Privatization in Michigan:

An Overview of State Efforts to Privatize Liquor Distribution and Warehousing, the Accident Fund, and the Biologic Products Division

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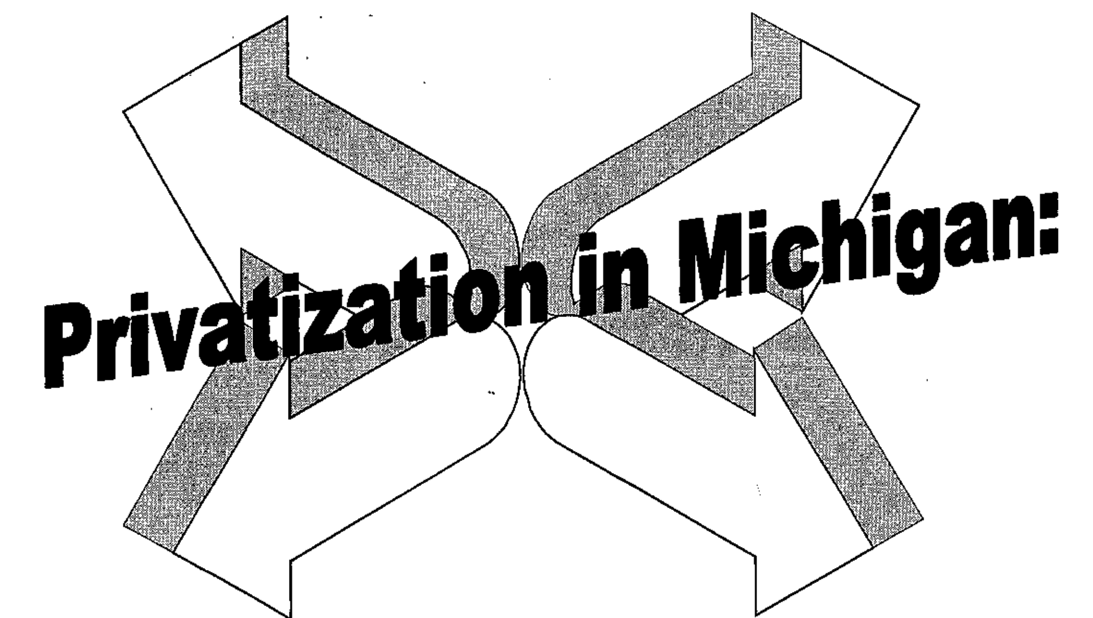

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PRIVATIZATION

INTRODUCTION

Peter Drucker the writer and Fortune 500 business and management consultant, coined the term "privatization" in the 1960s. The word, which first appeared in the American lexicon in 1983, in general, means a governmental function, activity, or asset that, in order to diminish the size and role of the public sector, is wholly or in part transferred to the private sector. Privatization is based on the economic premise that because public monopolies are protected from the competitive forces of the marketplace, they may operate inefficiently without fear of losing their customer base or going out of business. Thus privatization's underlying objective is to interject the competitiveness and ingenuity of the private sector in order to increase productivity, reduce expenditures, and advance service quality.[1]

Privatization consists of numerous, distinctive management practices designed to advance public sector performance through private sector involvement. These management practices include:

- **Contracting Out**, a state enters into agreements with private firms, for-profit or not-for-profit, to manage state programs, provide services or conduct public projects with state funds.
- **Asset Sale**, a state sells its assets to private firms or individuals to raise sales revenues and enlarge the tax base.
- **Vouchers**, a state allows eligible clients to purchase state services or programs from private providers available in the open market.
- **Franchises**, a state gives a private firm monopoly privileges to manage state programs or provide state services in a given geographic area.
- **Grants and Subsidies**, a state makes monetary contributions to help private firms provide state services or state programs.
- **Public-Private Partnerships**, a state conducts state projects in cooperation with the private sector, sharing ideas and resources or relying on private resources instead of spending state funds.
- **Deregulation**, a state removes its regulations from the services previously monopolized by government in favor of private provision of the service and competition against government agencies.
- **Service Shedding**, a state drastically reduces the level of a state service or stops providing a service so the private sector can assume the function with private resources.
- **Volunteerism**, a state uses volunteers to help manage state programs or deliver services to the public.[2]

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[1] National Governors Association, *An Action Agenda to Redesign State Government*, (1993), 42.

[2] The Council of State Governments (CSG), *State Trends & Forecasts: Privatization*, (November 1993), 9.

ARGUMENTS FOR PRIVATIZATION

- Helps government save taxpayer money in management and service delivery.
- Is necessary for speedy implementation of certain programs.
- Provides high-quality services in some areas.
- Is necessary when government lacks expertise or personnel to carry out certain programs.
- Uses more innovative approaches and technology.
- Helps dissolve unnecessary government monopolies.
- Offers services more effectively due to flexibility and less red tape.
- Slows the growth of government or downsizes government.
- Introduces competition between government employees and private providers.
- Is an alternative to traditional ways of improving government productivity.

ARGUMENTS AGAINST PRIVATIZATION

- Does not save government and taxpayer money.
- Does not guarantee market competition and can result in "private monopolies."
- Leads to corruption, including political patronage, kickbacks, and bribes.
- Lose of control by policy-makers and managers over privatized services and functions.
- Diminishes accountability of government officials.
- Private gain and public good do not always correspond.
- Is not necessary because other productivity improvement approaches are available.
- The quality of privatized services and functions are compromised due to private providers' profit motives.
- Lowers state employee morale and brings fear of displacement to affected employers.[3]

MICHIGAN PRIVATIZATION

From President Theodore Roosevelt's Square Deal through the various social experiments that comprised the Great Society, the argument that the national government was primarily responsible for solving economic and social ills held sway in Washington, D.C. It was not until the election of President Ronald Reagan that opponents of "big government" were given full political voice. In part elected on a promise to reduce the size, range, and invasiveness of the federal government, President Reagan, in 1987, assembled the *President's Commission on Privatization*, which released its report the following year. Though the commission offered no sweeping plan, it did recommend several initiatives to increase private sector participation in government contracting. These initiatives produced limited results, it has been asserted, because the federal

[3] CSG, *Private Practices: A Review of Privatization in State Government*, (1998) 2.

government has been traditionally inclined toward privatization. Over the years, the federal government has intentionally avoided participating on any equity basis with private, non-governmental entities. As a result, proponents of privatization have concentrated much of their reform activities at the state government level.[4]

In January 1983, Michigan was $1.7 billion in debt, a deficit that amounted to one-sixth of total annual expenditures and one-third of operating expenses, and was on the verge of bankruptcy.[5] Upon taking office in 1983, Governor James J. Blanchard initiated a financial recovery program, which required the 19 state departments to reduce operating costs through the elimination and streamlining of state services. From 1983 through 1985, 30 programs and boards were eliminated, reducing the cost of government by at least $336 million, and in combination with an increase in the state income tax the debt was eradicated, and the state posted a positive $500 million cash balance.[6]

In conjunction with state efforts to make government leaner and more cost-effective, Representative Tom Mathieu sponsored House Bill No. 4634 (1984 PA 15). This act required the Department of Management and Budget (DMB) to survey state agencies to determine whether there was unnecessary duplication of activities between state agencies and private businesses. Supporters of this act argued that many governmental agencies enter into essentially commercial and industrial ventures subsidized by taxpayers in direct competition with the private sector. It was expected that this act would spur economic development and job creation and retention.

In 1986, DMB, pursuant to 1984 PA 15, released its report to the Legislature. This report listed and described 49 actions taken by state agencies to reduce state competition with the private sector since 1983. According to the report, most of the 49 state programs involved the privatization or the "contracting out" of printing, engineering, architecture, surveying, and temporary secretarial help. The report, at the request of the DMB, also surveyed state agency directors to compile an inventory of activities in which the state sold goods and services, which competed or potentially competed with the private sector. The 38 compiled activities included Prison Industries, the Liquor Control Commission, and the Michigan Biologic Products Division. According to DMB, this survey was connected to legislation introduced by Representative Vincent Porreca.[7] This legislation (1986 House Bill No. 5627), modeled after Arizona law, would have prohibited certain educational institutions and agencies of state or local government from providing certain

[4] Congressional Research Service, Report for Congress, *Privatization: Meanings, Rationale, and Limits*, (February 1996) 95-522 GOV, 1-2.

[5] David Osborne, *Laboratories of Democracy: A New Breed of Governor Creates Models for National Growth*, (Boston: Harvard Business School Press, 1988), 146.

[6] Michigan Department of Management and Budget (DMB), *Reducing the Cost of State Government: A Progress Report to the People of Michigan*, (March 1994) 1-45; DMB, *Reducing the Cost of State Government in 1984: The Second Progress Report to the People of Michigan*,(August 1985) 1-35; DMB, *Reducing the Cost of Government: Michigan's Third Progress Report*, (1986) 1-63; Osborne, *Laboratories of Democracy*, 147.

[7] DMB, *Progress Report on Privatization Efforts in State Government*, (November 1986) 1-90.

goods and services that competed with the private sector. The measure died in the House Committee on Colleges and Universities.

The last privatization legislation offered that decade occurred in 1987. Representative Debbie Stabenow introduced House Bill No. 4372, which would have prohibited state agencies from participating in commercial activities. This bill died in the House Committee on Economic Development and Energy.

PERM

In the late 1980s, the Michigan economy slumped again. By 1990 unemployment was 7.6 percent, the worst among the nation's ten largest states, and the state was $1.8 billion in debt. From one point of view, the state's economic problems were due to the fact that in the 1980s, government spending grew faster than the rate of inflation. Excessive government spending, it was argued, was the result of the continual demand for new government programs and services and the inefficient and costly delivery of expanding existing services. To reduce budget deficits, many state policymakers sought to reduce government spending and contain the demand for tax dollars. More importantly, these policymakers sought to operate public services more efficiently. They contended that because public services operate outside the competitive realm of the private sector, oftentimes the result is low productivity and poor accountability. In order to achieve efficiency and productivity, advocates proposed tough cost-saving measures by the elimination of wasteful and unnecessary spending and internal management and operational reforms; with the privatization of numerous state governmental functions.[8]

On July 30, 1992, Governor John Engler issued Executive Order No. 1992-17, which established the seven-member Michigan Public-Private Partnership Commission. The commission was ordered to review a published draft of *Privatization in Michigan Recommendations to the Governor*, prepared by the Michigan Department of Management and Budget (DMB), Privatization Department, and make its own recommendations to the Governor.

After meeting for five months, the commission issued a final report and recommended, in part, that some aspects of state government be eliminated, retained, modified or privatized. By "privatize," the commission meant transferring the financing and/or the production of a service from government to individuals, businesses, and non-profit organizations. To determine whether or not to privatize, the commission proposed a methodology to analyze every program and activity of each branch of state government.[9]

The methodology was called PERM, reflecting the following policy options:

[8] House Republican Policy Committee Task Force, *Report on Privatization in State Government* (June 1992), 3.

[9] Michigan Public-Private Partnership Commission, *Final Report. P.E.R.M: Privatize, Eliminate, Retain or Modify. Recommendations to the Governor on Improving Service Delivery and Increasing Efficiency in State Government*, (December 1992), 5, 26-28.

- Privatization.
- Elimination ("service shedding").
- Retention in current form.
- Modification.

The analysis consisted of three parts:

- Description and history of the activity and proposed outcome.
- Justification for the proposed outcome, including impediments.
- Detailed cost-benefit analysis comparing existing cost (actual, not just budgeted) with alternatives.[10]

To spur the PERM process, the commission identified 203 specific activities that should be analyzed. Governor Engler instructed all department heads to review these activities and decide the appropriate courses of action. Decisions were then forwarded for review to the Privatization Department in the Department of Management and Budget (DMB). In 1995, the PERM process changed as the Privatization Division was given greater authority to choose which activities to analyze, particularly those activities that crossed agency lines.

PERM EFFECTIVENESS

It is very difficult to access the degree to which the PERM process is successful. Only two studies have attempted to determine its full extent and each reports conflicting information. Moreover, there is no comprehensive, systematic study that accesses the financial impact of state privatization efforts.

From January 1993 until its abolition as an independent unit in September 1997, the Privatization Department supervised the PERM process. Over this period, according to the Senate Fiscal Agency, 15 departments submitted 67 PERM reports and 51 percent (34) of said reports were submitted by three departments: Military and Veterans Affairs (14), Transportation (13), and the Department of Natural Resources (7). In addition, among the 67 PERM reports there were only 38 recommendations for privatization (57 percent), 3 for elimination, 19 for retention, and 7 for modification. Due to the lack of systematic follow-up, the fiscal agency reported that it was very difficult to ascertain the number of recommended privatizations that were actually privatized. Of the 38 activities recommended to be privatized, the departments identified only 24 activities that were actually privatized, or 63 percent of the activities recommended for privatization.[11]

[10] During the mid-1990s, several states have borrowed the Michigan privatization model to scrutinize state government operations, especially traditional activities that had seldom been questioned. See National Governors Association, *State Strategies for the New Economy*, 2000, 31.

[11] Michigan Senate Fiscal Agency, *Issue Paper: PERM Studies and the Use of Private Contractors in State Government*, (January 1998), 3-7.

The Senate Fiscal Agency findings are very different from those compiled by The Council of State Governments (CSG). In 1997, CSG conducted a nationwide survey of state executive agencies to determine the number of programs and services that had been privatized during the past 5 years. Among the 11 Michigan executive agency respondents, CSG reported that 119 services had been privatized. This number is significantly higher than the 38 recommendations for privatization and the actual 24 activities that had been privatized as cited by the Senate Fiscal Agency.

Despite the conflicting data, the CSG study did provide some important data: Among the 50 states Michigan had the fourth highest of number of privatized programs and services. In addition, the Departments of Community Health and Education reported that more than 15 percent of programs and services had been privatized resulting in cost savings of more than 15 percent.[12]

RELIABLE COST DATA

In 1997, the United States General Accounting Office (GAO) completed a study that identified major lessons learned by the state governments of Georgia, Massachusetts, Michigan, New York, and Virginia. All of whom made extensive use of privatization. One of the major lessons learned was the "need for reliable and complete cost data on government activities to assess the overall performance of activities target for privatization, to support informed privatization decision, and to make these decisions easier to implement and justify to potential critics."

Of the five state governments studied, only Virginia, through its Cost Comparison Program "Compete," obtained precise "complete cost and performance data." In fiscal year 1996, Virginia was able to identify complete costs of 45 percent of the government activities identified as privatization candidates. The other states made only "best estimates" because obtaining the required accounting information was too difficult. As a result, some of these states experienced "negative consequences." For example, the Massachusetts State Auditor, "citing inadequate cost analysis before privatization as well as a lack of substantiating data on the benefits claimed following privatization," questioned the reported savings of some privatization efforts.[13]

LIQUOR DISTRIBUTION AND WAREHOUSING

Unlike the Blanchard administration, Governor Engler's Department of Management and Budget (DMB) privatized some high profile state functions, principally the liquor distribution system, the Accident Fund, and the Biologic Products Division. According to John Kost, the former DMB Deputy Director, who headed state privatization efforts under Governor Engler from 1992 to May 1996, the administration was firmly committed to privatization on the philosophical ground that it was not the role of the state to be

[12] CSG, *Private Practices,* 9 and 11.

[13] United States General Accounting Office, *Privatization: Lessons Learned by State and Local Governments,* March 1997 (GAO/GGD-97-48) 3, 12-3.

involved in activities where clearly there were private sector alternatives. Moreover, Mr. Kost said, privatization was in the long-term fiscal interest of the state.[14]

Perhaps the most controversial of the state privatization efforts was the one concerning the liquor distribution system because it threatened public sector employees' job security. The passage of the 21st Amendment to the U.S. Constitution in 1933 repealed prohibition of liquor in this country. On April 10, 1933, Michigan became the first state to ratify the amendment and, when the amendment became effective, was therefore free to experiment with developing a new liquor control system. Later that year in a special session, the Michigan Legislature approved the Liquor Control Act (1933 PA 8 (Ex. Sess.)). Under this act, Michigan became one of 18 "control" states to adopt a system whereby the Liquor Control Commission was responsible for the purchasing, warehousing, distributing, merchandizing, accounting, and inspecting of spirits in addition to the licensing of manufacturers of all beer, wine, distilled spirits, and mixed spirits.

In 1996, prior to privatization, the Michigan Liquor Control Commission ordered liquor from three product distillers or manufacturers, two of whom, Hiram Walker and Heublein, were based in the state. This product was then shipped by private transport companies to the two state owned warehouses located in Lansing and Lincoln Park. The commission assessed a bailment charge of 83 cents per case on the manufacturer for storage, which was estimated to total about $4.0 million annually in revenue. Next, the product was shipped to a third warehouse in Escanaba and to 63 statewide regional stores. Unlike the Lansing and Lincoln Park warehouses, the Escanaba warehouse and the 63 regional stores were leased by the state. The commission assessed another bailment charge of 25 cents per case to the manufacturer to cover the cost of distribution, which was estimated to total about $2.0 million in revenue annually. It was estimated that these leases, along with maintenance and utility contracts, cost the state about $22 million annually.[15]

By 1996, the MLCC issued 4,128 convenience and grocery retailers with specially designated distributor (SDD) licenses (stores that sell liquor for off-premises consumption) and 8,971 specially designated merchant (SDM) licenses (stores that sell liquor on-premise), which included hotels, restaurants, and bars. Each of these licensees was personally and financially responsible for obtaining their beverage needs from a regional store. They or their employees could pick up an order or could contract with a private hauler to do so for them. In the high volume Detroit metropolitan area, delivery by a state-authorized agent was required and the licensee paid a delivery charge.

Under the liquor control act, the commission is required to establish uniform liquor prices in state liquor warehouses and regional stores, as well as in SDDs. The commission purchases liquor, marks up the price no less than 51 percent and not more than 65 percent and then sells it to SDDs and SDMs at a 17 percent discount.

[14] E-mail comments to the author, August 3, 2001.

[15] Senate Fiscal Agency, *Liquor System Privatization,* Senate Bill No. 1171 Enrolled Summary, January 22, 1997.

WELBORN PLAN

The first attempt to privatize the liquor distribution system occurred in November 1991. Senator Jack Welborn introduced Senate Bill Nos. 612 through 616. In short, the measures would have privatized the entire liquor distribution system by eliminating the merchandizing and warehousing functions of the liquor control commission and would have included the closing of the two state warehouses and 63 regional stores. It would have restricted MLCC responsibilities to licensing enforcement, tax collection, and auditing. Further, MLCC expenses would have been reduced by $27.5 million and would have eliminated approximately 450 FTE positions. The bills died in the Senate Committee on State Affairs and Military/Veteran Affairs Committee.[16]

ENGLER PLAN

In 1992, Governor John Engler, in his 1992/93 Executive Commerce Budget, (House Bill No. 5522) called for privatizing a portion of the state's liquor distribution system. The proposal would have closed all the regional stores, resulted in about 400 layoffs, but unlike the Welborn plan, it would not have affected the liquor warehouses in Lincoln Park, Lansing, and Escanaba.[17]

In addition, the plan would have divided the state into distribution regions and allowed private companies to bid for regional stores and distribution rights. Companies awarded contracts would transport product from the manufacturer to the state warehouses and then transport it to the regional stores where the SDDs and SDMs would have the option of picking it up or having it delivered. The commission would have managed the distribution and contracts and retained responsibility for purchasing, licensing, and enforcement. The administration predicted that the proposal would lead to an increase in the price of liquor. However, the state would have realized a one-time saving of $25 million for the sale of the state's liquor inventory at its regional stores. Further, the state would have realized annual savings of between $15 and $20 million based on the reduction in distribution costs. [18]

In February, the House Appropriations Regulatory Subcommittee removed the liquor privatization proposal, along with the proposed sale of the Accident Fund, from the Commerce Budget. Instead, the committee added section 356 (1992 PA 155) which "strongly" urged the Department of Commerce and the MLCC to reconsider their proposed plans to reorganize the liquor distribution system.

In March, Representative Morris Hood Jr. introduced House Bill No. 5685. This bill would have required the MLCC to maintain the liquor distribution system, including state

[16] Senate Fiscal Agency, *Liquor Distribution Revisions*, Senate Bill No. 612-616: Committee Summary, February 26, 1992.

[17] *Michigan Report*, February 6, 1992; *Michigan Report*, February 7, 1992; February 12, 1992.

[18] *Michigan Report*, February 26, 1992.

ownership of regional stores. The bill passed the House and died in the Senate Committee on State Affairs and Military/Veterans Affairs. In March 1993, Representative Hood reintroduced this measure as House Bill No. 4487, which died in the House Committee on Liquor Control.

MLCC PRIVATIZATION PLAN

In May 1993, the MLCC announced that it would privatize the state liquor distribution system. According to the proposal, the state would have been divided into four distribution regions, each of which would have been bid to a distribution company (vendor) to provide retail warehousing and delivery. Also, the commission offered each vendor a $1.00 long-term lease on state owned warehouses and equipment. The state soon withdrew this offer because of vendor liability concerns and state concerns of how well vendors would care for state property. In the end, this proposal was abandoned for two reasons. First, no vendor agreed to cover the Thumb and Upper Peninsula distribution territories. Second, the plan was suspended as supporters waited for the courts to decide on the legality of the Accident Fund sale.[19]

NEW ENGLER PLAN

In January 1995, Governor John Engler, in an effort to reenergize the liquor privatization process, appointed former state Senator Phil Arthurhultz to head the MLCC.[20] In February 1996, after a year of studying the issues, the MLCC passed a resolution ordering, in part:

- Closing the three state warehouses and regional stores and firing the 400 or so state employees;
- Canceling all product transportation, warehouse leasing, maintenance, and utility service contracts;
- Establishing a state-controlled liquor purchasing system that would require a designated distributor, or "authorized distribution agent (ADA)," to operate the new wholesale distribution system. The ADA would transmit licensee product orders to the MLCC. In turn, the MLCC would purchase the product from the distiller and sell it to the ADA;
- Prohibiting an ADA from having an interest in a supplier or retailer and vice versa;
- Abolishing the 83 cents per case bailment fee and the 25 cents per case bailment delivery charge. Retained revenue would assist ADAs in funding their own wholesale liquor distribution system;

[19] *Michigan Report*, May 27, 1993; *Michigan Report*, November 12, 1993; *Michigan Report*, April 5, 1995; *Michigan Report*, January 3, 1995.

[20] *Michigan Report*, January 3, 1995.

- Reducing product markup from 65 percent to 58 percent. The loss of revenue ($22,338,788) was expected to offset savings ($22,188,750) from the closure of the three state regional warehouses and make Michigan more competitive with neighboring states' retail prices. The retained revenue would also assist ADAs in funding their own wholesale liquor distribution system;

- Permitting "specially designated distributors" (SDDs), state-licensed package stores (party, grocery, and convenience stores) that sell liquor for off-premise consumption, to sell liquor products to "specially designated merchants" (SDMs) on-premise licensees (bars, restaurants, private clubs, hotels, bowling alleys, etc). At the time, this practice was prohibited. This new practice would dramatically reduce the number of retail destinations within the new distribution system from 13,099 to 4,128. Retained revenue would assist ADAs in financing the new distribution system; and

- Continuing price controls. Party and convenience store operators, who greatly depend on beer, wine, and liquor sales, would not have to worry that larger retailers would sell liquor at a loss and thus force the former out of business.[21]

Initially, the MLCC expected to implement its plan on May 1, 1996. Due to pending litigation to block the liquor privatization plan, the effective date was changed to January 12, 1997, to coincide with the end of the terminated state workers' first pay period following the holiday season. Also, the implementation date was pushed back because manufacturers were concerned that a change in the liquor distribution system during the busy holiday season could disrupt sales.[22]

REACTION

Opposition to the MLCC plan was divided among those who rejected the privatization of the liquor distribution system in principle and those who favored privatization, but wanted specific changes to the plan.

In part, opponents of the privatization of the state liquor distribution system argued:

- The system generated net profits of about $57 million in fiscal year 1990/91, which funded about $6.7 million worth of fire protection grants to cities and provided about $4.7 million worth of support to the Michigan State Housing Development Authority;

- Michigan Civil Service rules prohibited privatization;

[21] Michigan Department of Consumer & Industry Services, Liquor Control Commission, *The Privatization of Liquor Distribution in Michigan*, February 7, 1996.

[22] *Michigan Report,* July 16, 1996.

- The system employed about 400 people who were in specialized classifications that would preclude their being able to "bump" into other state classified positions and who generally are in their late 40s or 50s and thus would have dim prospects for starting a new career if they lost their jobs; and

- Anticipated savings likely would be fleeting: the main gain of selling the state liquor inventory would be one-time only, and may be well under the $25 million claimed, when the money owed on the inventory is taken into account. Money theoretically saved in operating costs would be offset by lost income tax revenue and the likely need to beef up enforcement staffing to ensure that private operators were complying with the law.[23]

Privatization supporters who wanted to change the MLCC plan primarily advanced the following arguments:

- Since the end of Prohibition, the United States Constitution has given exclusive authority for liquor regulation to state legislatures. Since alcohol is a controlled substance, the Michigan Legislature, not the MLCC, has the constitutional duty to protect its authority to regulate the liquor industry.[24]

- ADAs should be subject to many of the same limitations as state beer and wine distributors. For example, authorized agents must continue the present three-tier distiller/distributor/retailer system. Under this system, package stores are prohibited from becoming distributors to bars and restaurants and other on-premise consumption licensees because, without state oversight, liquor distribution controls would loosen and lead to smuggling. For example, if a bar was not restricted to purchase product directly from a distributor, the licensee may smuggle cheaper priced liquor from a neighboring state.[25] Consequently, the licensee would be able to sell a cheaper product that would compete more effectively with beer and wine.

- Retailer to retailer sales would effectively abridge the Legislature's constitutional requirement to regulate liquor.[26]

- ADAs must not be allowed to charge retailers delivery fees and for split cases, both of which would drive up liquor costs to the consumer.[27]

[23] House Legislative Analysis Section, House Bill No. 5685, June 25, 1992.

[24] *Michigan Report*, September 24, 1996; *Michigan Report*, November 12, 1996.

[25] *Michigan Report*, September 24, 1996.

[26] *Michigan Report,* November 8, 1996.

[27] *Ibid.*

LEGISLATIVE COUNTER MEASURE

In December 1996, Senate Bill No. 1171 (S-5) (1996 PA 440) was approved by the Governor. Sponsored by Senator Bill Bullard Jr., the act in part:

- Authorized the MLCC to privatize its merchandizing and warehousing divisions and contract with ADAs to perform the functions of these divisions;
- Abolished the commission's 83 cents bailment fee and the 25 cents distribution fee;
- Prohibited ADAs from having direct or indirect interest in a distiller or liquor retailer and vice versa;
- Required ADAs to make a "good faith effort" to provide employment to the 400 or so former state workers who were terminated following the privatization of the liquor distribution system;
- Prohibited ADAs from charging retailers delivery fees or split case fees. However, ADAs may charge retailers a $20 fee to deliver a special emergency order;
- Required ADAs to deliver to each retailer on at least a weekly basis. Also, retailers may pick up the product at the ADAs' warehouse;
- Allowed the MLCC to pay the distiller an additional amount of at least $4.50 but not more than $7.50 for each case of liquor purchased. The revenue is used to offset the distiller's costs of contracting with an ADA for the warehousing and delivery of liquor to retailers; and
- Retained the three-tier distribution system by prohibiting package stores from selling product to on-premise consumption licensees.[28]

Following privatization, 7 state certified ADAs maintained physical control of the state's liquor inventory, obtained liquor orders from liquor retailers, and delivered free of charge to retailers. The liquor control commission paid ADAs a $5.42 per-case fee for warehousing and delivery costs for each case purchased by a licensee. Further, ADAs collected and deposited proceeds from liquor sales into the Liquor Purchase Revolving Fund, which is used to fund the administration of the MLCC and the purchasing, warehousing, and distribution of liquor.

[28] Senate Fiscal Agency, *Liquor System Privatization*, Senate Bill No. 1171, Enrolled Summary, January 22, 1997.

DISPLACED STATE LIQUOR EMPLOYEES

In mid-December 1996, Governor Engler and the MLCC received commitments from the three prospective ADAs to offer positions to 316 of the 380 or so displaced state workers once the new distribution system went into effect. The positions ranged from facility managers to drivers' helpers and included heath care and retirement benefits.[29]

LITIGATION

In February 1996, the Michigan State Employees Association (MSEA) and the Michigan Association of Governmental Employees (MAGE), who represented MLCC stock workers and supervisors, respectively, filed suit in Ingham County Circuit Court for a temporary restraining order to block the privatization effort. In March 1996, the court ruled that the MLCC had the authority to eliminate its current distribution system. The unions appealed the decision to the Michigan Court of Appeals. Though the court declined to review the decision, it allowed the unions to appeal the circuit court decision to the Michigan Supreme Court.[30]

In July 1996, the MLCC approved rules defining and establishing qualifications for ADAs. In September, the Joint Committee on Administrative Rules (JCAR) rejected the rules.[31] Nevertheless, the MLCC filed the proposed rule with the Michigan Secretary of State, which became effective on September 11, 1996. In October 1996, MSEA and MAGE filed suit in Ingham Circuit Court arguing that the MLCC rules were invalid because they were not approved by JCAR. On January 10, 1997, two days before the newly designated ADAs were ready to take over liquor distribution, the court issued a temporary restraining order halting the privatization of the liquor distribution system. The court, in part, ruled that the administrative rules were not valid because they were not JCAR-approved. Shortly afterwards, many package liquor stores began to run out of product. As a result, the court, at the behest of the MSEA and MAGE, found the state in contempt for not resuming liquor delivery under the state-run system. In addition, the Distilled Spirits Council of the United States filed a writ of mandamus in Ingham County Circuit Court to order the state to resume accepting delivery of spirits from distillers. The state refused to distribute liquor, in part, because it felt that the privatization plan would eventually be implemented and did not want the MLCC to be overburdened with product when ADAs were authorized to begin deliveries. On January 21, 1997 the Michigan Court of Appeals dissolved the temporary restraining order that halted privatization. In

[29] Office of the Governor, John Engler, Press Release: *Liquor Jobs Offered for Displaced State Employees*, December 16, 1996. Prior to privatization, the MLCC had 532 employees and, as of September 30, 1997, it had 152 employees. See Michigan Office of Auditor General, *Financial Audit of the Michigan Liquor Control Commission*, Department of Consumer and Industry Services, October 1, 1996 through September 30, 1997, April 1999, 2.

[30] *Michigan Report*, February 5, 1996; *Michigan Report*, March 6, 1996; *Michigan Report*, March 19, 1996; *Michigan Report*, September 25, 1996.

[31] *Michigan Report*, July 15, 1996; *Michigan Report*, September 25, 1996.

turn, the unions appealed the decision to the Michigan Supreme Court, which rejected the motion.[32]

In November 1998, the Michigan Court of Appeals, in *MSEA* v *Liquor Control Commission* No.2 (232 Mich App 456), ruled that the MLCC did not violate state law in promulgating its administrative rules to privatize the state's liquor warehousing and distribution systems. According to the plaintiffs, sections 45(9) and 46(1) of the Administrative Procedures Act of 1969 (1969 PA 306), as amended, being MCL §§ 24.245(9) and 24.246(1), respectively, granted JCAR the statutory power to veto or approve proposed administrative rules. However, the Supreme Court, citing Article 3 section 2 and Article 4 sections 1, 22, 26, 33, and 37 of the *Constitution of the State of Michigan of 1963* ruled, in part:

> Requirements in the Administrative Procedures Act for approval by the Legislature's Joint Committee on Administrative Rules of proposed administrative rules of executive agencies are invalid because they violate the separation of powers principle established in the constitution and enable the Legislature to avoid adherence to the constitutional requirements that it legislate only by bills approved by majorities of both the Senate and the House of Representatives and that all bills passed by the Legislature must be first presented to the Governor for approval before becoming law.

FINANCIAL AUDIT

In April 1999, the Michigan Office of the Auditor General released its financial audit of the MLCC for the period October 1, 1996 through September 30, 1997. The auditor general examined the financial records of MLCC and reported 7 findings and 11 corresponding recommendations. In part, the audit found that MLCC did not:

- Adequately separate duties related to the administration and distribution of the state's liquor inventory, which potentially could lead to the misappropriation of liquor sales proceeds, or the state's liquor inventory.

- Ensure the proper distribution of liquor tax revenue in accordance with state law.

- Verify liquor inventory stored at ADA locations or determine the disposition of missing liquor inventory disclosed during the closing of state liquor stores and warehouses.

- Implement procedures to monitor or verify commissioners' use of state telephones and state-issued telephone credit cards or payroll and travel expenses.

[32] *Michigan Report*, December 27, 1996; *Michigan Report*, January 9, 1997; *Michigan Report*, January 10, 1997; *Michigan Report*, January 16, 1997; *Michigan Report*, January 17, 1997; *Michigan Report*, January 21, 1997; *Michigan Report*, January 30, 1997.

The audit also stated that MLCC either had complied with or would comply with the 11 recommendations.[33]

FISCAL ANALYSIS OF LIQUOR PRIVATIZATION

In May 1999, the Senate Fiscal Agency released its analysis of the fiscal implications of liquor privatization. Comparing data for FY 1995-96, the last full fiscal year under the state-run distribution system, and FY 1997-98, the first full fiscal year under the privatized distribution system, the agency concluded that the state-run system in FY 1995-96 would have resulted in a $3.7 million more in profits than the privatized system. However, this gap narrowed in FY 1997-98 to $1.6 million. The agency speculated that this narrowing could have been the result of a number of factors, including increased revenue due to changes in liquor sales as well as possible long-term reduced cost due to privatization.[34]

THE MICHIGAN ACCIDENT FUND

Although the privatizing of the Michigan Accident Fund did not impact state employees to the extent as the privatizing of the liquor distribution system, it was nevertheless contentious.

STATE AGENCY OR NOT?

The Michigan Accident Fund was established in 1912 as part of a Progressive era reform to provide employers an optional source from which to obtain liability insurance and workers with a uniform disability compensation system. Under 1912 PA 10, the "accident fund" was placed under the authority of the Commissioner of Insurance, who had the power to determine the amount of the premiums that employers had to pay into the fund. Prior to the act, workers' injury claims were settled on a case-by-case basis in the state's civil courts under the rules of its tort system.[35]

In 1917, the Legislature amended 1912 PA 10 to create an advisory board nominated by the policyholders to "advise with the Commissioner of Insurance as to the means and methods of administering the affairs of said accident fund..."[36]

[33] Michigan Office of the Auditor General, *Financial Audit of the Michigan Liquor Control Commission*, Department of Consumer and Industry Services, (April 1999) 1-44.

[34] Senate Fiscal Agency, *Notes on the Budget and Economy*, "An Analysis of the Privatization of the Merchandising and Warehousing Divisions of the Michigan Liquor Control Commission," (May/June 1999), 2.

[35] Michigan Research Institute, *The Michigan Accident Fund: A Need for Privatization*, (September 23, 1987), 2-4.

[36] 1917 PA 206, § 13.

By the early 1940s, the authority of the advisory board had grown to one of de facto control over the fund. Consequently, until 1976, the advisory board, with little input from the commissioner, managed the accident fund as if it were an independent entity. Nevertheless, the Legislature continued to regard the accident fund as a state agency, under the control of the insurance commissioner.[37]

In December 1976, the Michigan Attorney General, in OAG No. 5147, opined that the accident fund was a state agency and its employees were under the jurisdiction of the Michigan Civil Service Commission. As such, the Civil Service Commission set accident fund workers' compensation rates and classified fund employment positions into civil service positions. Instead of resolving the controversy, the opinion seemed to intensify the disagreement between the insurance commissioner and the advisory board over which office had control of the accident fund.

In 1984, after years of resisting the insurance commissioner's authority over the accident fund, the advisory board physically removed the commissioner and his employees from the building in which the accident fund was located. Further, the advisory board warned the commissioner and his employees, along with the civil service commission and the Michigan Department of Licensing and Regulation, that they would not be allowed to trespass on the premises of the accident fund without the prior approval of the board. These actions prompted the insurance commissioner to file a lawsuit against the advisory board. In February 1986, while the state's lawsuit against the advisory board was pending, the board announced that, effective April 1, 1986, it would set new accident fund insurance rates. Although the insurance commissioner refused to authorize the rate increases, the advisory board notified its policyholders that the rate increase would be collected. Pending the disposition of the lawsuit, the rate increases, which totaled $11,448,000 by the end of 1988, were held in escrow.[38]

In December 1988, the Michigan Court of Appeals, in *Commissioner of Insurance* v. *Advisory Board of the Michigan State Accident Fund* (173 Mich App 566) in part, ruled that the accident fund was a state agency; the commissioner had the authority to set fund rates; and fund employees were subject to the Civil Service Commission. The Michigan Supreme Court, on September 20, 1989, refused to hear an appeal of the Court of Appeals ruling.

PRIVATIZATION PLAN

Although the status of the accident fund had been settled in the state court system, many legislators remained dissatisfied with the outcome. In March 1990, Senator Frederick Dillingham introduced Senate Bill No. 885, which, in part, would have privatized the accident fund. However, in reporting out the bill, the Senate Committee on Human

[37] Michigan Senate Fiscal Agency, *Issue Paper: The Accident Fund: A Summary of its Origin, History, and Current Status as the State Regains Control*, (January 1990), 4-5.

[38] *Ibid.*, 5-6.

Resources and Senior Citizens rejected the privatization provisions. In 1993, Senator Paul Wartner sponsored Senate Bill No. 568 (1993 PA 201). This act, which was tie-barred to Senate Bill No. 346 and related to a five act package, in part, allowed for a nonprofit health care corporation to establish, own, and operate a domestic stock insurer in order to acquire the accident fund, which was the state's largest workers' compensation insurance company.

In part, supporters of the act argued that:

- The state should not compete with the private sector by its involvement in the insurance business;
- The state should divest itself from the accident fund because its assets were non-performing and therefore irrelevant since none of it went into the state treasury;
- Assets from the accident fund's sale would be used to replenish the Budget Stabilization Fund;
- The sale would result in lower insurance rates.[39]

In part, opponents of the act, who suspected that the legislation was drafted to suit Blue Cross/Blue Shield of Michigan (BCBS), argued that, unlike other insurance companies, BCBS was a tax-exempt quasi-governmental agency. As such, the proposed sale would be anti-competitive because BCBS was not subject to the same taxes and regulations as its 200 or so state competitors. Moreover, opponents maintained there was no reason to privatize the agency because the accident fund, which served 38,000 businesses, of which 80 percent were small businesses, worked well for over 80 years.[40]

In the spring and summer of 1993, the legislative package dealing with the sale of the accident fund passed the Senate. That fall, the package, however, stalled in the House following Representative Mary Brown's FOIA request for documents relating to the procedures in which the director of the accident fund had contracted and used bids to award contracts. According to the documents released under FOIA, DMB had awarded a contract to New York banking firm Barclays, DeZoette, Wedd Corporation (BDW) to prepare the accident fund for sale. Further, the released documents stated that the banking firm had been reimbursed in excess of $1.5 million for expenses. However, the State Administrative Board had not approved the BDW contract, which was a violation of contract rules established by the Executive Office.[41] Consequently, Representative Brown sponsored House Resolution No. 392, which requested that the Michigan Auditor General investigate the manner in which contracts relating to the sale of the accident fund were awarded.

[39] Senate Fiscal Agency, Senate Bill No. 568; John Kost e-mail comments to the author, August 3, 2001.

[40] *Michigan Report*, May 11, 1993, August 16, 1993, October 10, 1993; *House Journal*, House Resolution No. 392, 2571.

[41] *Michigan Report*, September 1, 1993.

In November 1993, the executive director of the accident fund and the director of DMB agreed that the contracts awarded to BDW and the expenses incurred before the contract was approved by the State Administrative Board were "inappropriate." Further, BDW had been asked to repay the $1.5 million.[42]

Also in September 1993, Representative Howard Wetters issued a FOIA request to have the state insurance commissioner release a 1991 report assessing the value of the accident fund by the international accounting firm of Coopers & Lybrand. However, the sole copy of the report was routed to the Executive Office, which initially refused the FOIA request on the grounds that the office was exempt from such requests. Later that month, the report was released and showed that the accident fund had excess reserves of some $90 million. Opponents of the privatization effort argued that the reserves total proved that workers' compensation rates were artificially high in order to make the sale of the accident fund more attractive. Proponents of the sale argued that the rates were approved by the state insurance commissioner and were competitive with rates offered in the private sector.[43]

In October 1993, according to the enrolled bill analyses, the following bills were signed into law with an effective date of April 1, 1994:

- Senate Bill No. 568 (1993 PA 201), in part, allowed a nonprofit health care corporation to establish, own, and operate a domestic stock insurer in order to acquire the accident fund;
- Senate Bill No. 346 (1993 PA 200), in part, provided for the transfer of the accident fund to a domestic stock insurer;
- Senate Bill No. 48 (1993 PA 195), in part, provided for the entitlement to retirement benefits of accident fund employees vested in the State Employee Retirement System;
- Senate Bill Nos. 49, 50, and 52 (1993 PAs 196, 197, 199), in part, deleted requirements concerning an audit of the accident fund; and
- Senate Bill No. 51 (1993 PA 198), in part, authorized the sale of the accident fund to a "permitted transferee."

LITIGATION

Following passage of the acts, a group of accident fund policyholders filed a class action lawsuit in the Ingham County Circuit Court of Claims asserting a contractual right to the estimated $90 million in fund surpluses and any proceeds from the sale. Moreover, they claimed that this "right" would be unconstitutionally impaired if the state was permitted

[42] *Michigan Report,* November 1, 1993.

[43] *Michigan Report,* September 3, 1993; September 7, 1993; September 15, 1993.

to retain the proceeds obtained from the sale.[44] In March 1994, the circuit court judge dismissed a motion by the state for summary disposition in the case. Further, it ruled in part, that policyholders had a right to any assets should the accident fund be sold. As a result, the sale of the accident fund was delayed while the state appealed the decision.[45]

In April 1994, Fun 'N Sun RV, Inc. filed another class action lawsuit seeking an injunction against the state from receiving any proceeds from the sale of the accident fund. The plaintiffs asked that all proceeds be placed in escrow pending the court-ordered disposition of the revenue. A week later, the judge ruled that the fund's assets were held in trust for the policyholders and that the proceeds of any sale must be distributed among those policyholders. The state appealed the decision.[46]

Eventually, the two cases were combined and filed with the Michigan Supreme Court. In December 1994, the supreme court, in *re Certified Question* (*Fund 'N Sun RV, Inc.* v *Michigan* (447 Mich 765) ruled, in part, that the policyholders failed to show contractual or property rights in the accident fund and therefore were not eligible to share in the sale's proceeds. Also, it ruled that though the state held the assets of the accident fund in trust, it did not establish an ownership interest on the part of the policyholders.[47]

In June 1994, two workers' compensation insurers filed a lawsuit in Ingham County Circuit Court against the Michigan Department of Treasury. The plaintiffs, Michigan Mutual/Amerisure Companies and Citizens Insurance Company of America, charged that they did not bid on the accident fund because BCBS was given preferential treatment. The lawsuit challenged the department of treasury's interpretation of a state statute that required BCBS to be assessed an additional surcharge because of its tax-exempt status. According to the treasury interpretation, assuming that BCBS bid $250 million, the surcharge would be based on the single business tax (2.3 percent) as it is applied to the bid price ($3.3 million). The plaintiffs argued that the surcharge should be based on the single business tax as it is applied to the number of years of premium sales that it took BCBS to accumulate the assets used for the bid (between $95 and $184 million). The plaintiffs petitioned the court for a preliminary injunction halting the treasury department from assessing the tax and a writ of mandamus ordering the department to calculate the business tax pursuant to its legislative intent. According to Senator Jack Welborn, who sponsored the section of law in question, the treasury department's interpretation was "plain wrong." The "intent" of the legislation, according to Senator Welborn, was to "level the playing field in the bid for the Accident Fund."[48]

[44] In *re Certified Question* (*Fund 'N Sun RV, Inc.* v *Michigan* (447 Mich 765); *Michigan Report,* October 19, 1993.

[45] *Michigan Report,* March 16, 1994.

[46] *Michigan Report,* April 4, 1993, April 11, 1993.

[47] Michigan *Report,* October 25, 1994; January 3, 1995.

[48] *Michigan Report,* May 27, 1994, June 6, 1994; June 30, 1994.

In mid-June 1994, the State Administrative Board approved the bid of BCBS to purchase the accident fund for as much as $255 million. Immediately afterward, the two other bidders, Michigan Insurance Partners and the Michigan Fund Company, joined the above-mentioned lawsuit charging, in part, that BCBS was given favorable treatment. At the end of June, the circuit court judge refused to issue an injunction stopping the sale of the accident fund or dismiss the case challenging the sale. A trial was set for mid-August 1994. After two days of hearing testimony, the circuit court judge dismissed the plaintiff's claims and, in part, upheld the department of treasury's interpretation of state statute. The claimants appealed the decision to the Michigan Court of Appeals. In *Michigan Mutual Insurance* v. *Department of Treasury* (docket No. 178228, unpublished), the court of appeals unanimously rejected the plaintiff's arguments.[49]

The final issue concerning the sale of the accident fund was resolved with Michigan Attorney General Opinion 6856, issued June 29, 1995. In February 1995, the Michigan Auditor General concluded that, from an accounting standpoint, the proceeds from the accident fund should count against the 1978 Headlee Amendment to the state constitution (Article 9, sections 25-34). This amendment limited the total amount of taxes that the Legislature may impose in any fiscal year on the taxpayers. The attorney general opinion, which took precedence over the auditor general interpretation, in part, stated:

> ...it is clear that the State of Michigan exchanged one asset, the State Accident Fund, for another asset, approximately 254 million dollars, its market value. Instead of owning the State Accident Fund and its building, the State of Michigan now has money that simply represents fair consideration for the value of the assets it transferred. In the common understanding, this even exchange of assets did not result in an increase in total state revenues under Const 1963, art 9, § 26.

In June 1995, the largest privatization transaction by any state in the nation's history was closed when BCBS paid the state $255 million for the accident fund. $195 million of the proceeds was deposited in the Budget Stabilization Fund, $20 million went to the Civilian Conservation Corp, which provides job training for at-risk youth, and $40 million was allotted to the newly created State Park Endowment Fund for park improvements.[50] In addition, supporters argue that as a consequence of the transaction BCBS reduced rates by an average of 9.2 percent in the first year of operations.[51]

MICHIGAN BIOLOGIC PRODUCTS DIVISION

The other high profile instance where Michigan divested itself of state assets involved the Michigan Biologic Products Division.

[49] *Michigan Report*, June 15, 1994; June 30, 1994; August 18, 1994; December 12, 1996.

[50] *Michigan Report*, June 20, 1994.

[51] GAO, *Privatization: Lessons Learned by State and Local Governments*, 29.

BACKGROUND

Founded in 1926, the Biologic Products Division (BPD) of the Department of Public Health (now the Department of Community Health) was the only biologic facility in the nation licensed by the United States Food and Drug Administration (FDA) to produce anthrax vaccine. It also manufactured vaccines for the prevention of tetanus, rabies, pertussis, DTP (diphtheria-tetanus-typhoid) and other infectious diseases. The north Lansing facility, which consisted of twenty-seven buildings, sixty acres of land, and a sheep farm, also produced blood derivatives albumin, immune serum globulin (particularly used against Hepatitis-A), and anti-hemophilic factors.[52]

In December 1995, Governor John Engler promulgated Executive Order 1995-25. This order detached the BPD from the Department of Community Health and established it as an interim, independent agency known as the Michigan Biologic Products Institute (MBPI). The order also provided that the institute would be administered by a three-member commission, the Michigan Biologic Products Commission (MBPC), which would ascertain the "fair market value" of the institute and prepare a plan for its privatization by February 4, 1998. If a suitable buyer could not be located, the state planned to close the institute.

In short, supporters of the plan sought to privatize the state vaccine laboratory for the following reasons:

- Principal pediatric vaccine, its major reason for existence, had been replaced by newer, state-of-the-art vaccines;
- Manufacturing facilities were woefully obsolete and the state could not afford to invest the significant revenue needed to make it commercially viable;
- Vaccine distribution dropped from over 700,000 doses in 1993 to a projected 20,000 doses in 1997;
- Losses of $16.6 million between 1993 and 1996: and
- As the last state-owned and operated vaccine laboratory in the nation, it was improper for state government to continue to use public funds to compete against the private sector.[53]

[52] House Legislative Analysis Section, House Bill Nos. 6191 and 6192 as enrolled, January 7, 1997; *Michigan Report*, December 5, 1995; *Michigan Report*, July 8, 1997 and December 16, 1997.

[53] John Kost e-mail comments to the author, August 3, 2001; House Legislative Analysis Section, House Bill Nos. 6191 and 6192 as enrolled, January 7, 1997; *Michigan Report*, December 11, 1996; United States General Accounting Office (GAO), "Contract Management: Observations on DODs Financial Relationship with the Anthrax Vaccine Manufacturer" (GAO/T-NSIAD-99-214), June 30, 1999, 3.

In October 1996, a preliminary determination of the fair market value of the MBPI placed its value ranging from "nominal" to $10.5 million.[54]

MICHIGAN BIOLOGIC PRODUCTS COMMISSION

In November 1996, Representative Donald Gilmer sponsored House Bill Nos. 6191 and 6192 (1996 PAs 521 and 522, respectively). The former act (The Michigan Biologic Products Institute Transfer Act) created the Michigan Biologic Products Commission (MBPC) and granted it the authority to provide for the sale and conveyance of MBPI assets and liabilities. The latter act, 1996 PA 522, amended 1943 PA 240 (State Employees Retirement Act) to provide employees of the MBPI and the Liquor Control Commission, whose employment were terminated due to the privatization of the state liquor distribution system, an early retirement option.

Although there was broad bipartisan consent that the state vaccine lab should be sold to the private sector, opponents of privatization questioned whether:

- Institute assets had been adequately appraised. Opponents argued that because MBPI was only one of two anthrax vaccine producers in the world, its fair market value was higher than estimated in the October 1996 preliminary determination;
- "Insider trading" had tainted the privatization process. Opponents argued that facility managers, who were legally permitted to bid on the purchase of the facility, unethically provided information that under-valued the institute's fair market value;
- MBPC failed to disclose to the Legislature relevant material regarding the conditions and terms of the proposed sale;
- Privatization process had been conducted in secrecy; and
- Facility sale would have a detrimental effect on the ability of Michigan citizens to obtain access to vitally needed vaccines in times of vaccine shortage as had occurred in the 1980s.[55]

In February 1998, with the statutory deadline for the its sale fast approaching, Representative Lingg Brewer sponsored House Bill No. 5300 (1998 PA 8). This act amended the 1996 Michigan Biologic Products Institute Transfer Act to, in part, provide for:

[54] House Legislative Analysis Section, House Bill Nos. 6191 and 6192 as enrolled, January 7, 1997.

[55] House Legislative Analysis Section, House Bill No. 5300, First Analysis, November 13, 1997; *Michigan Report*, August 21, 1997, September 19, 1997, December 8, 1997. The other anthrax vaccine producer was a British company that was not allowed to export its product to the U.S.

- Two year extension of the MBPI and MBPC so that the state may "independently" determine the fair market value of the institute;
- Ensure the application of the Freedom of Information Act to MBPC documents; and
- Grant the state preferential access to biologic products made by the institute.[56]

The Governor signed the bill into law on February 18, 1998.

BIOPORT PURCHASE

In June 1998, after nearly twenty companies expressed interest in the vaccine lab, the MBPC recommended that it be sold to BioPort, a subsidiary of the Maryland-based company Intervac, a pharmaceutical investment firm. It was announced that the bid price was an estimated $25 million, which included $3.25 million in cash, $12.1 million in secured notes, $4.6 million in product donations, and a maximum of $5 million over the next five years, in royalty payments. In addition, the company stated that the facility would remain in Lansing and would set aside 20 percent of the company's stock for purchase by the institute's 174 employees.

The bid process and the sale were independently evaluated by First Michigan Corporation, the State Auditor General, and the State Attorney Generals Office before being finalized by the State Administrative Board that September.[57]

In December 1999, it was reported that the state received only $14.45 million in the sale of the laboratory instead of the nearly $25 million that the administration publicized. In addition, it was reported that the state financed the sale. BioPort paid off the first state issued promissory note at 10 percent interest. The second and last paid note was interest-free. It was also disclosed that the state failed to publicize that the sale price included about $4.5 million that the federal government owed the state for vaccine purchases prior to the sale.[58]

LITIGATION

Among the minority investors in the institute were the seven members of the MBPI management team. A year earlier, the seven managers, under the name Michigan Biologic Products Incorporated, submitted a bid to purchase the institute. This bid was rejected because the group lacked the necessary capital. The disclosure that the cash-strapped MBPI managers now owned a 32 percent share of the vaccine lab caused Representative Brewer to file a lawsuit in Ingham County Circuit Court to block the sale of the lab to BioPort.

[56] House Legislative Analysis Section, House Bill No. 5300, First Analysis, November 13, 1997.

[57] *Michigan Report*, June 2, 1998 & September 1, 1998.

[58] *Jackson Citizen Patriot*, December 5, 1999; *Michigan Report*, December 6, 1999.

The suit alleged that, although the managers were permitted by law to bid on the MBPI sale, the defendants violated antitrust laws by conspiring to give special consideration to BioPort. Also, the suit claimed that the managers had a duty to disclose to the state that they had a monetary association with BioPort before the proposal was examined. In response, the MBPC argued that the suit was "purely political" since three independent evaluations confirmed that the bidding process and the final selling price were fair.[59] In February 1999, the sale of MBPI to BioPort was legally concluded when the Ingham County Circuit Court dismissed the lawsuit. The ruling opined that Representative Brewer, and his coplaintiffs, did not have standing to thwart the sale of the vaccine lab.[60]

CONCLUSION

For much of the twentieth century, political progressives have empowered government with the moral authority and responsibility to correct economic of societal struggles. However, during the last decades of the century, political moderates and conservatives, primarily on the state governmental level, maintained that while government intervention was necessary, the scope of government had grown too bloated, cumbersome, and inefficient. In 1983 and 1992, Governors James J. Blanchard and John Engler, respectively, successfully spearheaded movements to balance the state budget not only by the elimination and streamlining of state services, but by improving the productivity and quality of such services through the interjection of private sector participation in governmental activities. From 1983 to 1985, Governor Blanchard helped erase a $1.7 billion debt through an increase in the state income tax in combination with his financial recovery program *Reducing the Cost of State Government.* The recovery plan reduced the cost of government by at least $336 million, and privatized 49 state programs that competed with the private sector. From 1993 to 1997, Governor Engler, in his financial recovery program *PERM*, helped erase a $1.8 billion debt and privatized between 38 and 119 state services. However, it is difficult to determine the full extent of the PERM initiative because of conflicting information and the lack of a systematic, comprehensive study that accesses the financial impact of state privatization efforts.

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[59] *Michigan Report,* July 6, 1998 & October 28, 1998; *The Detroit News*, September 30, 1998; The managing director of Intervac was William Crowe, former chair of the Joint Chiefs of Staff and former ambassador to Great Britain.

[60] *Michigan Report*, February 16, 1999.