8545 (Cohen, 1987) (contract covering school bus drivers violated when employer acted unreasonably in contracting with outside carrier for trip to amusement park; arbitrator placed great weight on contractual provision which stated that drivers "shall have the right to have their name placed on the extra trip list").

*City of Birmingham*, 14 LAIS 2026 (Daniel, 1986) (contracting out some custodial work did not violate contract since it was economically reasonable and no bargaining unit employees were laid off).

*Lake County Bd. of Mental Retardation*, 13 LAIS 2116, 87-1 ARB §8005 (Abrams, 1986) (contracting out full-time vocational rehabilitation work did not violate contract in absence of subcontracting provision and since subcontracting did not undermine bargaining unit).

*Aurora-Hoyt Lakes Indep. School Dist. 691*, 13 LAIS 2057 (Kapsch, 1986) (contracting out garbage disposal which one employee had previously done did not violate contract where contract was silent on issue of subcontracting and effect on bargaining unit was de minimis).

*Woodhaven School Dist.*, 86 LA 215 (Daniel, 1986) (contracting out snow removal did not violate contractual prohibition against contracting out work where "the express intent [is] to affect an employee's job" since "loss of overtime on an infrequent or sporadic basis such as after a heavy snowfall does not demonstrate any . . . such intent").

*Army Corps of Eng'rs*, 81 LA 510 (Everitt, 1983) (employer complied with contractual requirement that it discuss contracting out before awarding contract).

*Laguana Salada Union School Dist.*, 81 LA 543 (Pool, 1983) (contracting out energy conversion project did not violate contractual limitation on subcontracting where an exemption was made for assignments which were excessive, especially since no bargaining unit employee was displaced).

*Town of Van Buren, Me.*, 80 LA 105 (Chandler, 1982) (contracting out police department work violated contract when employer had not met contractual requirement to negotiate over matter; such action also violated recognition article).

*City of Detroit*, 79 LA 1273 (Mittenthal, 1982) (subcontracting building trades work which resulted in about a 10 percent reduction in size of bargaining unit violated city's obligation to refrain from unreasona-

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<sup>73</sup>*Central Ohio Transit Auth.*, *supra* note 46, at 17.

bly reducing scope of bargaining unit which is "implied from the recognition clause").

*County of Koochiching*, 10 LAIS 2011 (Jacobowski, 1982) (subcontracting janitorial work which did not result in layoff of any bargaining unit members violated contract; contractual limitation implied from "the contract as a whole" where contract was silent on issue of subcontracting).

*City of Marquette*, 9 LAIS 2077 (Daniel, 1982) (contracting out solid waste collection and disposal upheld despite contractual provision which obligated the city "to avoid" subcontracting where city's "inability to avoid subcontracting was no fault of its own but a result of failed alternatives").

*Michigan State Univ.*, 82-2 ARB §8507 (Borland, 1982) (although use of social service recipients to do bargaining unit work pursuant to contract with social service agency which paid the recipients was deemed to be a subcontract, university did not violate contract silent on issue of subcontracting where performance of such work had little effect on bargaining unit employees).

*Denver Regional Transp. Dist.*, 9 LAIS 1125 (Kates, 1982) (public employer's purchase of rebuilt equipment which had previously been rebuilt by bargaining unit personnel violated contractual provision which permitted contracting out only where it involved warranty work "or in the event special tools and equipment are not reasonably available to the Employer").

*Tracy School Dists.*, 76 LA 883 (Bogue, 1981) (contractual restriction on contracting out held not applicable to employment training grant which funded wages for student workers who performed bargaining unit work).

*Milwaukee Metropolitan Sewerage Dist.*, 80-2 ARB §8608 (Pieroni, 1980) (contracting out work performed by engineering aids for major sewer project did not violate contractual subcontracting provision since no employees were adversely affected even though some engineering aide positions had not been filled when vacated due to promotions or retirement).

*Transit Auth. of River City*, 74 LA 616 (Chapman, 1980) (contracting out janitorial work did not violate contract in absence of subcontracting clause and where no bargaining unit employees were laid off).

*Lenawee County Road Comm'n*, 72 LA 249 (Daniel, 1979) (county's utilization of Army Corps of Engineers to help clear roads during blizzard did not constitute subcontracting covered by contractual limitation on subcontracting).

*Central Ohio Transit Auth.*, 71 LA 9 (Handsaker, 1978) (contracting out new project to provide transportation service to handicapped persons did not violate contract which was partially silent on issue of subcontracting where employer demonstrated reasonable basis for decision and it did not endanger bargaining unit job security).

*City of Hamtramck*, 71 LA 822 (Roumell, 1978) (employment of outside contractors to modernize data processing system did not violate contractual restriction on subcontracting where it "has no effect on existing jobs").

*County of Walworth, Wis.*, 64 LA 1328 (Epstein, 1977) (contractual limitation on subcontracting contained in nursing home contract was not violated when the counseling center discontinued use of nursing home to provide food service since the subcontracting clause at issue did "not relate to subcontracting by the County in other of its units which are covered by other agreements").

*City of Milwaukee*, 59 LA 537 (Mueller, 1972) (city violated subcontracting provision which prohibited contracting out where cost savings were based on the lower wage rates paid by the contractor).

*Gary School Bd. of Trustees*, 71-1 ARB §8213 (Sembower, 1971) (contracting out operation of elementary school violated several contractual provisions).

## II. THE HIDDEN COSTS OF OUTSOURCING: A UNION VIEWPOINT

SHELDON FRIEDMAN\*

### Introduction

The issue of subcontracting is a perennial one for the National Academy of Arbitrators. Conference papers dating back to the late 1950s have addressed and revisited the issue on several occasions.<sup>1</sup> Most of this past work has been analytical, focusing on the criteria used by arbitrators to settle subcontracting disputes.

That will not be the approach taken in this paper. The debate about the relative merits of the reserved rights versus the implied obligations doctrines, as applied to subcontracting disputes, is an important one. For a trade unionist it is disheartening that many arbitrators uphold the right of employers to subcontract work from recognized bargaining units. It is distressing that some arbitrators still refer to the reserved rights doctrine when giving management the right to erode a bargaining unit. As a matter of logic and fairness, it is not proper to

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<sup>1</sup>Sinicropi, *Revisiting an Old Battle Ground: The Subcontracting Dispute*, in *Arbitration of Subcontracting and Wage Incentive Disputes*, Proceedings of the 32nd Annual Meeting, National Academy of Arbitrators, eds. James L. Stern and Barbara D. Dennis (Washington: BNA Books, 1979), 125-166; Crawford, *The Arbitration of Disputes Over Subcontracting*, in *Challenges to Arbitration*, Proceedings of the 13th Annual Meeting, National Academy of Arbitrators, ed. Jean T. McKelvey (Washington: BNA Books, 1960), 51-77.