



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: RICHARD DOYLE
City Attorney

SUBJECT: Local Preference on Procurement

DATE: March 25, 2004

RECOMMENDATION

Approval of an Ordinance amending the San Jose Municipal Code to provide for a preference in the award of contracts for local businesses and small businesses

BACKGROUND

In response to direction to bring forward a local preference policy, on November 4, 2004, the City Attorney submitted for discussion a draft ordinance to create a local preference. At the November 4 meeting the Council directed Staff to: (1) Re-examine the issues pertaining to credit percentages and reevaluate the increase to a 5% credit percentage. (2) Re-examine the local goods purchases. (3) Conduct a further examination regarding local preference above \$100,000 as it relates to other cities and materials completed by the City Attorney to be routed to Council for further evaluation. (4) Have all matters reviewed by the Small Business Commission. (5) Examine ways in which Council can dispense with large umbrella-type consulting contracts.

ANALYSIS

1. Examination of percentage preference

Since 1993 the City of San Jose has been using two separate procedures for the application of a local preference, depending on the type of procurement. For supplies materials and equipment purchases, the preference is equal to 1% of the bid price for bidders that pay sales tax within the City of San Jose. For general and professional services the preference is essentially a tiebreaker in the RFP process to determine the most advantageous proposal.

Staff's recommendation at the November 4 meeting was to make the following changes:

- For supplies, materials and equipment the preference is increased from 1% to 2%
- For services (RFP's and Quotes) the preference is changed from a tiebreaker to a 5% bonus in *points* used in the evaluation.

2. Review by Small Business Commission

On November 12, 2003, the Small Business Development Commission's made the following recommendations:

- 1) To increase the preferences on RFQ/RFPs to 5% (of points) for local companies, and an additional 5% for small businesses for a possible total of 10% preference.
- 2) To allocate a 5% (dollar value) preference on the bid price for local *or* a 5% preference for small business for bids on the provision of goods and services, *but not both*, for a maximum possible total of 5%.

In both cases, the Commission recommended that local preference only apply to City of San Jose vendors. However, the Commission did not specifically recommend whether the definition of small business should also include an element of being local as well.

Definition of Local Business Enterprise

As stated above, the City uses two separate definitions of *local*:

1. For purchases of *supplies, materials, and equipment* local vendors are defined as vendors who pay their sales taxes using the Tax Code Area Number for the City of San Jose. Local Vendors are given a 1% credit which is equal to the amount of sales tax revenue received by the City as the result of the purchase. This definition was created at the time that the City Charter required that purchasing contracts be let to the lowest responsible bidder. Thus the 1% credit granted to local vendors was simply recognizing the fact that that was the amount of sales tax revenue that the City would get if the purchase were made by a San Jose vendor of goods. The City Charter was amended to remove the requirement that such purchases be awarded to the low bidder. Therefore the current purchasing ordinance can be amended to create a different local preference procedure without a legal issue that there is a conflict with the City Charter.
2. The procedures for the procurement of *General Services and Professional Services* currently use a definition of a "Local Business Enterprise" (LBE) which requires two elements:
 - Having a current San Jose business tax certificate; and
 - Having an office with at least one employee operating legally within the City of San Jose

LBE's are given a tie breaker preference where two proposals or quotes are substantially the same.

Staff Response to Council direction

Following the discussion by the Small Business Commission, staff analyzed Council's direction to look at a five percent preference in light of the overall goal of "Getting Families Back to Work." The Office of Economic Development reviewed data regarding where San Jose residents were employed. Their analysis determined that 50% of San Jose residents work in the City of San Jose, and an additional 40% of San Jose residents work in the County of Santa Clara outside the incorporated limits of the City of San Jose. Based upon this information, staff is now recommending that the definition of local be expanded to include the County of Santa Clara. This geographic definition is similar to those used by the City of Los Angeles which includes all of Los Angeles County, the City of Napa which includes all of Napa County, the Port of Oakland which includes for some purposes all of Alameda and Contra Costa Counties, and the City of San Francisco which is both a city and a county.

In addition to furthering the goals of getting San Jose residents "back to work," using a definition of local that includes the County of Santa Clara also more closely approximates disadvantages of the cost of doing business in this area; i.e. generally the costs of doing business in the City of San Jose are similarly as high as the costs countywide, thus reinforcing a finding that the program has a rational basis.

Under this proposal, the San Jose Municipal Code would be amended to include the following new definitions:

"Local Business Enterprise"¹ means a business enterprise, including but not limited to a sole proprietorship, partnership, or corporation, which has a legitimate business presence in the County of Santa Clara. Evidence of legitimate business presence in Santa Clara County shall include:

1. having a current San Jose business tax certificate; and
2. having either of the following types of offices operating legally within the County of Santa Clara:
 - a. The contractor's principal business office; or
 - b. The contractor's regional, branch or satellite office with at least on full time employee located in the County of Santa Clara.

"Small Business Enterprise " means a Local Business Enterprise that has Thirty-Five or fewer total employees.

By defining a Small Business Enterprise as a subcategory of Local Business Enterprise we are recommending that only Santa Clara County small employers be given a preference.

¹ Staff is now recommending that there only be one definition of "Local Business Enterprise" because having two definitions was difficult to implement and there is no longer a reason to tie the definition of local to a percentage of the sales tax received in San Jose.

Application of Preferences

For procurements of *supplies, materials and equipment* and for requests for quotes for *general services where price is the determinative factor* the preference for LBE's will be 2.5% of the cost submitted and an *additional 2.5%* of the cost submitted for local firms which are also SBE's. For *general and professional services solicited through an RFP process where cost is not the determinative factor* in selecting the most advantageous proposal, the preference will be a 5% *bonus in points* used in the evaluation for LBE's and an *additional 5% bonus in points* used in the evaluation for SBE's.

Exceptions

The current Local Preference Policy does not apply to the following types of procurement:

- i. Procurements where legal constraints on the expenditure of funds prohibit the application of the policy.
- ii. Procurements on behalf of the San Jose-Santa Clara Water Pollution Control Plant.

The first exception addresses the fact that some funding sources would not allow for a local preference. Some airport funds and federal and state grant monies may not allow the City to use a local preference. The second exception resulted from a Treatment Plant Advisory Commission (TPAC) decision to not use a local preference, which only benefited City of San Jose businesses when the source of funds was from a wider geographic area. If City Council adopts a new definition of LBE and SBE that includes firms countywide, then TPAC might be willing to include its purchases in San Jose's Local Preference Program.

3. Further examination regarding local preference above \$100,000 as it relates to other cities and materials

Local preference cannot be used in formal bids for public works in excess of \$100,000 because the City Charter Section 1217 requires that such contracts be awarded to the low bidder.

In our previous memoranda this Office advised City Council that under the court's decision in *Associated General Contractors of California, Inc. v. City and County of San Francisco*, 813 F.2d 922 (9th Cir. 1987), a city such as San Jose, which has a charter provision which requires that contracts be awarded to the lowest responsible bidder, cannot include a local or small business preference in making the determination of responsibility. In that case a general contractors association brought a challenge to a San Francisco ordinance that gave a 5% preference to local business enterprises in the award of contracts. The Court held that to the extent that the San Francisco charter restricted purchases "to the lowest reliable and responsible bidder," the preference was in violation of the charter and therefore invalid.

Our Office continues to advise that the *Associated General Contractors* decision prohibits a local preference on public works procurements that require contracts be let to the lowest responsible bidder.²

4. Local Goods Purchases

Our Office continues to advise that public works contracts cannot have a specification that requires contractors to purchase construction materials locally. However, in response to the interest in maximizing the use of local vendors for the purchase of construction materials, the Office of Economic Development (OED) has been exploring what can be done to ensure that sales or use tax dollars that are generated by projects in San Jose accrue to the City. OED advises that a portion of the effort will include working with the contracting departments and the City Attorney's Office to build the awareness of the City's vendors as to the importance of contractors buying locally whenever possible to support the local economy.

OED, in consultation with the Auditor's Office, will also be working with individual companies to ensure that use tax filings are filled out properly to allocate use tax dollars to the City. When companies make large purchases (over \$500,000) out of state the corresponding Use Tax should be allocated to the City. State law does not penalize companies when tax documentation is filled out incorrectly. Use Tax dollars often fall to the State Tax Pool. San Jose only receives a portion of dollars from the State Pool, thus the City receives less than its appropriate share of Use Tax dollars.

5. Umbrella-type Consulting Agreements

At the November 4th Council meeting, Council inquired about the possibility of eliminating large consulting agreements for engineering and design services, so that the City could more effectively ensure that local firms were given an opportunity for these works. There is no legal impediment to changing this practice.

CONCLUSION

The draft ordinance responds to Council direction by modifying the existing local preference program, with two changes in how the preference is applied:

- For bids and RFQ's for supplies, materials and equipment and quotes for services where cost is the determinative factor the preference is increased from 1% to 2.5% for LBE's and an additional 2.5% for local firms which are also SBE's.

² This Office has not analyzed whether it would be legally permissible to include local preferences in design-build contracts which are exempt from the low bid requirements pursuant to the recently adopted Measure D Charter Amendment.

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- For RFP's for general and professional services the preference is changed from a tie-breaker to a 5% bonus in *points* used in the evaluation for LBE's and an additional 5% bonus in *points* used in the evaluation for SBE's.

In addition, the ordinance codifies the requirement that all professional service contracts for more than \$5,000 be obtained on a competitive basis where practicable, and that when the competitive process is used, it should include the above referenced local and small business preferences.

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