AUDITOR OF THE COMMONWEALTH

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AUDITOR

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June 20, 1997

97-2512-9

Patrick J. Moynihan
General Manager
Massachusetts Bay Transportation Authority
Ten Park Plaza
Boston, Massachusetts 02116-3974

Dear Mr. Moynihan:

On May 23, 1997 this office received the Massachusetts Bay Transportation Authority's (MBTA) revised proposals to privatize the operation and maintenance of bus routes from the Charlestown and Quincy garages, respectively.

Pursuant to the requirements of Chapter 7, Sections 52-55, MGL, the privatization law, and specifically Sections 54(6), 54(7), and 55(a), the Office of the State Auditor hereby notifies you of its objection to the awarding of these contracts.

In its resubmissions, the MBTA sought to address the findings contained in this office's objection of May 16, 1997. In the area of corrected accounting deficiencies, we note that the MBTA's revised submissions contain reductions in claimed savings of over $2.7 million for the Charlestown garage and over $900,000 for the Quincy garage.

Your May 23, 1997 resubmission of the MBTA's proposals to privatize the operation and maintenance of bus routes from the Charlestown and Quincy garages, respectively, corrected certain of our previously identified deficiencies and satisfactorily clarified others. However, other substantive areas of disagreement remain because the MBTA's comments (1) did not address certain issues, (2) were nonresponsive, or (3) were not satisfactorily explained and, accordingly, remain an obstacle to the award of these contracts.

Specifically, this office continues to object to these two proposals due to the MBTA's continuing failure to comply with several of the substantive requirements contained in Section 54(7)-namely, cost, quality, compliance with the public interest requirement, and compliance with the privatization law. We find the MBTA's certification in each of these areas to be incorrect.

During the course of this review, we received written responses from the MBTA in response to our written inquiries. A main objection to these inquiries is the MBTA's belief that our review should be limited to the areas of noncompliance that we identified in our first report. We believe that the statute contemplates a full review of each proposal sent to us, regardless of whether it has been previously submitted. Having said that, we note that the great majority of our findings were contained in whole or in part in the first report. Secondly, any relevant areas in which the MBTA has revised its data and presentation represent new data, which are new items and clearly reviewable. Such revisions were contained in numerous areas of the revised submission. Thirdly, new data and new explanations from the MBTA have revealed related issues and questions in subject areas that the prior report did address. Finally, it is our position that we were precluded from fully conducting the initial review due to the deficiencies contained in those submissions, as detailed in our first rejection. A review of any submission or resubmission, to be complete, must look at the proposal in its entirety.

In addition, we note that, because the MBTA failed to adequately address several of our prior findings, the prior rejection of May 16, 1997, on the basis of those findings, is not withdrawn herein. The related findings contained herein supplement our original ruling and need to be addressed by the MBTA prior to resubmission.

I. COST SAVINGS

Section 54(7)(iii) – Pursuant to this section, the agency must certify and demonstrate that a proposed contract will be less than the estimated cost of keeping the service in-house, taking into account all comparable types of costs. Based on the initial and current presentation of the cost information supplied to this office, it is determined that the costs of contracting out this service will not result in a cost savings.

A. Vehicle Maintenance Plan

As we previously determined and reported, although the MBTA has not demonstrated any cost reductions at the Everett facility, it nonetheless has projected estimated cost savings of $23.8 million and $6.9 million, respectively, for the Charlestown and Quincy facilities.

The MBTA's response to this observation as expressed in its May 23, 1997 privatization resubmission essentially states that it is not required to show a cost savings but merely to provide:

> *…estimate of the costs of regular agency employees' providing the subject services in the most cost-efficient manner (the in-house cost estimate), the expenses that the Authority anticipates it would incur if it were to continue to perform the subject services itself using the most efficient organization (MEO) of its resources. Because the in-house cost estimate includes only the costs of performing the subject services, and because the subject services contribute only 40% of the Everett facility's workload, the total MEO expense of the facility's operation should be adjusted so that only 40% of this cost is included in the in-house cost estimate.*

The MBTA contends that its position represents-

> *The proper treatment under the Pacheco Law of the expense of operating the Everett heavy maintenance facility…*

In an effort to obtain an understanding and verification of the MBTA's contention that it need only to show that in-house costs exceed contract amounts, we asked the MBTA to explain how the projected "cost-savings" of $23.8 million (Charlestown) and $6.9 million (Quincy) will be realized. However, in lieu of providing any information or explanation to resolve the matter of whether any reductions to the MBTA's in-house cost for the Everett facility would be realized from this outsourcing initiative, we were told:

> *The questions persist in talking in terms of "savings" comparisons, and as such, are obviously based upon the Guidelines…*

Contrary to the MBTA's "Guidelines" assertion, our reference to "savings" is a direct quote from the MBTA's Executive Summary and Response to Previous Objection, wherein the MBTA's General Manager states the following:

> *Contract performance costs and other continuing costs amounts to $29,682,000 (Charlestown), $6,225,000 (Quincy) over the five-year contract period, creating a savings of $14,789,000 (Charlestown) $8,261,000 (Quincy).* [Underscoring added.]

Since it is a relevant fact that these MBTA-designated "savings" include therein $23.8 million and $6.9 million for Charlestown and Quincy, respectively, the MBTA's stated "savings" for Charlestown would actually result in a negative savings, that is, contract amounts exceeding in-house amounts by $9 million and reduced savings of only $1.3 million for the Quincy garage if those "savings" ($23.8 and $6.9 million) were excluded. We therefore believe it to be incumbent upon the MBTA to explain how it intends to reduce its costs at the Everett facility for those services presently supporting the Charlestown and Quincy garages.

Because the following "contractual provisions" are not indicative of substantial reduced costs resulting from the outsourcing initiative, we further inquired as to how the MBTA intends to achieve such cost reductions.

> *Service Agreement 5.3.3.*
>
> *The Contractor shall, during the period from the commencement of Service Date to the second anniversary thereof, acquire all new and rebuilt engines, transmissions, and other heavy maintenance components necessary to the Leased Vehicles through the MBTA's Everett Massachusetts facility provided that the quality of work performed at the Everett facility by the MBTA and cost for such work is comparable to that which can be obtained by the Contractor from other vendors.*

Exhibit A, Section 5.B, of the proposed contracts further provide:

> *The Bus Operations Contractors shall continue to use the Everett Facility for certain heavy maintenance functions for the first two-years of the Agreement, at a cost at, or below that detailed in Attachment 8: Heavy Maintenance Pricing Sheet. After that time, individual agreements with the Everett facility operator, or other vendor, shall be negotiated by the Contractor. The Maintenance Plan submitted by a Contractor must include the details of its maintenance program.*

In response, the MBTA stated:

> *You are mistaken in asserting that the language that you quote in paragraph 2(a) (the latter identified provision) of your memorandum is taken from the proposed contracts. In fact, the quoted language was contained in the RFP, but the terms of the proposed contracts on this point are significantly different. In particular, Attachment 8 to the RFP is not carried forward into the proposed contracts. Accordingly, the requests that you make in this paragraph are of no significance.*

Contrary to the MBTA's assertion that the quoted provisions citing "Attachment 8" are not included in the proposed contracts, that citation is contained in Section 5.B to Exhibit A of the proposed

contract, as identified above. Although the MBTA asserts that Attachment 8 is not carried forward into the proposed contracts, Section 5.B of the proposed contracts specifically refers thereto. If, however, the MBTA has yet other revised contracts, they have not been provided to us as required by Chapter 296, Section 54.

This calls into question the MBTA behavior in these procurements but also what other amendments or revisions exist that have not been shared with us. Therefore, the completeness of these proposals is questioned.

In order to determine the relevant facts of the cited contractual provision, we made the following inquiry only to be told that our inquiries "are of no significance."

> *We need to know what the "cost… detailed in Attachment 8…" represents-- that is does it represent the actual cost of the various line item work or is it a pricing list? If actual cost, please provide us with the individual cost components comprising each of the line item amounts on Attachment 8. Also, if "actual cost," please explain why the contractors would be permitted to pay for work "at a cost… below that detailed in Attachment 8."*
>
> *If, on the other hand, Attachment 8 represents prices rather than costs, please provide us with a comparison of the "price" with "actual cost" for each of the work line items.*

The relevancy of our inquiries should be readily apparent to the MBTA. Moreover, it is in its best interest to provide the requested data so that the relevant facts can be established. Notwithstanding the MBTA's contention that it need only to show that in-house costs exceed contract amounts, the MBTA nevertheless conjectures:

> *There are a number of other productive and income-generating uses to which the Everett facility might be put, but the impact of that eventuality, although likely beneficial, is beyond the scope of the inquiry that the Pacheco Law permits.*

In our opinion, all relevant facts dealing with the MBTA's cost savings determinations are appropriate inquiries with the Pacheco Law."

B. Non-Revenue Vehicles Maintenance – Arlington Facility

The MBTA's revised submission of May 23 increased its claimed "cost savings" in the repair of non-revenue vehicles utilized for the bus operations from $835,851 to $1,273,209 for Charlestown and

from $242,946 to $370,068 for Quincy. However, similar to the condition cited in the preceding comments pertaining to the Everett facility, no data were presented by the MBTA demonstrating a cost reduction to result from the proposed outsourcing of the bus operations.

We noted that, whereas the MBTA previously indicated that 26 and 8 non-revenue vehicles are needed to support the Charlestown/Fellsway and Quincy garage operations, respectively, it now claims that 39 and 11 such vehicles are needed in support thereof. In view of this significant increased revision to the MBTA's initial outsourcing initiative submission, we inquired as to the disposition to be made of the affected vehicles and the cost reductions to be made at the Arlington facility.

In lieu of responding to our inquiry, the MBTA stated:

> *The number and disposition of the vehicles from the Arlington facility was not a basis for the objection to the first submission. It is the MBTA's position that the State Auditor cannot use the resubmission as an opportunity to raise additional issues. The statute is clear that the Auditor may object to a submission, detailing the basis for the objection, that the MBTA can then respond to the objection, and that on the basis of this response, the Auditor can withdraw his objection.*
>
> *Whether the MBTA sells the vehicles, scraps the vehicles or uses the vehicles in other parts of the system so as to avoid a purchase of new vehicles is within MBTA management discretion. For the purpose of the review of the submissions, the important fact is that the non-revenue vehicles will not be utilized for the two bundles being outsourced.*

Contrary to the MBTA's assertion, our inquiry was based upon the significant increase to the Arlington facility's in-house cost estimate as revised by the MBTA. Surely, the MBTA does not seriously believe that we are not required to review its in-house cost estimate revisions and to seek explanations pertaining thereto if the revised data are not adequately supported.

We believe that the question of whether any costs at the Arlington facility supporting the Charlestown/Fellsway and Quincy garages will be reduced as a result of the MBTA's outsourcing initiative is a relevant issue that needs to be established before we can accord acceptance thereto.

C. Changes and Extra Work

We previously reported that the proposed contract with each of the two contractors provides for additional pay at contractually stipulated rates for non-scheduled and emergency services, which

according to the contractual provisions, could exceed $24.3 million and $4.9 million, respectively, for the Charlestown and Quincy bus operations. These nonscheduled bus services are a contractual requirement for events such as First Night activities that are certain to arise over the five-year contract period, the payments for which are directly related to the outsourcing of the two bus operations.

We therefore opined that the totality of the bus services being contracted out must be evaluated in any decision either to retain such service in-house or to contract out. The scheduled and non-scheduled bus services are an integral part of the services to be provided by the contractors and, in our opinion, are not deemed to be severable for decision formulation. We also believe that potential incentive payments, which could amount to $2.3 million and $2 million, respectfully, under the Charlestown/Fellsway and Quincy proposed contracts, must be factored into the cost of contract performance, especially since such payments are to be made in the event contractors meet some of the performance standards that are currently achieved by MBTA employees.

We further reported that, although we expected to review the considerations accorded by the MBTA for the required non-scheduled bus services, we did note any data pertaining thereto in the documents provided to us. Instead, those documents were and still are confined solely to the scheduled portion of the total bus services to be provided by the two contractors.

The MBTA's resubmission of May 23 addresses only the emergency service portion of the "nonscheduled service" provision contained in the proposed contract, as follows:

> *The other category of service, "emergency service," was properly not included within the MBTA's in-house cost analysis as this service is not budgeted for. If it were to be included, the costs would be offset, resulting in a "wash."*

The MBTA's resubmission, however, neither provides "wash" cost data nor addresses paragraph 6.2 of Section 6.0, Compensation and Method of Payment, contained in the Service Agreement with each contractor, as follows:

> *6.2. Planned Non-Scheduled Operating Service*
>
> *The MBTA shall pay the Contractor for additional planned non-scheduled operating service (to cover special events, including, without limitation, First Night, or to*

> *cover major construction projects), based upon the Contract Price. [Underscoring added.]*

Because this contractual provision implies that the additional payment for planned non-scheduled operating service may not be included in the revenue hours (650,400, Charlestown; 170,700, Quincy), we asked for the following classification so as to establish the relevant facts concerning the MBTA's revenue hour estimates.

> *Since the contract provisions do not define the services identified as unplanned, unscheduled and emergency, please provide us with (1) a detailed description for each category of service for additional payment, (2) the makeup of the FY 1997 budgeted revenue hours for each bundle (Charlestown/Fellsway, 650,400 hours; Quincy, 170,700 hours) separately identified to scheduled bus routes and each special event or other non-bus route event. Similar data are to be provided for fiscal year 1996.*
>
> *Also, how does the MBTA segregate its in-house costs incurred for unplanned, unscheduled and emergency services in such areas as materials, tires, fuel, services, maintenance, cleaning, supplies, medical supplies, injuries and damages, employee straight-time pay, etc.? If such segregation is maintained, please provide such data to us.*

With respect to the "revenue hour" portion of our inquiry, we were told that "(1) the revenue hours listed in the contract are inclusive of all special events, and (2) no special events require additional payments to the contractors as payment will be made at the agreed upon rates." However, no data, analyses or other documents were provided by the MBTA to support this assertion. Because these revenue hours (650,400, Charlestown; 170,700, Quincy) were developed by the MBTA, one would expect that the MBTA would have such data readily available to it. We believe that the composition of the MBTA's estimated revenue hours is a relevant fact that needs to be established before we can accord acceptance thereto.

Further, although the MBTA continues to assert that its in-house cost estimates do not include any costs incurred in providing emergency services, it has neither responded to our inquiry concerning "cost segregation" in such areas as materials, tires, fuel, services, maintenance, cleaning supplies, medical supplies, injuries and damages, employee straight-time pay, etc., nor provided any information, data,

analyses, or documents showing that these costs, which surely must have been incurred in providing emergency services, are not also included in its in-house cost estimate.

It is highly unlikely that the MBTA's costing procedures provide for this finite degree of cost gathering, other than for injuries and damages. Accordingly, the MBTA needs to support its contention that its in-house costs do not include costs attributable to emergency services, which the MBTA estimated could exceed $24.3 million and $4.9 million, respectfully, for the Charlestown and Quincy garages. We believe this matter to be a relevant issue requiring resolution prior to our acceptance thereof.

D. Pension Costs

The MBTA's May 23 resubmission still does not provide any pension payments for any of the 729 employees whose positions are to be eliminated. The MBTA reiterates its position that:

> *Since approximately 1,100 bus operations employees have fewer than ten years of service, the Authority anticipates that the application of its personnel policies, particularly seniority preferences, would obviate any need to lay off any employees who are eligible for retirement benefits as a result of this initiative.*

Although we do not agree with the MBTA's previously stated position that those employees who are "vested" in its pension plan and who elect not to displace other employees, less senior to themselves, are deemed to have left on their own volition and not from the privatization of their respective positions, we are restricting our comments to the MBTA's cost savings determinations.

The "avoidable costs" amounts identified in the MBTA's resubmission includes cost savings of $16 million (Charlestown) and $4.4 million (Quincy) for pension costs, which are based on the premise that all employees are or will be "vested" in the pension plan prior to the expiration of the five-year contract period. Data were not presented, however, showing how many of the affected 729 "nonvested" employees would have attained "vesting" during the five years, had the MBTA not sought to privatize its bus operations. Since these 729 employees have the least number of individual service years with the MBTA, many still may not attain such "vesting" during the contract period.

In this respect, we note that of the "approximately 2,000 people in bus operations and the corporate functions supporting bus operations," 1,100 "have fewer than ten years of service," according to the

MBTA—indicative of a high attrition rate not supportive of MBTA's premise that all 729 affected employees would have attained "vested" status during the five years.

Accordingly, we do not believe that the MBTA has reasonably demonstrated that it will save $16 million (Charlestown) and $4.4 million (Quincy) in pension costs by terminating the employment of 729 nonvested employees affected by the MBTA's outsourcing initiative.

In a related matter, the MBTA, in computing its potential liability under "13c Liability," has determined that the "weighted average years of service, dedicated employees" to be "4.50" for both the Charlestown/Fellsway and Quincy bus operations employees to be affected by the outsourcing initiative.

E. Unreported Buy-Out Costs

In response to our previous report stating that the MBTA did not account for the payment of accrued vacation time to employees who either quit or whose employment is terminated, the MBTA stated, "since the Authority maintains a separate accrued vacation liability account, it was not included in the in-house cost estimate."

We do not agree that "accrued vacation time" is not included in the MBTA's cost savings calculations. Those calculations are based on 52 weeks of annual wages, for each of the five years of contract performance, that the MBTA has concluded it would not need to pay as a result of outsourcing its bus operations. Included within those 52 week annual wages is vacation time either taken by employees or accrued. For instance, the first of the five-year period's 52 week wages claimed as a cost savings by the MBTA includes employee accrued vacation time earned in the preceding year but taken during the following year. Thus, although those employees would have worked less than 52 weeks during the first contract year, the MBTA nonetheless has identified all 52 weeks of wages as a cost savings, even though they include prior year's accrued vacation time.

Since the MBTA's in-house cost savings include vacation time taken and accrued for the entire five-year period, the MBTA should have factored into the respective cost savings determinations the vacation buy-out amounts to be paid to the affected employees upon privatization.

F. Fuel

We previously reported that the MBTA's cost "savings" determinations "double-counted" the amount of Massachusetts fuel taxes accruing to the Commonwealth. The MBTA's Executive Summary and Response to Previous Objection states that it has revised its cost comparison by excluding state fuel taxes from the contractor's pricing and still is showing such fuel taxes as an in-house cost.

The proposed contract with ATC/Vancom (for the Charlestown/Fellsway "bundle") provides:

> *Fuel may be purchased from the MBTA at a price equal to MBTA's cost for such fuel.*

The contract does not, however, define MBTA's "cost for such fuel." Accordingly, and considering that the fuel cost to the MBTA would include state fuel taxes that the MBTA has stated it is exempt from paying, we requested for the MBTA to explain how the fuel "cost" charged to ATC/Vancom is to be determined.

The MBTA responded by stating:

> *The price that a contractor would pay the MBTA for any fuel it may purchase was not a basis for the objection to the first submission. It is the MBTA's position that the State Auditor cannot use the re-submission as an opportunity to raise additional issues. The statute is clear that the Auditor may object to a submission, detailing the basis for the objection, that the MBTA can then respond to the objection, and that on the basis of this response, the Auditor can withdraw his objection.*
>
> *However, since the conclusion of contract negotiations, the parties have decided that both contractors will provide their own fuel under the contract.*

We do not agree that we are precluded from inquiring as to whether the revisions made by the MBTA, concerning state fuel taxes, would impact on the "cost" of the fuel to be charged the contractor. We believe that the MBTA's definition of what constitutes a chargeable "cost" is a relevant fact that needs to be clarified before we can accord acceptance thereto.

Concerning the MBTA's contention that "the parties have decided that both contractors will provide their own fuel under the contract," no such revision is contained in the proposed contract with ATC/Vancom. If there is still another revised contract, that contract has not been provided to us.

G. "13(c)" Liability

Under federal transportation law, an agency can be liable for substantial severance costs to displaced workers. The affected unions and the MBTA disagree on the application of the so-called "13(c)" provisions, and the matter is currently in litigation.

In the Office of the State Auditor's May 16, 1997 objection to the MBTA's first submissions of these proposals, we expressed our concerns relative to this potential liability and strongly recommended that the MBTA resolve the full extent, if any, of its liability to affected employees, prior to privatization. In fact, as far back as January 1997, this office recommended to the MBTA, in writing, that the 13(c) issue be addressed. The MBTA, when resubmitting its proposal one week later, declined to follow this recommendation. Subsequent to its resubmission, the MBTA declined an invitation from the union, and the recommendation of this office, to arbitrate the "13(c)" issue on available dates during the first week of June.

Because of pending arbitration, this office did not evaluate the MBTA's potential projected liability analysis, instead recommending that the MBTA resolve the issue of its applicability. However, not only did the MBTA decline to arbitrate this issue, it recalculated its maximum liability exposure as part of this submission. Accordingly, our current review of the MBTA's revised potential liability shows that the MBTA, as described below, significantly underestimated its potential liability by utilizing incorrect wage data and relying on a number of unsupported assumptions.

Given the MBTA's decision not to follow our recommendations, and its significantly flawed estimation of "13(c)" liability, we further reviewed available information in order to evaluate the likelihood that the MBTA would incur severance costs under these two proposals. This review concluded that the MBTA must address the probability that "13(c)" liability will apply to these proposals and that the extent of liability is ascertainable, as summarized below.

In summary, the extent of "13(c)" liability, by itself, would more than exhaust the total savings claimed for the two proposals, without even considering other significant findings. It is clear from the record that the MBTA has recognized this potential liability; in the two proposed contracts, the MBTA

assumes full responsibility for any "13(c)" liability that arises directly out of the execution of the contracts. Secondly, in 1996 the MBTA filed an action in court, seeking declaratory judgment that "13(c)" does not apply to these and other privatization initiatives. However, both the MBTA and the unions have since engaged in legal maneuverings that have prevented this issue from being ruled upon. Given the magnitude of the potential liability, the MBTA should resolve this issue prior to privatization.

The analysis below demonstrates what this office believes to be an accurate approximation of potential "13(c)" liability. As discussed below, the MBTA's "13(c)" analysis compares dissimilar data and utilizes a number of unsupported assumptions.

- The MBTA analysis, in addressing the 66 employees who will become unemployed as a result of these contracts, assumed that these individuals will become re-employed at either 75% or 90% of their current salary and benefits. However, information published by the Division of Employment and Training and provided to this office by the MBTA demonstrates that the average wage that would be available to these individuals for comparable positions would not only be significantly less than 90%, but likely to be less than 75%.

- The MBTA's analysis compares 85% of the MBTA wages and fringe benefits with 100% of the contractor's wages and fringe benefits. The MBTA stated in writing to this office that this comparison is appropriate because the contractors would be hiring fewer personnel than the MBTA to perform these operations. We disagree. The correct formula would be to compare what the MBTA currently pays the individuals expected to work for the contractor, with the wages and benefits the contractors will pay these individuals. The MBTA knowingly engaged in a dissimilar comparison that significantly understated the variance between its current wages and benefits and the contractors' proposed wages and benefits.

- The MBTA's analysis is based upon the premise that, if those MBTA employees who become employed by the contractors enter into a collective bargaining agreement with the contractors, then MBTA exposure will cease. The analysis therefore caps MBTA liability after one year. The MBTA, when requested, provided no legal basis for this premise, stating only that it was based upon "advice of counsel."[1] However, our review of the "13(c)" agreement, reveals no basis to support the MBTA's one-year cap. Nor has this office been shown any data to support the likelihood of a collective bargaining agreement being executed within one year.

- In calculating its own total wages and benefits for employees expected to be hired by the contractors, the MBTA failed to include overtime payments to these employees. According to our understanding of the "13(c)" agreement, these costs should have been included.

Based on these findings, we find the potential liability that could be incurred by the MBTA to be at least $47.3 million, consisting of $36.0 million for Charlestown/Fellsway and $11.3 million for Quincy.

[1] On June 19, 1997 this office received a letter from MBTA counsel that, in part, addressed this issue. The arguments contained therein did not change our position.

We view these numbers as conservative, in light of the fact that they are based on the MBTA's assumption that 85% of the displaced MBTA employees will go to work for the contractors, and that those employees laid off will become re-employed at a wage that is at least 75% of their current wage. By comparison, the MBTA concluded that such liability would be between a minimum of $3.8 million and a maximum of $10.2 million.

II. QUALITY OF SERVICE

The MBTA does not know whether the proposed contractors can meet acceptable quality service levels, let alone exceed the quality of services that is currently provided by regular MBTA employees, as required by Massachusetts General Laws, Chapter 7, Section 54(7)(ii):

> *The quality of the services to be provided by the designated bidder is likely to satisfy the quality requirements of the statement prepared pursuant to paragraph (1), and to equal or exceed the quality of services which could be provided by regular agency employees pursuant to paragraph (4);* [Underscoring added.]

This office finds incorrect the MBTA's certification that the proposals meet the statutory quality standards.

In its May 19, 1997 response to the Auditor of the Commonwealth's May 16, 1997 objection to the awarding of the privatization contracts, the MBTA stated:

> *In many instances no benchmarks are listed because the MBTA does not currently track these performance measures. Therefore, a baseline must be established with the contractors.*

Four days later, on May 23, 1997, the MBTA reported that the proposed contracts with the two contractors have been revised to set forth several performance factors, primarily dealing with quantitative service delivery attributes, such as pull-out performance, accident rates, and mean distance between mechanical failures. This sudden availability of data again calls into question the MBTA's reasonableness in completing and presenting the proposals for review. The only qualitative service indicator performance factor cited in the revised proposed contracts pertains to customer complaints (Charlestown/Fellsway, 1.94; Quincy, 6.91 – per 100,000 boardings). The MBTA, however, still has not contractually established performance factors for the following:

- Operating Performance Factors

  Mean distance between service interruptions
  Revenue collection:
  Half-trip detail

- Service Quality Indicators

  Passenger environment survey
  On-time performance

According to the following "technical support" comments accompanying the MBTA's revised May 23, 1997 submission, these Service Quality Indicators are not required by Section 54:

> *On-board Passenger Environment Survey: Beyond the requirements of Section 54, the Authority has included an innovative monitoring process to capture and track information about bus cleanliness, on-time performance and driver courtesy. This process, based on capturing a random sample of services, is specific to each vendor's garage. Currently, only cursory on-time performance is captured, and only on a system level. No information about passenger environment is collected.*

Other than the MBTA's assertion that qualitative performance service indicators, such as "on-time performance" is excluded from the statute's requirement that "the quality of the services to be provided by the designated bidder is likely to satisfy the quality requirements," no explanation is offered for not considering "on-time bus service," an important, if not the most important, quality factor in providing bus service to the MBTA's ridership.

In this respect, the newly designated general manager of the MBTA has been quoted as saying:

> *Customer service – it's the driving force for every agency in state government. Giving the public the best service you can provide. When I say service, the piece I mean is thinking of myself, sometimes, as still being the bus driver. I was there. I sat in that seat. Doing that job is the hardest one that anyone can [imagine]. And I don't forget that. I never forget that.*

The fact that the MBTA did not, and still may not, collect "information" about "passenger environment" (e.g., on-time service) does not lessen the requirement that the MBTA's management study, preceding its decision to contract out its bus operations, should have developed a performance work statement defining its requirements in terms of measurable performance standards.

The MBTA contends that it:

> *has developed an aggressive customer-focused performance standards program that meets and exceeds both the letter and spirit of Section 54. The intent is to provide a verifiable, continual process that ensures service quality equal to existing conditions while developing an innovative program of incentives and penalties that encourage the contractor to exceed those standards.*

Although this quality assurance surveillance plan is highly desirable as a means of measuring performance, its effectiveness must be measured against the "quality of services which could be provided by regular agency employees" rather than by "existing conditions"--that is, to determine the most efficient method of providing the bus service. Nonetheless, the MBTA still has not provided measurable performance factors for key qualitative attributes.

We also inquired as to the effort being undertaken by the MBTA, if any, to develop experience performance factors for all the remaining baselines not so established, and were told:

> *The Pacheco Law requires certification that "the quality of the services to be provided by the designated bidder is likely to satisfy the quality requirements of the statement prepared pursuant to paragraph (1), and to equal or exceed the quality of services which could be provided by regular agency employees pursuant to paragraph 4."*

Although the MBTA did not address our inquiry, it is pertinent to note that, whereas Chapter 296 states "quality of services which could be provided by regular agency employees", the MBTA informed us that "the Authority intends to hold the contractors not to the Authority's existing standards, but to a higher one." In our opinion, existing standards do not correlate to Chapter 296 quality requirements which could be provided by regular agency employees. Accordingly, we believe that the need to establish appropriate performance factors for each pertinent performance attribute based on the quality of service which could be provided by regular agency employees is a relevant fact for the MBTA to clarify.

Therefore, the MBTA has failed to provide a reasonable, responsible standard or basis to demonstrate that the proposed service will equal or exceed the quality of that which could be provided by agency employees.

In the course of our quality review, we noted that the MBTA's employees are enjoined from taking part in or instituting any job action that would disrupt or otherwise cause a work stoppage or impairment in providing passenger service.

Since employees of the proposed contractors are not so enjoined, it is essential that contingency plans be prepared setting forth the measures that the contractor plans to institute in the event of employee work stoppages or other impairments to providing bus service to its riderships. However, none of the documents provided us by the MBTA indicated that such contingency plans had been prepared or obtained by the MBTA.

III. NONCOMPLIANCE WITH PUBLIC INTEREST REQUIREMENTS

Liquidated Damages

The MBTA's May 23 resubmission still does not identify the nature of the "losses" to be paid the contractor under the proposed contract for the privatization of the Charlestown bus operations, which provides:

> *In the event that the MBTA terminates this Agreement without cause at any time, the MBTA shall pay to the contractor liquidated damages in the following amounts for the respective periods set forth below…*

According to the contractual terms such payment can range from a high of $740,000 during the initial stages of contract performance to less than $50,000 during the latter stages. The contract further states:

> *Such liquidated damages shall be deemed to be full compensation to the Contractor for any losses, costs, or expenses which it may suffer or incur as a result of such termination.*

Because the proposed contract does not define the specific losses, costs, or expenses, we asked the MBTA for such definition, but were told:

> *These figures (potential payment) are not an element of the "contract cost" under C. 7, S. 54(6), since they are not a component of the cost of performance under the designated bid (nor would they be incurred in addition thereto), and are accordingly immaterial to the review contemplated by MGL, C. 7 S. 55.*

Although the MBTA continues to express its opinion that Chapter 296 does not give "to the Auditor wide-ranging authority to determine whether a contract is in the public interest," it nevertheless explained that the liquidated damages provision is intended to be for the "start-up costs" that the contractor will be unable to recoup in the event of a termination of the contract by the MBTA. However, since "start-up costs" by definition are "costs" and not "losses," and considering that the MBTA contends that the Liquidated Damages provisions are intended to compensate the contractor for unrecovered "start-up costs," a simple resolution to this area of contention would be MBTA's revision to the proposed contract to so provide.

Pending such revision and the MBTA's continued refusal to identify the nature of the "losses" to be paid for liquidated damages, we see no alterative but to rely on the contractor's position relative thereto, namely:

> *In the event the Contract is terminated without cause by MBTA, MBTA shall pay to the Contractor all costs and expenses in connection with the cancellation… as well as Contractor's projected profit as reflected in its Response to the RFP.*

In the absence of any data to the contrary, the payment for "projected profit" for services not performed is clearly not in the public interest and, accordingly, not in compliance with Section 54 (7)(v) of Chapter 7, MGL, which states in part:

> *No agency shall make any privatization contract and no such contract shall be valid unless the agency… first complies with each of the following requirements…*
>
> *(v) the proposed privatization contract is in the public interest, in that it meets the applicable quality and fiscal standards set forth herein.*

We believe that contract payment provisions not clearly identifying what is intended for payment is a relevant fact requiring contractual clarification.

IV. NONCOMPLIANCE WITH PRIVATIZATION STATUTE

Flawed Procurement Practice

Both the initial and current reviews have dealt with the issue of fuel taxes and which party would be responsible for purchasing fuel. The MBTA, responding to our request for data on the revised pricing of the contractor's bid, stated that "… we fail to understand how the information that you request is

relevant to, or otherwise within the scope of your legitimate review under the Pacheco Law." Accordingly, there is no assurance that the negotiated significant revision to the contract price originally submitted by ATC/Vancom to operate the Charlestown garage does not pertain in part to the fuel procurement issue.

It is axiomatic that all potential bidders base their respective review and analyses on the same set of plans and specifications outlined in an agency's Request for Proposals. Any revisions thereto made prior to bid opening must be made known to potential bidders for their consideration in determining whether to bid. Similarly, any major revisions to the plans and specifications requested by a successful bidder during contract negotiations after bid opening must be denied or the procurement process must begin anew if major revisions are to be made to the published plans and specifications.

Although the plans and specifications set forth in the MBTA's Request for Proposals do not contain any provisions for advance payments to be made to the successful bidder, nor for the MBTA to provide fuel at cost to the contractor, revisions to those plans and specifications nevertheless were made to accommodate the request of the successful bidder of the Charlestown garage as follows:

(1) Advance Payments

> *In order to reduce costs to MBTA, the payment structure should be modified. Inasmuch as the number of hours are set forth in the RFP, and therefore, the cost of the System will be determinable prior to commencement of the Contract Term, billing can be bifurcated. The annual cost should be divided by 12, and 85% thereof should be paid by wire transfer on the first day each month… In this manner, Contractor's cost of working capital will be reduced, and therefore, MBTA's costs likewise will be reduced.*

(2) Fuel

> *The RFP currently provides that the Contractor is to provide fuel and bill MBTA therefor. This procedure is not cost effective, inasmuch as if the Contractor purchases the fuel, the Contractor must pay all applicable taxes. Conversely, we understand that if the MBTA purchases and provides the fuel to the Contractor, these taxes would be avoided, thereby saving the System considerable funds. This arrangement further would reduce projected costs of the Contractor by relieving the Contractor of the cost of interest on the working capital necessary to fund fuel purchases.*

The proposed contract provisions were revised by the MBTA to now provide:

> *On the first Business Day of each month, the MBTA shall pay by wire transfer in immediately available funds to an account designated by the Contractor an amount equal to [seventy-five percent (75%)] of the product of the Contract Price times the total number of Revenue Hours scheduled for such month.*

As a result, the contractor will receive a perpetual monthly advance of $2.8 million during the first 12 months of the 60-month contract, which increases to $3.3 million during the final 12 months. Thus, the contractor need only self-finance its busing operations by approximately $1 million, a month, of the $243.4 million contract price.

The proposed contract further provides:

> *Fuel may be purchased from the MBTA at a price equal to MBTA's cost for such fuel.*

In our opinion, these very favorable terms and conditions accorded to the successful bidder for the Charlestown/Fellsway garage, in contravention of those contained in the MBTA's Request for Proposals, are of sufficient magnitude to have warranted either a rejection of those terms or a resolicitation of bids to provide similar financial terms and conditions to other potential bidders, thereby extending the range of competition.

Furthermore, we do not believe that the proposed contractor's contrivance to deprive the Commonwealth of its fuel taxes by having the MBTA purchase the fuel for the contractor is in the Commonwealth's best interest. Although the MBTA is exempt from paying these taxes, it nonetheless makes such payments. However, since it is exempt, there is no assurance that the MBTA will continue to pay fuel taxes. Although the MBTA now states that the contractor will provide its own fuel, no revision to the proposed contract has been shown to us.

Chapter 7, Section 54, states in part:

> *No agency shall make any privatization contract and no such contract shall be valid unless the agency, in consultation with the executive office for administration and finance, first complies with each of the following requirements…*
>
> *(6) After soliciting and receiving bids, the agency shall publicly designate the bidder to which it proposes to award the contract. The agency shall prepare a*

> *comprehensive written analysis of the contract cost based upon the designated bid…* [Underscoring added.]

This requirement is specific to the designated bid, that is the bid submitted by the successful bidder, and not to any later changes made by the parties thereafter. Thus, not only is the MBTA's procurement practice considered to be unsound and highly questionable, but it is also apparently in contravention of Chapter 7 requirements.

V. CONCESSIONS

Section 54(4) of Chapter 7, MGL, states, in part:

> *Any employee organization may, at any time before the final day for the agency to receive sealed bids pursuant to paragraph (1), propose amendments to any relevant collective bargaining agreement to which it is a party. Any such amendments shall take effect only if necessary to reduce the cost estimate pursuant to this paragraph below the contract cost pursuant to paragraph (6).*

Pursuant to this provision, the employee organizations affected by the two submissions, collectively known as the Union Consortium (UC), submitted collective bargaining changes in a timely manner. The MBTA valued the UC concessions at approximately $4 million--$3 million for Charlestown/Fellsway and $1 million for Quincy. The UC believes that the value of its concessions is approximately $29.5 million.

Pursuant to Section I of this report, this office determined that the cost of contracting out each of these proposals will not result in a cost savings. This determination was reached based on the findings contained in Section I, and does not "factor in" the value of the UC concessions into the cost savings. However, we do note that, if our review had resulted in a determination that a cost savings existed between the in-house and the contract cost, we would be required to place a value on the submitted concessions, and to further determine whether the value of those concessions would negate the identified amount of savings.

Recommendation

We believe that the MBTA should seriously address each of the above substantive issues disclosed by our review. A carefully considered objective analysis of these matters, such as the Everett and

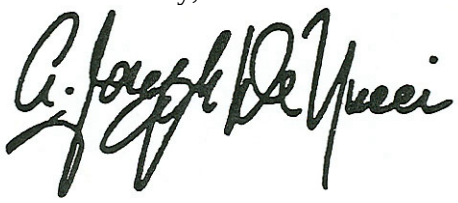
Arlington facilities, quality of service, changes and extra work, pension costs, 13(c), and bid price changes, should be undertaken prior to privatization. A hasty, ill-considered, rather than a thorough analysis, would not well serve the MBTA's ridership and the taxpaying public.

Conclusion:

Therefore, pursuant to Section 55(a) of Chapter 7, MGL, this office hereby notifies the MBTA of its objection to the awarding of these contracts. In accordance with Section 55(d), this objection is final and binding on the MBTA, until such time as a revised certificate is submitted and approved by this office.

As always, this office is available to discuss our findings and provide further assistance to the agency.

Sincerely,



A. JOSEPH DeNUCCI
Auditor of the Commonwealth