LEGISLATION THAT BANS OR SEVERELY RESTRICTS OUTSOURCING RAISES SERIOUS POLICY QUESTIONS, MAY VIOLATE THE U.S. CONSTITUTION AND RISKS JEOPARDIZING U.S. OBLIGATIONS UNDER INTERNATIONAL TRADE AGREEMENTS.¹

INTRODUCTION

It is almost impossible in this election year to read a newspaper or view a news program without encountering arguments about the alleged evils of “outsourcing” and its detrimental impact on the struggling American economy. In response to this mounting negative public opinion, and with a clear eye on the possible political benefits to be derived from joining the bandwagon, legislators in Congress and at least 36 states have proposed over 100 bills aimed at either banning or severely restricting outsourcing. This flurry of legislative activity has raised a number of policy issues, not the least of which is how will the United States replace the 6.4 million American jobs that may be lost if foreign countries and businesses retaliate against the United States by adopting similar outsourcing restrictions.²

The inquiry does not end at the policy level, however. A studied legal analysis suggests that much of the outsourcing legislation proposed at the state level may, at a minimum, violate the foreign affairs power and the Commerce Clause of the United States Constitution, while legislation proliferating at the federal level risks violating U.S. obligations under a number of international trade agreements. Given these and other fundamental flaws, there has never been a better time for businesses to shape the outsourcing debate by availing themselves of political and legal strategies designed to minimize the deleterious consequences of protectionist outsourcing legislation.

LEGISLATIVE SUMMARY

As noted above, more than 100 bills have been introduced in at least 36 states, each one aimed at restricting outsourcing. The National Foundation for American Policy maintains an updated list of such bills and their texts on its Web site.³ The overwhelm-


³ The list and text of the bills is available at http://www.nfap.net/researchactivities/globalsourcing/
ing majority of these bills have not yet become law, but at least one has been enacted and their sheer volume seems to indicate that more may well become law.

State outsourcing legislation falls into three broad categories. Some state legislation prohibits state contract work from being performed overseas or requires that state contracts be performed by individuals who are United States citizens or otherwise authorized to work in the United States. Other state proposals give preferences to in-state corporations and business interests, or refuses to provide tax incentives or state funding to private businesses unless those businesses restrict their own outsourcing activities. Still other state bills restrict the transmission of financial, medical, or other personally identifiable information overseas, either directly or by placing severe limitations on call centers.

Federal outsourcing legislation has taken a similar approach. Some proposed federal legislation such as Senator Christopher Dodd’s (D-CT) bill (S. 2094), The United States Workers Protection Act, attempts to ban or severely restrict the performance of federal contract work overseas, while other proposed federal legislation imposes obligations on Federal Government contractors to employ their workers domestically or to observe a minimum domestic requirement.4

Still other proposed federal legislation – such as that proposed by Senator Hillary Clinton (D-NY)5 – prohibits sending individuals’ personal data overseas without the express permission of each person, while legislation proposed by Senator John Kerry (D-MA), the presumptive Democratic presidential nominee, attempts to require employees at call centers to disclose their physical locations to the called parties.6

SOUND PUBLIC POLICY DISFAVORS OUTSOURCING RESTRICTIONS

While there are plenty of statistics bandied about concerning the perceived costs of outsourcing, conveniently neglected is any meaningful analysis of the true economic cost of a world without outsourcing. This is exactly where we may be headed if the proposed state and federal outsourcing restrictions become law and foreign countries retaliate by enacting similar restrictions.

As noted above, U.S. subsidiaries of foreign companies (i.e., Siemens, Novartis, Honda) employ 6.4 million Americans in high-skill sectors such as technology, pharmaceuticals, financial, and automotive.7 Jobs at these companies pay compensation, on average,
that is 16.5% higher than the average compensation paid by U.S. companies,\(^8\) and these companies generate annual federal tax revenue of nearly $28 million.\(^9\)

Moreover, according to figures released March 12th by the U.S. Department of Commerce, new foreign direct investment (FDI) in the U.S. totaled $82 billion in 2003, over twice the amount from the previous year.\(^10\) This increased capital investment has the potential to boost jobs supported by U.S. subsidiaries by 400,000.\(^11\) Increased foreign investment means more factories, more research and development and more jobs being “insourced” into the United States by companies based abroad.\(^12\)

To understand what these numbers mean on a smaller scale, take the example of the state of California. California ranks first in the nation in terms of the total number of “insourced” jobs.\(^13\) U.S. subsidiaries of foreign companies employ 713,500 Californians.\(^14\) If, as some California legislators have suggested,\(^15\) a ban on outsourcing is an appropriate policy to protect Californians, such a ban would be just as logically appropriate if enacted by foreign countries that insource jobs into California, thus putting at risk the livelihoods of the over 700,000 Californians employed by U.S. subsidiaries of foreign corporations. Yet, available information suggests that California businesses outsourced far less than 700,000 jobs in 2003, meaning that Californians actually benefit in a world where reciprocal outsourcing exists.

This math is fairly straightforward and illustrates an important point: the pursuit of protectionist changes in public policy, ostensibly for parochial, short term political purposes, risks inviting retaliation in the form of limits on foreign outsourcing into the U.S. and eliminating, not preserving, U.S. jobs.

**STATE OUTSOURCING RESTRICTIONS MAY BE UNCONSTITUTIONAL**

Aside from the public policy concerns, state efforts to encroach on the federal government’s authority to speak with one voice in matters affecting foreign commerce raise constitutional and other legal concerns.

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\(^8\) Id.


\(^11\) Id.

\(^12\) Id.


\(^14\) Id.

\(^15\) See S.B. 1451 (Cal. 2004); S.B. 1492 (Cal. 2004).
State Bans on Performing Public Contract Work Overseas

The first and most legally suspect category of proposed state legislation are bills that, in general, require public procurement and other public contracts to be performed within the United States or by United States citizens.\(^{16}\) Such prohibitions arguably improperly intrude on the federal foreign affairs power and violate the U.S. Constitution’s Foreign Commerce Clause.\(^{17}\) Both the foreign affairs power and the Foreign Commerce Clause are logical consequences of the need for the United States to speak with a unified voice in relations with foreign nations and, if necessary, prevent states from acting independently in the area of foreign commerce.\(^{18}\)

A number of courts have emphasized the policy dangers of individual states treading into the foreign affairs realm, affirming the already shaky legal footing underlying state laws that propose wholesale restrictions on public contracts being performed overseas. “‘These are delicate matters. If state action could defeat or alter our foreign policy, serious consequences might ensue. The nation as a whole would be held to answer if a State created difficulties with a foreign power.’”\(^{19}\) This is particularly true given the possibility that foreign nations could retaliate and enact similar protectionist legislation, placing at risk nearly 6.4 million jobs.

As a result, proposed state legislation that prohibits the performance of public contracts overseas is – at a minimum – subject to challenge on constitutional grounds. Businesses impacted by proposed state legislation restricting outsourcing should urge lawmakers to carefully consider the constitutional consequences of their actions.

In-State Company Preferences and Tax Incentives

A second category of proposed state legislation involves bills that either couch local favoritism as preferences or attempt to limit awarding state funding or tax incentives to private businesses unless those businesses restrict their own outsourcing activities. While not outright prohibitions on outsourcing, these restrictions operate largely to the

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\(^{16}\) See, e.g., S.B. 389 § 1 (Wisc. 2004) (providing that, with certain limited exceptions, “the department and its agents may purchase contractual services only if those services are performed within the United States”); S.B. 501 (Conn. 2004); H.B. 1281 (Ga. 2004).

\(^{17}\) U.S. Const. art. I, § 8, cl. 3.

\(^{18}\) See Am. Ins. Ass’n v. Garamendi, 123 S. Ct. 2374, 2386 (2003) (“There is, of course, no question that at some point an exercise of state power that touches on foreign relations must yield to the National Government’s policy, given the ‘concern for uniformity in the country’s dealings with foreign nations’” that inspired the Constitution’s allocation of the foreign relations power to the Federal Government in the first place.); Nat’l Foreign Trade Council v. Natsios, 181 F.3d 38, 49 (1st Cir. 1999) (“The Constitution’s foreign affairs provisions have been long understood to stand for the principle that power over foreign affairs is vested exclusively in the federal government.”), aff’d sub nom. Crosby v. Nat’l Foreign Trade Council, 530 U.S. 363 (2000).

\(^{19}\) Bethlehem Steel Corp. v. Bd. of Comm’rs of the Dep’t of Water & Pwr., 80 Cal. Rptr. 800, 803 (1969) (quoting United States v. Pink, 315 U.S. 203, 232 (1942)) (holding that California’s Buy American Act is an unconstitutional intrusion into the federal foreign affairs power).
same effect and, as applied, likely raise constitutional concerns under the Commerce Clause.\textsuperscript{20}

Under the Commerce Clause, states generally may not regulate commerce outside their borders, nor may states enact blatantly protectionist laws without substantial justification. The Supreme Court “consistently has distinguished between outright protectionism and more indirect burdens on the free flow of trade. . . . [W]here simple economic protectionism is effected by state legislation, a virtually \textit{per se} rule of invalidity has been erected.”\textsuperscript{21} This is particularly true where, as here, many states are attempting to use “[their] regulatory power to protect [their] own citizens from outside competition.”\textsuperscript{22}

\textbf{State Bills Restricting Call Centers and Sending Data Overseas}

The third general category of proposed state legislation restricts companies from sending certain financial, medical or personal identifying information to a foreign country or severely restricts the operations of foreign call centers.\textsuperscript{23} Although these restrictions may not, on their face, raise significant constitutional concerns, they may nonetheless, as applied, implicate the federal foreign affairs power and the Foreign Commerce Clause.

Moreover, proponents of this state legislation fail to appreciate that Congress has already passed a number of federal laws aimed at protecting consumer privacy, including the Fair Credit Reporting Act (FCRA),\textsuperscript{24} the Health Insurance Portability and Accountability Act of 1996 (HIPAA),\textsuperscript{25} and the Gramm-Leach-Bliley Financial Modernization Act of 1999 (GLB).\textsuperscript{26} Each of these statutes contains provisions that may preempt, in whole or in part, efforts undertaken by the various states to limit the global sourcing of personal information.

\textsuperscript{20} State preference laws also likely raise issues under the Privilege and Immunities Clauses of Article IV of the U.S. Constitution and the 14\textsuperscript{th} Amendment. Taken together, these provisions “outlaw classifications based on the fact of non-citizenship unless there is something to indicate that non-citizens constitute a peculiar source of the evil at which the statute is aimed.” \textit{Toomer v. Witsell}, 334 U.S. 385, 398 (1948).


\textsuperscript{22} \textit{Id.}, 447 U.S. at 44.

\textsuperscript{23} See, e.g., H.B. 3186 (Wash. 2004); S.B. 400 (Conn. 2004).

\textsuperscript{24} See 15 U.S.C. §§ 1681 \textit{et seq.}

\textsuperscript{25} It is important to note that while HIPAA expressly provides that its provisions supersede any contrary provisions of state law, HIPAA does not preempt state laws that impose stricter standards for the protection of confidential information. \textit{See Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, § 264 (c), 110 Stat. 1936, 2033-34} (set out as note to 42 U.S.C. § 1320d-2). State laws also control to the extent they are necessary to prevent fraud and abuse, to ensure appropriate regulation of insurance and health plans, for state reporting on health care delivery or costs, or to address controlled substances. \textit{Id.} § 262 (codified at 42 U.S.C. § 1320d-7(a)(2)). Whether a particular state statute banning the outsourcing of medical information would be deemed to be stricter than HIPAA’s provisions and thus not preempted would necessitate a thorough review of the legislative history of both the state statute and HIPAA.

\textsuperscript{26} See 15 U.S.C. §§ 6801-6827.
For example, recent amendments to the FCRA severely limit the ability of the states to restrict the distribution of consumer credit information between a credit reporting agency and its affiliates, while HIPAA expressly provides that business entities covered thereby are “permitted to disclose protected health information to their business associates, and to allow those business associates to create and receive protected health information on the covered entity’s behalf, but only if the covered entity obtains ‘satisfactory assurances’ that the business associate will appropriately safeguard the information.”

Gramm-Leach-Bliley similarly permits a financial institution to provide nonpublic personal information to a third party to perform services for or functions on behalf of the financial institution, provided that the financial institution fully discloses to consumers that this information will be provided to third parties and enters into a contract with the third party that requires the third party to maintain the confidentiality of the information.

None of these statutes appears to make a distinction between affiliates or business associates located within the United States and affiliates and business associates located throughout the rest of the world. State laws purporting to make such a distinction, then, could be subject to challenge because they may be preempted by federal law.

**OUTSOURCING RESTRICTIONS MAY ALSO VIOLATE U.S. OBLIGATIONS UNDER EXISTING TRADE AGREEMENTS**

In addition to the constitutional concerns discussed above, proposed state and federal legislation restricting outsourcing may also violate U.S. obligations under a variety of trade agreements, including the World Trade Organization Government Procurement Agreement (GPA). The GPA obligates contracting parties, such as the United States, to give foreign suppliers, goods, and services “no less favourable” treatment than those same goods or services would be given domestically. The GPA also prohibits member countries from discriminating among domestic suppliers on the basis of foreign ownership or the provision of foreign goods or services.

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29 See 15 U.S.C. § 6802(b)(2). Like HIPAA, GLB also permits states to enact laws with broader financial privacy protections.


31 GPA art. III(1).

32 Id. art. III(2).
Perhaps the best illustration of the consequences of enacting protectionist legislation without regard to U.S. trade obligations is the federal Thomas-Voinovich Amendment to H.R. 2989 and 2673. The Thomas-Voinovich Amendment provides that “[a]n activity or function of an executive agency . . . may not be performed by a contractor at a location outside the United States” unless the activity or function was previously performed by federal employees outside of the United States. 33

While the Thomas-Voinovich Amendment is likely not, on its face, violative of the GPA because it forces all contractors, regardless of nationality, to use domestic workers, as applied it may lead to several violations of the principles of national treatment and non-discrimination.34

First, foreign corporations seeking government contracts may have a large majority of their workforce firmly established in countries other that the U.S.35 Should one of these companies wish to compete for a government contract, it would be forced under the new law to relocate any and all employees that may work on the contract to the United States, thus raising the costs of the contract to levels much higher than those of domestic bidders whose workforce is primarily located in the U.S. and providing “less favourable treatment” than that accorded domestic firms.36

Second, the Thomas-Voinovich Amendment may violate the GPA because by forbidding contract work to be performed outside of the United States, it necessarily discriminates on the basis of “the country of production of the good or service being supplied.” Similar arguments can be made with respect to the application of other state and federal bills that attempt to ban or severely restrict outsourcing.

CONCLUSION

As discussed above, it is clear that proposed state and federal legislation that bans or restricts outsourcing raises core public policy and legal concerns. Given the very real threat of retaliation, lawmakers should be urged to carefully consider the consequences of their actions before proceeding with outsourcing legislation. Businesses contemplating outsourcing arrangements, as well as those currently engaged in such transactions, would be well served to develop strategies to address the political and legal consequences of proposed outsourcing legislation.

– By Shannon Klinger and Lynn Sykes

35 Id.
36 Id.
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