GENERAL ASSEMBLY OF THE STATE OF TENNESSEE
FISCAL REVIEW COMMITTEE

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UPDATE – REVIEW OF PROPOSED FINAL CONTRACT

FISCAL REVIEW COMMITTEE STAFF REPORT

PROPOSED CONTRACT FOR PRIVATE OPERATION OF SOUTH CENTRAL CORRECTIONAL FACILITY

June 22, 2007

Procedural History

The Fiscal Review Committee is required by law to review the request for proposals (RFP) and proposed contract for private operation of the South Central Correctional Facility (SCCF) in Wayne County. The new contract is scheduled to take effect on July 1, 2007.

On December 13, 2006, the FRC staff issued a report (copy attached) on the proposed RFP making the following recommendations:

(1) Make the FRC mid-contract cost comparison after year two binding in determining whether the contract should be extended for the final three years;

(2) Delete language from the RFP specifying a maximum bid that the Tennessee Department of Correction (TDOC) would accept;

(3) Modify the RFP process to allow TDOC to engage in negotiations with a proposed vendor after receiving a response to the RFP; and

(4) Strengthen the Comptroller's authority to audit the contractor to assess issues such as turnover, its effect on violent incidents in the prison, and the ability of the contractor to meet its obligation to provide safety and security comparable to a state prison.

The Fiscal Review Committee voted unanimously on December 13 to forward the staff recommendations to the Select Oversight Committee on Corrections (SOCC) for further consideration. On January 10, 2007, SOCC met and adopted the FRC staff recommendations. SOCC forwarded its report to the State Building Commission, which met on January 11, 2007 to consider the proposed RFP. Commissioner Little of TDOC told Treasurer Dale Sims that SOCC's recommendations were being addressed in the RFP. The Building Commission then approved TDOC's request to issue the RFP.

After completing the RFP process, TDOC decided to award the contract to the existing contractor, Correction Corporation of America (CCA). On June 12, 2007, TDOC provided FRC with a copy of the proposed final contract for review and comment. Due to the short time frame for review by FRC, SOCC, and the House State and Local Government Committee, a joint meeting of these committees has been scheduled for June 26, 2007 to consider the proposed final contract.

Recommendations (1) and (4) were incorporated in the RFP and the proposed final contract. TDOC has acknowledged that Recommendation (3) was within the scope of TDOC's existing contract authority. Recommendation (2) was not incorporated, in light of an opinion from the Attorney General dated February 12, 2007 (copy attached) that the maximum contract price must be included in the RFP, although the maximum price had not been included in previous RFPs.

Issues Raised by Proposed Final Contract

1. Cost savings.

TDOC's proposed budget improvement for a "contract inflator" for SCCF for FY07-08 was substantially reduced in the Governor's Budget. TDOC had proposed a $4,017,400 contract inflator, an increase of 15.6 percent that would have automatically maintained the contract at five percent below the state's cost of operating the comparable facilities (Northeast Correctional Complex and Northwest Correctional Complex). Instead, the contract inflator was reduced to $848,200, a 3.3% increase approximately reflecting the percentage increase in the Consumer Price Index. This change reduced the budgeted contract price by $3,169,200 in FY07-08. (Information provided by TDOC to the Senate State and Local Government Committee for its budget hearing on March 6, 2007, listed this reduction at $3,249,700.)

The two RFP responses were significantly below even this reduced figure. The three-year cost of CCA's bid was $74,687,000. The three-year cost of Management & Training Corporation's (MTC) bid was approximately $75,102,000 (one-half of one percent higher than CCA's bid). This cost compares with the actual FY06-07 contract price of $25,766,500. Multiplying the FY06-07 cost times three years, with no allowance for inflation, the three-year cost would be $74,908,200. The projected cost of CCA's bid for FY07-08 is approximately $24,348,000, a cost approximately $1,418,500, or 5.5 percent, less than in FY06-07.

Actual expenditures under the existing and new contract are assumed by TDOC to be slightly less than these amounts. CCA is paid on a per inmate per day basis. The budgeted contract price assumes 98 percent capacity. CCA's daily census typically varies between 96 and 97 percent of capacity.

Under the proposed contract, the maximum three-year cost will be $74,687,000 (CCA's bid), compared with $93,206,700 projected in the RFP (the RFP cost was calculated using the higher inflator that was not funded in the Governor's Budget). The cost reduction over three years, compared with the maximum stated in the RFP, will be $18,519,700.

The appropriated amount for this contract in FY07-08 is $25,817,600, which exceeds the proposed contract price by approximately $1,469,600. TDOC should be asked what it intends to do with these excess funds.

The cost reduction also raises questions whether the new, lower cost is achievable, whether CCA will subsequently ask for the contract price to be increased, or whether CCA is bidding below cost for other reasons (e.g., using this contract as a loss leader to demonstrate its ability to manage prisons economically). Alternatively, if the contract can be performed profitably at the reduced cost, then it appears the state may have overpaid for the previous contract.

2. Proposed staffing reduction.

Both bidders on the contract, CCA and MTC, included substantial staffing reductions from current levels. The existing contract requires CCA to maintain 411 positions at SCCF. This staffing level is approximately equivalent to the State's staffing at NWCC and NECC.

Under the new contract, CCA will maintain 365 positions at SCCF, a reduction of 46 positions, or 11.2 percent. (MTC had proposed 327 positions, a reduction of 99 positions, or 24.1 percent.) CCA will maintain 109 "security/operations" positions, a reduction of 17 positions, or 13.5 percent, from existing levels. Unit management and security will have a combined decrease from 296 to 261 positions, a reduction of 35 positions or 11.8 percent.

The proposed final contract requires CCA to have no more than a 50 percent annual turnover rate in "security personnel" as of each June 30 (Section A.5.d). Historically, turnover in these positions at this facility, and at other CCA-operated prisons, has been much higher. For calendar year 2005, the last year for which data are available from TDOC, correctional officer turnover at SCCF was 70.2 percent, compared with a system-wide average of 25.8 percent excluding SCCF and two other CCA-operated prisons, Hardeman County at 74.1 percent, and Whiteville at 80.9 percent. (Including all three CCA facilities, the system-wide turnover rate increased to 35.7 percent.)

The State is required by the Tennessee Constitution to maintain safe and humane prisons. In addition, CCA is contractually required to maintain safe, secure and humane conditions at SCCF. The staffing reductions in the new contract raise the issue whether these constitutional and contractual obligations can be met at the reduced staffing levels. The contract requires CCA to meet staffing standards of the American Correctional Association (ACA). The ACA standards require the prison to use a formula to determine staffing needs and to maintain correctional officer posts "in or immediately adjacent to inmate living areas." *ACA Standards for Adult Correctional Institutions No. 4-4177 (4th Ed. 2003).* The ACA standards, however, do not specify staffing levels. They provide only that staffing patterns should meet certain criteria such as "goals, legal requirements, character and needs of the inmates supervised, and other duties required of staff." *ACA Standard No. 4-4050.* There are no quantitative standards against which to measure the adequacy of staffing levels.

The safety and security concern is magnified by the relatively high level of violent incidents at SCCF in past years as measured by TDOC standards. If CCA is able to operate SCCF properly at reduced staffing levels, TDOC may need to consider whether its staffing patterns at comparable facilities should be adjusted. These determinations can only be made after the new SCCF contract has been in place for a period of time sufficient to allow this evaluation.

The proposed final contract contains ambiguous language concerning the ability of CCA to obtain additional State funds if staffing levels are determined by the State to be inadequate. Section A.5.d states: "Notwithstanding any provision contained herein to the contrary, Contractor shall provide adequate staff to fulfill its obligations under this Contract, which shall be at a minimum the number of staff set forth in the proposal." Section A.5.e.3 requires CCA to add additional staff if the State determines at any time that the staffing is "inadequate." This section authorizes CCA to seek additional compensation from the State through an adjustment in the per diem for inmates.

Thus, it is unclear whether CCA could seek additional compensation if the

State determines that additional staff is required. Given the reduced contract price, there is a significant likelihood that this issue may arise during the term of the contract.

In addition, the reduced contract price may make it difficult for SCCF to comply with the 50 percent turnover limitation. This issue should be monitored closely.

Staff Recommendations

1. In light of reduced contract price, reduced staffing levels, and the historic level of violence at SCCF, cost and performance should be closely monitored by SOCC, FRC, and the House and Senate State and Local Government Committees, on at least an annual basis, through reports by TDOC to these committees.

2. The annual contract inflator included in the Governor's Budget each year should be based upon the CPI, rather than automatically rising to the level five percent below the State's cost of operating comparable facilities.

3. Any excess funds appropriated for the new contract in FY07-08 should not be included in TDOC's work program for FY07-08 and should revert to the State Treasury.

4. The ambiguous contract language concerning additional compensation for additional staff should be amended to clarify that the financial cost of any additional staff required upon a determination by the State that existing staff levels are inadequate shall be borne entirely by CCA.

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FISCAL REVIEW COMMITTEE STAFF REPORT

PROPOSED REQUEST FOR PROPOSAL FOR OPERATION OF SOUTH CENTRAL CORRECTIONAL FACILITY

DECEMBER 13, 2006

Introduction

The Fiscal Review Committee is required by law to review the draft request for proposal (RFP) for the new contract for operation of the South Central Correctional Facility (SCCF) in Wayne County. The Committee staff has conducted a background review and analysis consisting of the following:

- Review of the 2001 RFP and contract entered into with Corrections Corporation of America (CCA);
- Multiple meetings with officials of the Tennessee Department of Correction (TDOC) in Nashville;
- Review of prison operation and cost data provided by TDOC for SCCF, Northeastern Correctional Center (NECC) and Northwest Correctional Center (NWCC), the two prisons designated for comparison in reviewing performance and cost in operation of SCCF by CCA;
- Tour of SCCF and meetings with the warden, her staff, and corporate officials of CCA;
- Meeting with TDOC's contract monitors for SCCF;
- Tour of NECC and meetings with the warden and his staff;
- Review of the proposed 2006 RFP and pro forma contract;
- Meeting with staff of the Select Oversight Committee on Corrections; and

- Attendance at the Governor's budget hearing for TDOC.

Based upon this review, the FRC staff has prepared this overview and outline of issues for consideration by the Committee in evaluating the proposed RFP.

Overview

The prison privatization statute authorizes, but does not require, the State to contract for the operation of a facility by a private vendor. CCA operates SCCF pursuant to a five-year contract awarded in 2002. CCA has operated the prison continuously since 1992. The current contract expires on June 30, 2007. By law, CCA is required to operate the facility at a cost at least five percent less than the State's cost of operating comparable facilities (NECC and NWCC). The contract will cost the state approximately $25 million in FY06-07 (not including administrative and contract administration costs incurred by TDOC for SCCF).

CCA successfully completed a cost and performance comparison in 2004 after two years of experience with the contract. The comparison concluded that CCA had met the statutory requirement of cost savings of at least five percent below the state's comparable cost and had similarly met required performance standards. The FRC staff report dated May 3, 2005, documented savings by CCA of 11.1 percent (allowing a deduction from CCA's costs for sales and use taxes paid). Based upon that two-year review, the contract was extended to its full five-year term.

There are two mechanisms in the statute for increasing costs during the term of the contract. The first is an annual escalator during the contract term based upon the Consumer Price Index (CPI). This mechanism is not utilized in the current contract.

The second mechanism allows for price increases "if the general assembly specifically authorizes those adjustments and appropriates funds for that purpose, if required." Tenn. Code Ann. § 41-24-104(b)(2). This process is utilized in the current contract. It is described as a "contract inflator" and is included as an improvement each year in the Governor's budget.

Under the current contract, the annual contract inflator is 3.3 percent. This amount, which is greater than the CPI increase during the period 2002-date, was negotiated between CCA and TDOC.

During the term of the current contract, TDOC's cost of operating state prisons has increased substantially, largely as a result of wage and benefit increases provided to correctional officers and other prison staff. The cost increase for operation of state prisons has substantially exceeded the contract inflator in the current SCCF contract. Thus, the difference between the cost of operating the comparable state prisons and the cost of the state's contract with CCA has grown wider. The state has achieved greater savings in the past two years of the contract and will also achieve greater savings in the last year of the contract. In the final year of the contract, the State's total cost for SCCF (including administrative costs and the contract cost) will be approximately 15.7 percent less than the cost of the comparable state prisons.

Going forward, TDOC has proposed a contract inflator for FY07-08 of $4 million, which will cover the first year of the new contract. The inflator is approximately a 15.6 percent increase over the last year of the existing contract. TDOC's rationale for this increase is that it will keep the SCCF contract cost at approximately five percent below the state's cost of operating NECC and NWCC. This inflator is reflected in the maximum acceptable bid which TDOC proposes to specify in the RFP.

The existing cost differential may be reflected in prison operations, although this conclusion could not be definitively established based upon the information available to the FRC staff. It warrants further assessment (see Issues for Consideration section).

Currently, according to Warden Lindamood of SCCF, beginning correctional officers are paid $8.72 per hour. After six months, a new correctional officer receives a pay increase to $9.14 per hour. This wage compares with a beginning wage of $11.42 per hour for state correctional officers. In addition, the benefits offered to state correctional officers are substantially greater, particularly in the areas of insurance and retirement. The pay and benefits differential is such that Warden Lindamood and the TDOC contract monitors agreed that employees at SCCF would jump at the chance to work at the adjacent state prison facilities.

SCCF experiences high turnover in correctional officers. Warden Lindamood estimated the current annual turnover rate at 48-49 percent. Non-CCA officials estimated turnover at 75-80 percent. At the time of our visit to SCCF on November 17, 2006, FRC staff asked for data from SCCF to confirm the turnover statistics. CCA agreed to provide this information but to date it has not been received. The turnover rate at NECC and NWCC varies from 15 to 26 percent according to records of NECC and other data from TDOC.

SCCF, a combination medium- and minimum-security facility, also experiences a high rate of violent incidents as measured by TDOC. In FY05-06, SCCF had 7.43 violent incidents per 100 inmates, compared with 2.83 at NECC and 6.52 at NWCC. Although NECC and NWCC are not maximum-security institutions, NECC permanently houses some maximum security prisoners. The system-wide average, including maximum-security prisons, was 5.70.

CCA disputes these statistics. CCA contends that it over-reports violent incidents to err on the side of caution and that some violent incidents at the comparable state prisons are not reported.

Likewise, CCA contends that it has incurred sharp increases in costs for inmate health care in the past two years due to the changing health care status of inmates that it receives. In general, CCA contends that it is receiving a less healthy set of inmates and that its costs are being driven higher as a result. CCA contends that the $4,000 contractual cap on its in-patient health care costs is being overwhelmed by out-patient costs, which are not capped.

The infirmary and pharmacy facilities at SCCF and NECC appear to be similar. NECC has a physician and a dentist on duty 40 hours per week. SCCF has a physician on-site two days per week and utilizes a physician's assistant as well.

FRC staff did not attempt to resolve these conflicting assessments but believes that these and other issues warrant further consideration in the RFP process, as outlined below.

Issues for Consideration

1. Whether the RFP should require that the contractor meet the cost savings standard as determined by FRC.

Under prior law, for the contract to be extended for the final three years, the contractor had to meet the five percent cost savings standard for the first two years as determined by FRC staff based upon criteria set out in the RFP and the contract. (The contractor also had to meet performance standards.) Chapter 883 of the Public Acts of 2006 amended this statute to make the cost comparison a "consideration" but not the deciding factor in determining whether the five percent savings requirement had been achieved.

Although the comparison is no longer determinative under the statute, TDOC has authority to make it determinative under the terms of the RFP and the contract. The criteria for the cost comparison have not changed from the current contract in the proposed RFP, but the draft RFP makes the cost comparison only a consideration, not determinative, in making the five percent savings assessment. The Committee may want to consider whether to recommend modifying the RFP to make the FRC cost comparison determinative.

2. Whether TDOC should delete language from the RFP that would specify a maximum bid that TDOC will accept.

In an environment in which it is entirely possible, perhaps likely, that only one bid will be received, specifying a maximum bid that TDOC will accept is tantamount to inviting the bidder to bid at that amount. This strategy virtually ensures that the state will achieve savings no greater than five percent. If a maximum bid is not specified, a bidder is more likely to make its lowest and best bid. For this strategy to work, however, TDOC must be prepared to "walk away" from the process and operate the prison directly if no satisfactory bid is received.

The Committee may want to consider whether to recommend deleting the language from the RFP specifying a maximum acceptable bid.

3. Whether TDOC should modify the RFP process so that it can engage in further negotiations with a proposed vendor after receiving a response to the RFP.

TDOC should structure the contract award process so that the state's considerable leverage in negotiating for the operation of SCCF can be fully utilized. Again, this strategy requires a willingness by TDOC to walk away if negotiations do not produce an acceptable result.

The Committee may want to consider whether to recommend modifying the RFP process to increase the state's leverage in negotiations for the new contract.

4. Whether the RFP should be amended to strengthen the Comptroller's authority to audit the contractor to assess issues such as turnover, its effect on violent incidents in the prison, and the ability of the contractor to meet its obligation to provide safety and security comparable to a state prison.

The contractor has a fundamental obligation under the prison privatization law to provide safety, security, and constitutionally required services at the same level as a state prison. The level of staff turnover and the apparent rate of violent incidents at SCCF raise concerns about whether these requirements are being met. These concerns warrant a thorough review by the Comptroller, including review of employment and disciplinary records, to determine whether the cost savings achieved by the contractor through lower wages are having a negative impact on safety, security, or other basic prison functions.

The Committee may want to consider whether to recommend modifying the RFP to increase the Comptroller's authority to audit for these issues. The Committee may further want to consider requesting that the Comptroller make such an assessment and report to the Fiscal Review Committee and the Select Oversight Committee on Corrections on the results of the assessment.

STATE OF TENNESSEE

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February 12, 2007

The Honorable James W. White
Executive Director
Fiscal Review Committee
320 Sixth Avenue, North - 8th Floor
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FISCAL REVIEW

Dear Mr. White:

In response to your request, attached is opinion number 07-12. If you have further questions or comments, please contact this office.

Sincerely,

Robert E. Cooper, Jr.
Attorney General and Reporter

JCP:nlr

Enc.

STATE OF TENNESSEE
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February 12, 2007

Opinion No. 07-12

South Central Correctional Facility RFP

QUESTION

Does TENN. CODE ANN. §§ 12-4-109, 41-24-101 *et seq,* or any other state statute or regulation require the Department of Correction to include in the RFP the contract maximum price stated in Section 3.3.6 of the proposed RFP?

OPINION

Yes. TENN. CODE ANN. § 12-4-109(a)(1)(A) requires that evaluation criteria must be included in the RFP.

ANALYSIS

TENN. CODE ANN. § 41-24-101, *et seq.* known as the "Private Prison Contracting Act of 1986" authorizes the State to contract for correctional services for only one (1) medium security or minimum security facility opened after July 1, 1991, pursuant to the requirements and procedures specified in Chapter 24. Corrections Corporation of America (CCA) is the current vendor whose contract expires in a few months.

The Department of Correction (DOC) is preparing to issue a Request for Proposals (RFP) to send to potential vendors. Pursuant to TENN. CODE ANN. § 41-24-104(a)(1), the Attorney General, the State Building Commission (SBC), and the Commissioner of the Department of Correction must first approve any request for proposals, any original contract, any contract renewal and any price and/or cost adjustment or any other amendment to any contract. The SBC gave its approval to issue the RFP at its January 11, 2007 meeting. This Office gave its approval to the SBC and DOC Commissioner Little by letter dated February 1, 2007.

The RFP and contract contain objective performance criteria and cost criteria to measure the level and quality of services as required by TENN. CODE ANN. § 41-24-104(c)(2). The statute requires that the cost of the private operation and the cost to the state to monitor the private operation is at least five percent (5%) less than the State's cost for essentially the same services.

This Office has reviewed the applicable statutes for private prison contracting with the procurement statute, TENN. CODE ANN. § 12-4-109, and determined that the contract maximum price stated in Section 3.3.6 of the proposed RFP should be included in the RFP. The cost figure is the basis for the evaluation, and evaluation criteria should be included in RFPs. *See* TENN. CODE ANN. § 12-4-109(a)(1)(A). Moreover, the information is readily available as a public record. This Office, therefore, recommends that this cost figure be included in the RFP based upon RFP statutory requirements.

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Requested by:

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