

# INTERFACE

by Jack Stout

## Performance Security

*Jack Stout has been at the forefront of innovation in the design and implementation of EMS systems for the past dozen years, and with his company, The Fourth Party, has been involved in the establishment of several sophisticated ambulance systems.*

*Topics covered in "Interface" include questions of law, labor relations, purchasing practices, public safeguards, bidding procedures, regulation, and business relationships as they apply to private sector participation in the provision of advanced life support.*

*If you have a question, a problem, or a solution related to the public/private interface in ALS, address your letter to: "Interface" jems, P.O. Box 1026, Solana Beach, CA 92075.*

**P**erhaps the single biggest barrier to the private sector being the principal provider of ALS services in some of America's largest cities is the fact that the administrative technology for the safe and reliable management of such public/private arrangements is still in its infancy.

It takes lots of cities involved in lots of contracting, franchising or regulating, along with lots of mistakes, corrections, legal testing in court and literally millions of dollars in time and direct expense to produce a mature, tested and reliable administrative technology for managing a single type of public/private relationship. There are no shortcuts.

The continuing evolution of administrative technologies for cable television franchising is a terrific example from another service industry. Cable television franchising and regulation technology are about halfway along in the evolutionary process and, in another 15 or 20 years, local governments will have at their disposal two or three fully developed and tested administrative technologies for dealing with cable TV service.

The ALS industry, in contrast, has barely begun a similar evolution, partly because many private sector industry representatives refuse to accept the need for genuine public controls and safeguards. The fact that a proven and crisis-tested administrative technology does not

exist is evidenced by the number of cities that rely heavily upon government-operated ALS services. In general, agencies of local government "socialize" a service — that is, perform the service as an in-house operation — only when the private sector fails to fulfill the role, and when the government doesn't know how to employ the resources of the private sector safely and effectively.

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A full-blown administrative technology has hundreds of facets and takes into account numerous contingencies — things that could go wrong. The discussion here, though, will be limited to a single critical issue: the complex question of performance security.

In most other industries, performance security arrangements have become fairly standard. For example, if local government decides to build a new city office building, the plans are drawn up, specifications made clear and bids are solicited from qualified contractors. In such cases, a small *bid bond* is usually required, followed by a 100 percent *performance bond* required from the winning bidder. In essence, such a performance bond is a promise from a financially strong bonding company, often an insurance company, that if the contractor doesn't complete the work as contracted, the bonding company will see to it the work is completed by someone else, or the bonding company will have to cover the purchaser's losses up to a maximum liability of 100 percent of the original contract.

Such performance bonding requirements generally help to weed out bids from completely unqualified companies, since such companies may be unable to secure bonding, and they provide the purchaser with some

assurance that the work will get done at the contracted price. However, as a practical matter, such bonding provisions are often extremely difficult to enforce against the bonding company, often requiring extensive and expensive litigation over a period of months or even years to collect.

Other industries use different forms of performance security including license bonds, liquidated damages provisions with backup payment arrangements and so on. But the point is that whenever government elects to depend heavily on a private company for an essential product or service, a legally enforceable plan *must* exist to deal with contractor failure, no matter how unlikely such failure may seem.

### **Trust Me, I'm Special**

Companies accustomed to furnishing high-cost goods or services to government agencies, or even to large private businesses, have come to expect strong performance security requirements. Every industry has its own customary methods and amounts for performance security, but no experienced private company in a mature industry expects to be completely free of performance security requirements.

The ALS industry, is however, not a mature industry. As a result, some ALS companies are not only surprised when performance security is required, they are actually offended. I recently heard one medium-sized BLS provider suggest to a local government that substantial performance security wouldn't be necessary, as long as the city contracted for ALS services with that private provider. The owner's argument was that the company had been in business for nearly two decades, was reasonably stable financially and had excellent motives and intentions.

The whole point of performance security is to deal with the question of contractor failure. The owner in question insisted that failure was impossible. Never mind that this BLS provider had never previously operated under stringent ALS performance standards, nor that bankruptcies, extended strikes, overwhelming tort claims and numerous other calamities can topple even the most experienced and stable companies. That owner's suggestion was that the



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city should have faith that failure wouldn't occur, and that no plans needed to be made to deal with the possibility of failure. Clearly, failure is possible for all of us, and where an essential life-saving service is at issue, such as in the case of ALS, no unit of local government can responsibly operate without a means of safely handling a private sector collapse.

## Elements of ALS Performance Security

Where a new road is being built, or a new city office building, the performance security arrangements need only address an eventual solution to what is essentially a financial problem. That is, a partially completed building may sit for months while litigation takes place and other arrangements are made for completion. It's inconvenient, but not deadly. The performance security will be used *after the fact*, in many cases to reimburse the buyer for costs already incurred to complete the project.

In the case of ALS service, the performance security needs are

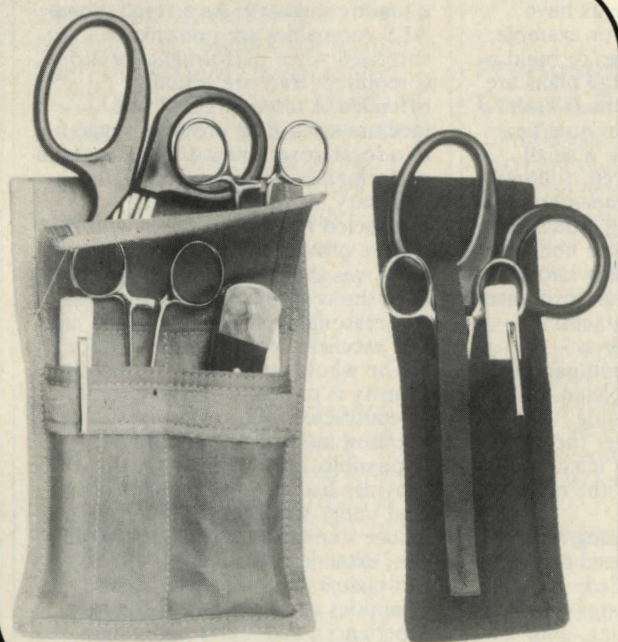
entirely different. We are not so much concerned about loss of money as we are about loss of lives. To understand ALS performance security requirements, assume for the moment that you are the city manager of a city of 300,000 people served by a private ALS provider delivering superb performance. Now assume a calamity. What kind of calamity? Life can be creative. A 24-year-old company goes bankrupt. The warning signs were there for months, but no one anticipated how fast the shut-down could take place. Or try this: the original owner of the company has a heart attack, dies and his surviving wife takes over the business. Normally a sweetheart, her new power turns her into a tyrant, and nearly everyone in management bails out in protest, draining the company's only real strength — its key personnel. Service deteriorates, somebody influential dies needlessly and you are told to fix the problem and fix it fast. Or how about this: you took the offer from the guy who said "trust me," closed down the city's own ALS department and now you find that your "trust me" businessman completely underestimated what it takes to become a high performance ALS provider, and he's begging for more time, higher

rates, a subsidy or all three.

It doesn't do any good to argue that "it can't happen here." The whole purpose of performance security is to plan for what you would do if it does happen here. You either have such a plan or you don't. Remember, you are the city manager and when something goes sour you have two concerns: first, you are accountable for letting it go sour in the first place; and second, you are responsible for cleaning up the mess. You won't get very far with simply arguing that it sure didn't seem like anything could go wrong. Things go wrong. Everybody knows that. (See why so many cities are served by government-operated ALS services?)

In any case, imagine yourself in a situation where you must replace a private ALS provider. The first problem you notice is that, if you want to go to bid, it's going to take at least six months to conduct the bid process, award the bid and allow the new bidder time to get on the job. Ten to 12 months is probably more realistic. But you've got a mess on the streets *right now*, and you are expected to take over by Monday. (This is Friday.) Now you are in a good position to figure out what you wish you had in the form of performance security. Table 1 lists a few of

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## Table 1: Security Provisions

### 1. Clear definition of failure.

Probably the worst situation you could be in is one where the provider is failing, miserably, and everybody knows it, but the provider won't admit it. You can't arrange to take over the service, and you can't even initiate a new bid process, unless you first arrange for a bad-provider-ectomy. If your contract or franchise doesn't have some method of clearly and quickly defining and declaring a major breach of responsibility, *without lengthy litigation to prove you are correct*, you may be in for a long and frustrating ordeal. In the meantime, your citizens' lives are at risk.

### 2. Take over now, litigate later.

Assuming your previous contract or franchise arrangement did make provision for rapid declaration of breach, the next thing you will wish you had is an enforceable agreement with the provider that takeover can be immediate, and that any litigation concerning the takeover must occur later. With such a provision, you'll have a better chance of convincing the judge at the hearing on the injunction or the temporary restraining order that the provider should be shut down now, and that he is free to litigate later. If you are wrong, and there wasn't really a breach, the provider can collect handsomely later. But, since human lives are at stake, the question of damages should not delay the process of takeover. (Such a provision should clearly state that, in cooperating with the takeover, the provider in no way indicates his acceptance of the finding of major breach.)

### 3. How about the equipment?

Now that you've got what you thought you wanted — the right to an emergency takeover of service — you are going to need some ambulances, on-board equipment, an inventory of expendables and supplies, a communications system, spare parts and other odds and ends. If your fired provider owns all the equipment, he may have some interesting news for you when you try to buy it or lease it from him. You could put provisions in the contract or franchise arrangements which indicate that the provider will turn all of the equipment over to you, probably at a predetermined effective interest rate, in the event of major breach. The problem is that you are dealing with property rights, and it may be impossible for you to seize such equipment without first proving through litigation that a breach actually occurred. Shutting down a public service business is one thing; taking another person's equipment for your own use is quite another. In general, such equipment takeover provisions are probably worthless if seriously contested by the fired provider. When the heat is on, you will wish the equipment was held in the public sector, or that you had required the provider to hold equipment in an independent leasing company, subleasing that equipment to the city, which in turn subleased the equipment again to the provider corporation. If properly structured, such a three-way lease arrangement would work, even if contested, though not as easily as municipal owner-

ship of equipment. (Keep in mind that a creditor may actually hold title to your provider's equipment, and the creditor may not legally be able to furnish that equipment to the city without the permission of the provider. Even if bankruptcy is the problem, bankruptcy laws may considerably delay the city's acquisition of the equipment if the provider chooses not to cooperate.)

### 4. Good paramedics don't grow on trees.

So far you've managed to declare breach, you've got the power to take over service, and you've got the equipment. But the reason you are taking over service is probably somehow related to quality of care, and unless you can find experienced personnel to operate your new business, your new service might well be worse than the old one. Your problem is further complicated by the fact that, chances are, you only want to operate the service for a short term, until you can rebid the system or otherwise find a replacement provider. Where are you going to find 50 or 60 licensed paramedics, willing to work at a short-term job, with little certainty of future employment? If your previous provider has "gone down the tubes," financially speaking, chances are personnel will be available. But if he's a big operator, with services in other cities, and if he's mad at you, he may just take his best people with him, maybe all of them. Paramedics are generally pretty loyal to the community they serve, but if they are participating in employee bonus or retirement programs that vest slowly, they may not be able to afford to stay in the community. You may wish your contract or franchise arrangement had required the provider to establish an employee retirement program of a type that would not be negatively affected by an employee's decision to remain with the community after a change in providers.

### 5. Unlicensed provider?

Now that you've got a breach, the right to take over, equipment and personnel, you may need a state paramedic provider's license. In most states, the application process is lengthy and time consuming, and so unless you have planned far ahead, you are going to be operating under emergency approvals or no license at all. (The "no license" method of emergency takeover may give your malpractice insurance carrier a heart attack, or you may simply have to operate without coverage.) You will discover a menagerie of administrative details such as vehicle licenses, a state paramedic provider's license, insurance coverage requirements, a problem with access to controlled drugs, problems with transferring emergency calls coming in on old private lines and so on. The state license issue, and several other issues, can best be handled by structuring your contract or franchise in such a manner that the state license is actually held by the city, with the private company serving as a contractor operating under the city's license. Similarly, insurance arrangements can be structured to be quickly transferable. Other methods, somewhat less certain but still effective, can also be employed,

but most require some sort of advanced planning and legal preparation.

### 6. Operating capital.

Well, you've nearly succeeded. You've got the right to take over, equipment, personnel, a state license, insurance, expendables and supplies, communications capability, telephone access and provision to transfer calls coming in on now-defunct numbers. You've got middle and upper management personnel, a coverage plan and a vehicle basing methodology. Not bad. What's left? Money. In a high performance system big enough to serve your medium-sized community, you will need at least \$300,000 in pure operating capital, not counting equipment costs, supply inventory, facility costs or other startup expenses. Even assuming that you can lease facilities and vehicles and finance all start up costs somehow, and even assuming that you can generate ambulance statements, including Medicare and Medicaid, within 72 hours after your first transport is made, you will still need at least \$300,000 in operating capital to make it through the first seven months of field operations. That's because of the collection lag involved in fee-for-service ambulance billings. And if you fail to generate statements immediately after startup, you will need even more operating capital — cash. A conventional performance bond won't do it, because you need the money now — not after you win a lawsuit with the bonding company. About now, you will be wishing you had required a \$300,000 irrevocable letter of credit, trust fund deposit or specially designed performance bond acknowledging the instantaneous payment requirement, leaving litigation for later. Otherwise, you will be calling an emergency meeting of the city council, your employer, and you will be begging for emergency funds to be taken from God only knows what other department of city government. Bad program planning has now taken the form of bad fiscal planning: the stuff that causes managers of big cities to become managers of little cities. You don't need a 100 percent performance bond, you need \$300,000 — now.

There is one workable alternative to the cash requirement. If you had access to the daily income from your previous provider's outstanding accounts receivable, you could get by. That's because your operating capital requirements are equal to the average cash value of outstanding accounts receivable. If you could get access to those funds, chances are you would have a fair start at covering operational expenses. You might have to raise rates or temporarily shuffle some city funds, but you could get by. (That's one of the reasons some cities choose to separate, contractually, billing and collection functions from field operations. When you fire a contractor who owns all the accounts receivable, he gets a sort of reverse performance bond payment — a bonus — since his expenses largely stop, while income from accounts receivable continues to flow in for a year or more. In one city this "trickle" piled up nearly one million dollars in income for the previous owners of a defunct ambulance company.)



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the provisions you'd wish you had included in the previous contract or franchise.

### Conclusion

Before government can rely upon the private sector for an essential service, a means must exist to ensure that private sector failure, financial or performance, doesn't cost the government large and unforeseen emergency appropriations. Without such assurances, government will always tend to employ in-house operations, and rightly so. Thus, other industries have evolved complex public-private arrangements, incorporating somewhat standardized performance security provisions.

In the case of ALS services, the problem is more complicated. Financial safety is not enough. The citizens must also be protected from service interruptions, deterioration or poor performance. It is obviously unreasonable to expect any large city to place the lives of its citizens in the hands of a private ALS provider unless that city holds a fully enforceable power to declare breach of duty,

to effect takeover immediately and to finance that takeover through specialized performance security arrangements which recognize the need for *immediate* availability of funding. Put another way, if you can't fire a company safely, then you can't hire that company safely.

The development of solid performance security provisions will benefit not only the public sector, but the private sector as well. First, only better-quality providers are willing to comply with such performance security requirements, while the rest of the industry avoids such clearcut accountability and responsibility. (Performance bonding is so new in our industry that even the largest ALS providers sometimes have difficulty in obtaining a performance bond, while the more specialized "pay first, litigate later" bonding may be impossible to obtain at this stage in our industry's evolution.) But with the industry's best companies in the running, cities currently relying upon "socialized" ALS systems may be less reluctant to consider the private alternatives.

Second, if every city government could be certain that it could give the private sector the opportunity to serve, without jeopardizing the lives of citizens or risking a difficult and embarrassing financial emergency, how many more cities would give it a try? Finally, when city managers get together to talk about ALS (and that's not very often), they inevitably hear the horror stories of private sector shakedowns for emergency city subsidies, outright bankruptcy, ridiculous street-level competition and generally poor performance. It doesn't take many such bad experiences to poison the reputation of the entire private sector of the ambulance industry, and all the successes in the world won't blot out the occasional failure. When we can replace "trust me, I mean well" with truly safe and effective performance security measures capable of handling the inevitable occasional failure, huge new markets will open up to the private sector of the ambulance industry — markets now reserved for less risky reliance upon socialized prehospital care systems. □

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