Coates' Canons Blog: Local Preferences in Public Contracting, Part 4

By Eileen R Youens

Article: https://canons.sog.unc.edu/local-preferences-in-public-contracting-part-4/

This entry was posted on November 10, 2010 and is filed under Local Preferences, Purchasing, Construction, Property Transactions

This is the fourth installment of a series of posts discussing the efforts of the City Council of Emerald City, North Carolina, to support its local businesses by adopting a local preference policy. (You can find the earlier installments **here**, **here**, and **here**.) In the last post, City Attorney Tin Man gave the City Council an explanation of Emerald City's legal authority, under North Carolina law, to implement a local preference policy. The Council was happy to hear that North Carolina law would permit local preferences for purchases and construction projects costing less than the informal bidding threshold, and for service contracts, and that—under North Carolina law—the City could enact a local preference policy for other contracts if the General Assembly gave them the authority to do so. But the Tin Man cautioned them that North Carolina law was not the only potential stumbling block to instituting a local preference policy. In this post, we'll hear what the City Attorney Tin Man has to say about the United States Constitution and local preferences.

"What does the Constitution have to say about local preferences?" asks Council Chairwoman Glinda.

"I'll get to that in just a minute," responds Tin Man, "but first I want to quickly review the three general types of local preferences, because this will be important to the rest of our discussion. There are three general types of local preferences: hiring preferences, which require contractors to hire a certain percentage of local workers; purchasing preferences, which require contractors to use supplies or materials that are made locally; and contract award preferences, which give local bidders or proposers an advantage in the award of public contracts." [I discussed these in the first post in this series, which you can find **here**.]

"OK," says Tin Man, "so now let's talk about the Constitution. Successful constitutional challenges against local preferences have come out of three constitutional doctrines: the Privileges and Immunities Clause, the Commerce Clause, and the Equal Protection Clause. I'll start with the Privileges and Immunities Clause, which is found in article IV, section 2 of the Constitution. It says that "the Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States."

"What does that mean?" asks Cowardly Lion.

"Essentially it means that you can't treat someone from one state worse than someone from your home state just because of the fact that the person is from a different state," responds Tin Man. "After all, we're the *United* States—the purpose of this clause was to help make us one nation instead of simply a collection of individual mini-nations."

"So we can't enact local preferences because of this Privileges thing?" asks Cowardly Lion.

"Well, the courts have said that direct public employment is not a privilege protected by the Clause, so the Privileges and Immunities Clause only comes into play when we're talking about local hiring preferences—not contract award preferences or purchasing preferences," says Tin Man. "But a carefully drafted local hiring preference should still be OK, as I'll explain in a minute. I hope you'll let me give you a brief explanation of the Commerce Clause and Equal Protection Clause first."

"Fine, go ahead," grumbles Cowardly Lion.

"The Commerce Clause is found in article I, section 8 of the Constitution," continues Tin Man. "It says that 'Congress'—not the States—'shall have the Power . . . to regulate Commerce . . . among the several States.' And the doctrine of the 'dormant Commerce Clause' or 'negative Commerce Clause' basically says that because Congress has the power to regulate interstate commerce, states and local governments don't have the power to take actions on their own that burden interstate commerce."

Glinda cuts in, "So you're saying we can't adopt any kind of local preference, because that would burden interstate commerce?"

"No," says Tin Man. "There's an exception to the dormant Commerce Clause known as the market participant exception. Under that exception, a state or local government *can* regulate commerce that the state or local government itself engages in—such as hiring contractors, awarding contracts, and buying goods."

"Oh, I see," says Glinda. "And you said there was one more constitutional doctrine to consider?"

"Yes," says the Tin Man. "That's the Equal Protection Clause. It's found in the Fourteenth Amendment, and it says 'no State shall . . . deny any person within its jurisdiction the equal protection of the laws.'"

"What does that have to do with local preferences?" asks Cowardly Lion, incredulously.

"It does seem like a stretch," agrees Tin Man, "But the courts have interpreted this language as a check against laws or policies that treat one group of people differently from another group of people. If a law or policy treats groups of people differently because of certain characteristics—like race or religious affiliation—then it's really difficult for a law or policy to survive a challenge under equal protection. But treating people differently because of where they live or where their business is based is not such a big deal, as long as the reason for the treatment is legitimate, and the law or policy has some rational relationship to that legitimate goal."

"So what does all of this mean for us?" asks Glinda. "What kinds of preferences are permitted?"

"Well," responds Tin Man, "it depends on what type of preference we're talking about."

Hiring preferences

"Hiring preferences are the most problematic," explains Tin Man, "because they interfere with contracts between private parties—specifically, contracts between a contractor and its subcontractors. After reviewing the cases, I've come up with the following criteria for a hiring preference that has the best likelihood of surviving a constitutional challenge:

"1. The policy, ordinance, or resolution establishing the preference should be worded to reflect a legitimate interest of the City, such as encouraging local industry, reducing local unemployment, or enhancing the local tax base.

"2. The preference should target qualified unemployed resident workers—such as workers that have signed up for unemployment assistance—rather than targeting all residents, regardless of their qualifications or employment status.

"3. The preference should establish a goal rather than a quota. In other words, it would require contractors to make good faith efforts to employ resident workers rather than simply rejecting contractors who fail to hire a specific number of resident workers.

"And, fourth, the real challenge: the local hiring goal should be based on data regarding how many jobs on public works projects are given to non-local workers when qualified unemployed resident workers are available to perform those jobs," Tin Man explains.

"How could we get that data?" asks Cowardly Lion.

"We'd need to work with a consultant," responds Tin Man, "We don't have anyone on staff who could come up with that data on their own."

Cowardly Lion growls softly to himself as the Tin Man continues. "Contract award preferences and purchasing preferences are not as problematic as hiring preferences because they don't interfere with contracts between private parties. I'll discuss contract award preferences next."

Contract award preferences

"Here's the criteria I've come up with for a contract award preference that has the best chance of surviving a constitutional challenge:

"1. No criminal penalty must be imposed on a public employee or officer who awards a contract without taking the preference into account.

"2. The percentage preference should be relatively small. Five percent seems to be acceptable, but anything higher than that is more likely to be struck down. A reciprocal preference—that is, one that is only imposed on bidders from states or local governments that have their own local preference, and only imposed to the same extent as that preference—has the best chance of surviving a constitutional challenge. [I discussed these in the first post in this series, which you can find **here**]. Also, setting a larger percentage preference for contracts under a certain dollar amount, and a smaller percentage preference for contracts over than amount is a common practice that seems finds favor with courts. For example, if the contract is less than $1 million, you could give a 5% preference to local vendors (up to $50,000), and if the contract is $1 million or more, the preference would only be 2% (to reduce the actual dollars involved).

"Finally, as with a hiring preference, the policy, ordinance, or resolution establishing the contract award preference should be worded to reflect a legitimate interest of the City, such as encouraging local industry, reducing local unemployment, or enhancing the local tax base."

"What about getting data about how contracts awarded to non-local companies hurt Emerald City?" asks Glinda.

"Courts don't look for that data when reviewing contact award preferences," Tin Man replies. "They seem willing to assume that contract award preferences have a plausible relationship to improving the local economy."

Purchasing preferences

"There are even fewer restrictions on purchasing preferences," continues Tin Man. "As long as the policy, ordinance, or resolution establishing the preference is worded to reflect a legitimate interest of the City, such as encouraging local industry, reducing local unemployment, or enhancing the local tax base, the preference should survive a constitutional challenge."

A couple of key points

"With that said," warns Tin Man, "there are a couple of things to watch out for with all three of these preferences. First, the preference cannot apply to projects funded by federal grants when those grants prohibit the use of geographical preferences."

"Do many federal grants prohibit geographic preferences?" asks Chairwoman Glinda.

"Yes, they do," responds Tin Man. "The prohibition is found in something called the Grants Management Common Rule, which applies to all federal grants, although some grants have specific language that overrides this prohibition on geographic preferences." [You can read more about the Grants Management Common Rule **here**.]

"And second," continues Tin Man, "If we ask our legislators to change the bidding laws to authorize us to adopt a local preference, we should ask them to work towards adopting legislation that gives us the *authority* to adopt such a preference, but does not *require* us to do so."

"Is that because of the market participant exception you explained a few minutes ago?" asks Cowardly Lion.

"Exactly," Tin Man replies. "There's some question about whether a local government could take advantage of that

exception when the preference is imposed at the state level rather than the local government level."

"Unless you have any questions, that's it for me," concludes the Tin Man. "I think Purchasing Officer Scarecrow will be ready to talk with you next about whether a local preference will be able to achieve the goals you discussed earlier."

[Note: A bulletin is forthcoming which will provide a more detailed discussion of the information presented above, along with case citations.]