Coates' Canons Blog: Local Preferences in Public Contracting, Part 1

By Eileen R Youens

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Hard times have come to Emerald City, North Carolina. People are out of work, no one is buying or building anything, and it doesn't look like things will get better anytime soon. The Emerald City Council has decided that they need to take action to help out their local businesses, so they decide to pass a local preference policy. Is such a policy legal?

My next few blog posts will focus on local preferences in contracting—that is, when can a North Carolina local government give a preference to a contractor or vendor based on whether the contractor or vendor is "local" or based on whether the contractor or vendor will promise to hire local employees? Although the U.S. Constitution and the North Carolina General Statutes place substantial restrictions on how and when local governments in North Carolina may institute local preferences, carefully worded preferences are permissible in a few limited contexts. This first post will set out some definitions and key questions. In later posts, I'll discuss the answers to those questions.

Defining "local"

So, who is "local," anyway? The first step in defining "local" is to establish the geographic scope of the preference. Does "local" mean your municipality, zip code, county, state, country, or continent (e.g. the North American Free Trade Agreement)? The next step is to determine who will be covered by the preference within that geographic area. Residents of the area? Taxpayers? Companies with a majority of employees living in the area? Companies with a majority of shareholders living in the area? Companies headquartered in the area? Companies with a principal place of business in the area? Companies that have paid state/county/city property taxes on equipment necessary to perform the contract under consideration? Companies headquartered in the area, but only if the company is smaller than a certain size (by number of employees, amount of yearly profits, or some other measure of the company's size)? How a unit chooses to define "local" will depend on the goals the unit hopes to achieve through its preference policy.

Defining local preferences

What is a "local preference"? Local preferences can be implemented through statutes, regulations, ordinances, and written and unwritten policies. There are three types of local preferences: (1) hiring preferences, which require contractors to hire a certain percentage of local workers; (2) purchasing preferences, which require contractors to use supplies or materials that are made locally (e.g. **the Buy American Act**); or (3) contract award preferences, which give local bidders or proposers an advantage in the award of public contracts.

There is not much variation in the first two types of local preferences—hiring preferences and purchasing preferences. However, there are four major variations in contract award preferences. In one variation, the awarding government applies a specific percentage price increase to bids from non-local bidders, or applies a specific percentage price decrease to bids from local bidders. Because many bids are awarded based on price, this has the effect of giving the local bidders a better chance at winning contracts, even if their bids are higher than their non-local competitors. For example, let's say Dorothy, Inc., a non-local bidder, is the lowest bidder on an Emerald City construction project with a bid of $1 million. The Wizard, Co., a local bidder, has the next lowest bid, $1,009,000. Dorothy clearly has the lowest bid. However, if Emerald City applies a 5% increase to non-local bids, Dorothy's bid is increased (for purposes of determining which bid is lowest) to $1,050,000, making The Wizard the lowest bidder. And, similarly, if Emerald City applies a 5% decrease to local bids, The Wizard's bid would be decreased (for purposes of determining which bid is lowest) to $95,8550, again making The Wizard the low bidder.

A second variation is bid price matching, where the awarding government is required to local bidders the opportunity to match the lowest bid if the lowest bidder is a non-local bidder. (An example of this second variation is Governor Purdue's recent Executive Order 50, which I discussed in an **earlier post**.) Revisiting our Emerald City bid from the previous paragraph, let's say Emerald City's new ordinance provides that if the lowest responsive, responsible bidder is non-local, the lowest local bidder whose bid is within 5% of the non-local bidder's bid must be given the opportunity to match the lowest bidder's bid. Accordingly, if Dorothy's bid was $1 million, and The Wizard's was $1,009,000 (which is within 5% of $1 million), Emerald City's ordinance would require the City to give The Wizard (the local company) the opportunity to agree to perform the contract for $1 million.

A third variation is a reciprocal preference, where the awarding government is required to apply a percentage increase to non-local bidders' bids only if the non-local bidder's jurisdiction applies such a preference. For example, let's say Kansas (Dorothy, Inc.'s principal place of business) applies a 5% increase to non-local bids. If Emerald City has a reciprocal bid preference, it will apply that same 5% increase to Dorothy's bids on Emerald City projects. **G.S. 143-59(b)** applies such a preference to state contracts in North Carolina (but not to local government contracts) for "equipment, materials, supplies, and services" costing more than $25,000.

A fourth variation is a tie-bid preference, where the awarding government will award to an in-area bidder when the in-area bidders' bid and an out-of-area bidder's bid are equal in price and quality. If Dorothy and The Wizard both bid $1 million for an Emerald City construction project, Emerald City would award the contract to The Wizard, the local company. **G.S. 143-59(a)** applies a tie-bid preference to state contracts (but not to local government contracts) for the purchase of "foods, supplies, materials, equipment, printing or services."

Questions to Consider

If your unit of government is considering implementing a local preference policy, and after you've settled on a definition of "local," you'll need to consider the following five questions:

1. Is the policy constitutional?
2. Do you have the authority to implement the policy?
3. Does the policy comply with rules applicable to grants?
4. What goals are you trying to achieve through the policy?
5. Will the policy achieve those goals?

My next posts will focus on these five questions. Stay tuned!

Links

- en.wikipedia.org/wiki/Buy_American_Act
- canons.sog.unc.edu/?p=2271
- www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_143/GS_143-59.html