

February 4, 2004

Hon. Joel I. Klein
Chancellor
New York City Public Schools
Department of Education
52 Chambers Street, Room 314
New York, NY 10007

Re: Food Purchasing Procedures
SCI Case #2002-2380

Dear Chancellor Klein:

An investigation conducted by this office has substantiated that officials at the Office of School Food and Nutrition Services (“OSFNS”) have failed to adequately exercise oversight of food purchasing procedures. Obvious weaknesses in the bidding procedures coupled with contract requirements that tended to favor one vendor were ignored by the OSFNS for many years, allowing that vendor and others to reap profits far in excess of what they should have earned. These failures were exacerbated by officials at the Office of Purchasing Management (“OPM”), who also failed to protect the integrity of the bidding process despite mounting evidence that vendors were exploiting it. The ineffectiveness of both offices resulted in millions of dollars of wasted expenditures on excessively priced food contracts.

Favoritism of certain vendors is perhaps explained, in part, by our finding that two former officials at OSFNS, Bruce Hoffman and Vincent Romano, each engaged in misconduct by accepting gifts valued in excess of \$2,500 from individuals who had been conducting business with OSFNS.¹

Oversight deficiencies have carried over into the process seeking to award a new citywide food distribution contract to a sole vendor. We found that the Department of Education (“DOE”) had been considering contracting with a vendor with significant issues concerning its fitness as a responsible bidder. However, DOE officials failed to

¹ Bruce Hoffman was transferred to the DOE’s Division of Instructional and Information Technology in January 2002, while Vincent Romano retired in April 2003.

properly evaluate proposed contract language and qualifications as they pertained to this vendor.

This investigation began in September 2002, following a referral by the Antitrust Division of the United States Department of Justice (“Antitrust Division”) regarding potential misconduct by DOE officials in the purchasing of school food. The investigation was expanded upon the review of a report issued by Decision Strategies, Inc. (“Decision Strategies”), a consulting firm hired to oversee food vendors and examine the DOE’s food purchasing procedures.

This letter will make certain recommendations, some of which mirror those by Decision Strategies, for rectifying the deficiencies in the DOE’s food purchasing procedures. It will also identify those DOE officials most responsible for facilitating an environment in which certain food vendors took advantage of the New York City School System and recommend appropriate action concerning them.

Overview of Food Purchasing

OSFNS is the office primarily responsible for providing over 800,000 meals to New York City schoolchildren every school day, with annual costs ranging in the tens of millions of dollars. Specifically, OSFNS must ensure that contracted food vendors deliver nutritious meals to the schools throughout the year.

The supply and delivery of most food items is divided into six geographic areas or “aggregate classes,” with one class per borough except Brooklyn, which has two.² Three contracts are awarded per class: one for produce products, one for grocery, and one for frozen food.³ The specifications regarding the DOE’s needs, such as the type, brand, and quantity of food originate with OSFNS and are submitted to OPM to be formulated into each contract. These contracts are competitively bid and awarded on a yearly basis.⁴

The bidding process for each food contract takes roughly five to six months from the time that specifications are gathered by OSFNS until the contract period begins. According to DOE officials, the contract process generally proceeds as follows:

- Initially, the procurement and food technology departments of OSFNS develop contract specifications based upon the projected needs of the DOE for the coming contract year.

² Prior to the 2002 contracts, New York City high schools were serviced by a separate contract.

³ There is a separate citywide contract for the supply of milk to the schools.

⁴ Following a recommendation from Decision Strategies, the duration of food contracts was increased to one year from six months in 2002. DOE officials are currently considering awarding a three-year citywide distribution contract to one vendor.

- Officials in those departments then edit the current contract to reflect those needs, such as changes in product type and estimated quantity needs.
- The edited contract is then sent to OPM for formulation into a bid package.
- Interested food vendors receive this package approximately four to five months prior to a particular contract period.
- Vendors then submit their bids, which are opened publicly, approximately one to two months later.
- OPM conducts an analysis of the bid prices to determine the projected winner of each contract and informs OSFNS.
- If a projected winner's price on a particular item is inordinately high in comparison to other bidders, the OPM purchasing agent for that contract requests a voluntary reduction of the price from the vendor.
- If a projected winner's price on a particular item is inordinately low in comparison to other bidders, the OPM purchasing agent makes a recommendation that OSFNS take advantage of the low price by purchasing a larger quantity of that item than originally estimated, with corresponding reductions in the purchase of other similar items.
- Inspectors from the Food Technology unit of OSFNS inspect the facilities of the projected winners.
- OPM awards the contract to the winning vendor for each geographic area.

Federal Investigation of Food Vendor Collusion

An investigation by the Antitrust Division revealed widespread collusion between food vendors during the 1990's, resulting in the arrest and indictment of numerous individuals and companies. According to the indictment, several vendors conspired to shut out competition and raise their prices in an effort to dominate the DOE's contract process. Co-conspirators agreed in advance to divide up the various geographic areas by submitting fixed bids in an effort to ensure who would win each contract. In some cases, certain companies agreed not to win any contracts and submitted high bids in exchange for a portion of the profits from the winning bidders. Twenty-five individuals and fourteen companies were convicted of varying crimes, including conspiracy to commit unfair trade practices in violation of the Sherman Act. The defendants were ordered to pay fines and restitution of over \$30 million, with 13 individuals being sentenced to a period of incarceration.

A major DOE food vendor, the Irving Libertoff Company (“Libertoff”), was a defendant, along with its principal owner, Stuart Libertoff, in the Antitrust indictment. In May 2001, Stuart Libertoff pled guilty and was sentenced to 18 months in jail and a \$250,000 fine. The company also pled guilty, was placed on five years probation, was fined \$4,000,000 and ordered to pay restitution of \$2,500,000. In October 2000, prior to the resolution of the criminal case against it, Libertoff sold its assets to H. Schrier, Inc., (“Schrier”) a sales company already owned by Libertoff. The ownership of that company was then transferred to the children of Stuart Libertoff and the children of his brother Gary, who ran the warehouse operation for Libertoff. The DOE consented to Libertoff’s assignment of its 2000 food contracts to Schrier, but required that Schrier divest itself of Stuart and Gary’s control and submit to monitoring. However, Stuart and Gary have retained ownership (with their children) of the Libertoff warehouse in Brooklyn and continue to lease the property to Schrier.

During the Antitrust investigation, the DOE hired the consulting firm of Decision Strategies to monitor food vendors under contract to ensure that the companies severed their ties to individual defendants and ceased any corrupt practices. Decision Strategies also was delegated the responsibility for identifying weaknesses in the DOE’s food purchasing procedures which allowed the collusion to occur. A 2000 interim report and the 2002 final report issued by Decision Strategies contained several recommendations for eliminating such weaknesses, primarily by enhancing competition during the bidding process.

Competitive Bidding Skewed by Donated Commodities

Ineffective bidding procedures employed by OSFNS officials allowed certain vendors to exploit the DOE. Specifically, these vendors bid low prices or “low-balled” on foods that were overestimated in the bid package and higher prices on foods that were underestimated in the bid package. The low prices allowed the vendors to underbid their competitors, whereas the high prices and high actual usage of certain items caused the DOE to pay the vendor far in excess of its original bid price.

Every year, the DOE receives millions of dollars worth of donated foods under a federal/state program. By contract, vendors deliver the donated items to a DOE contracted vendor’s warehouse to await pick-up and delivery to the schools by yet another contracted vendor. Many of the donated foods require processing after receipt, for example dough, sauce, and cheese are processed into pizza, necessitating a separate contract for that step. Such items are returned to the warehouse after processing to await delivery to the schools. For the most part, the same items are donated in large quantities from year to year.

In addition to the dozens of non-donated food items a vendor must bid on, a vendor must also submit a bid on the foods that are normally donated, primarily to ensure that the schools can obtain the products if the donated stock is not available. Prior to the food contracts currently in effect, a vendor's bid prices on the purchase and sale of items that were otherwise or normally donated (hereinafter "normally donated"), as well as the bid prices on the purchase and sale of non-donated items, were multiplied by the estimated quantity for each item in the new contract.⁵ The vendors also bid on the "delivery" cost of transporting any donated items from the warehouse to the schools. That cost also was multiplied by the estimated delivery quantity for each item in the new contract. The aggregate bid prices on normally donated and non-donated bids, along with the delivery price, would constitute the overall bid figure submitted by a vendor, the most relevant factor in the awarding of contracts.

According to Bruce Hoffman, who held the position as Director of Procurement in OSFNS for 20 years before his transfer to the Division of Instructional and Information Technology ("DIIT") in 2002, with very few exceptions, the normally donated items were purchased from the vendor only when the donated stock was depleted during the school year. Lisa Damato, Hoffman's replacement as Director of Procurement at OSFNS, agreed that this policy continues to remain in effect. Usage reports for previous contract years indicate that donated stock rarely was depleted to the point where vendors had to purchase and sell such products themselves. For example, the 2002 frozen food bid package (#1F064) identified 13 normally donated items that vendors were asked to submit a bid price on in the event that they had to purchase these items and sell them to the schools. However, during the 2002 contract year, vendors purchased and sold only 8.5% of the total volume of those items delivered to the schools, with the remaining 91.5% coming from the donated stock.

As identified in the Decision Strategies report, the inclusion of bids for the normally donated items could skew a vendor's aggregate bid price to the detriment of the DOE.⁶ Experienced vendors who know that they are rarely called on to purchase and sell normally donated foods will lower the bid price or "low-ball" such items, even below what its actual cost might be, in an effort to win a contract. Such low prices will offset increases in the vendor's bid price on non-donated items, which they often sell to the schools. Therefore, the practice results in vendors being awarded contracts based on costs they will rarely incur and inflated prices on goods they will actually sell to the DOE. Although vendors engaged in low-balling commit no contractual violation, the practice effectively nullifies the purpose of competitive bidding.

The underlying reason vendors were able to low-ball was overstated estimates on the expected usage of normally donated items in the bid package. Hoffman, Damato, and

⁵ According to each food contract, the estimated quantities are supposed to be based on the actual usage of the product during a particular time period of the previous contract year.

⁶ Decision Strategies final report, pages 12, 16-17.

Vincent Romano, the former Deputy Chief of OSFNS, all stated that these estimates were based on actual usage figures from a previous period of time.⁷ However, prior to the 2003 contracts, actual usage reports bore virtually no resemblance to the usage figures that were put in the bid packages.⁸ The following chart, based on the 2002 Frozen Food contract (#1F064) areas ultimately serviced by Schrier, reflects the 13 normally donated items that vendors were asked to bid on in the event they had to purchase and sell those items to the schools.⁹ According to language in the bid package, the estimated usage figures being bid on originated from actual usage during a previous ten-month period.

<u>Item</u>	<u>Bid Package Usage (7/1/00-5/1/01)</u>	<u>Actual Vendor Sales (7/1/00-5/1/01)</u>
Fish and Cheese	22,770	0
Omelette Plain	3,894	5,466
French Bread Pizza	40,375	0
Pepperoni Pizza	25,600	0
Ground Beef	1,704	161
Ground Beef Patty	9,247	7,831
Meatballs	7,277	0
Broiled Beef Patty	13,593	20,307
Breaded Chicken	23,509	106
Roasted Chicken	17,248	0
Roasted Turkey	20,681	14,893
Turkey Sausage Patty	5,894	0
<u>Potatoes, Round Fried</u>	<u>5,598</u>	<u>473</u>
Total:	197,391	49,237

It is evident from this analysis that the bid usage figure total, which was 301% higher than it should have been, had a dramatic effect on the overall bid prices submitted by the vendors.¹⁰ In particular, Schrier's bid prices on these items were almost always significantly lower than the average bid price.

OSFNS officials could not explain the disparity between the bid package figures and the actual vendor sales figures. Larry Weintraub, Director of Operations at OSFNS, which includes accounting, told investigators that actual vendor sales figures are inputted into the OSFNS computer system by the accounting office.¹¹ Weintraub confirmed that

⁷ Specifically, the three officials agreed that procurement officials use computer data input by the accounts payable unit at OSFNS, which is based on the volume indicated in vendor invoices and school receipts.

⁸ Decision Strategies initially highlighted these inaccuracies but were unable to obtain an explanation from officials at OSFNS. Decision Strategies final report, pages 11-12.

⁹ Schrier was awarded the contract to service the Bronx, Queens, and Brooklyn #1 geographic areas.

¹⁰ Cost/price analysis indicated throughout this report is based on research conducted by this office, using records supplied by OPM, OSFNS, and Accenture Consulting.

¹¹ Weintraub has been the Director for approximately one and a half years, having previously served as the Deputy or Financial Administrator in Operations for approximately three and a half years.

the usage figures contained in the bid package should match the actual vendor sales figures in the system for whatever time period is indicated, with some minor deviation due to late invoices that may not have been inputted into the system when the bid package was being drafted. Thus, Weintraub was at a loss to explain why the figures in the #1F064 bid were so different from the actual usage figures. He added that employees in OSFNS's Procurement or Food Technology offices are responsible for entering those figures in each bid package. Damato also could not explain the discrepancies, stating that she was not the Director of Procurement at the time those figures were utilized. Moreover, neither Weintraub nor Damato could explain why only a ten-month period of usage was used in the bid package in the first place, as opposed to twelve months which would mirror the contract's length.

When confronted with these figures, Hoffman, who was the Director of Procurement during the period when the figures were used, retreated from his original assertion that the bid figures were based on actual usage. After consultation with Romano and Lloyd Caminske, a former Supervisor of Purchase in OPM currently acting in a part-time supervisory capacity, Hoffman implemented a usage figure policy to protect against a vendor who might take advantage of the DOE.¹² Specifically, Hoffman claimed that the bid package estimate on each normally donated item came from the combination of what the vendor purchased and sold of that item and what the vendor delivered from the donated stock of that item during the previous period. Hoffman asserted that to use only the vendor sales figure would have allowed the vendor to increase individual bid prices on normally donated items with very little impact on the total bid price. This, according to Hoffman, would have hurt the DOE if the donated products were depleted and the DOE had to order large quantities from the vendor.

Hoffman's "policy" explanation is unsupported by the actual usage figures. An examination of the usage figures for all 13 normally donated items, indicates that the amount a vendor sold plus the amount a vendor delivered of a particular item bore no relation to the usage figure in the bid package for each item. In fact, contrary to Hoffman and Romano's supposed effort to protect the DOE, the obvious and most significant result of using much higher bid usage figures on the normally donated items was to allow vendors to exploit the DOE through low-balling.

While the donated food estimates were inordinately high, the non-donated and donated delivery estimates were grossly understated. Since high bid prices by vendors on those items were multiplied only by the understated figures such prices were not

¹² Hoffman indicated that he and Romano had discussed this policy with the "management" of OPM. When asked to be more specific, the only individual in OPM Hoffman could recall discussing it with was Caminske. However, neither Romano nor Caminske recalled ever having participated in the formulation of bid usage policies.

adequately reflected in the bid total. An examination of the first ten items (all non-donated) in the 2002 bid package for the geographic areas won by Schrier, indicate how the bid package figures had no relation to actual usage:

<u>Item</u>	<u>Bid Package Usage (7/1/00-5/1/01)</u>	<u>Actual Vendor Sales (7/1/00-5/1/01)</u>
Plain Bagel	3,639	6,271
Cinnamon Raisin Bagel	3,325	7,234
Plain Bagelette	3,254	6,190
Sweet Potato Muffin	3,974	7,429
Croissants	4,046	8,397
Buttermilk Biscuits	2,750	6,641
Orange Cranberry Muffin	4,531	9,798
Blueberry Muffin	7,830	14,462
Corn Muffins	3,034	6,454
Orange Sunshine Muffin	3,290	7,220
Total:	39,673	80,096

The 2002 donated delivery estimate also had no relation to the actual delivery during the same time period for those three geographic areas, as indicated here:

<u>Item</u>	<u>Bid Package (7/1/00-5/1/01)</u>	<u>Actual Delivery (7/1/00-5/1/01)</u>
Donated Delivery	159,863	312,088

Multiplying a high vendor price on plain bagels by the smaller bid figure had less of an effect on that vendor's bid total usage figure than had it been multiplied by the actual usage figure. Neither Weintraub nor Damato could explain these disparities, with Weintraub indicating that such differences would not have been attributable to the few invoices that may not have been entered into the system in a timely fashion. Hoffman could not say for certain but claimed that there were "glitches" in the computer system, which he complained to Romano about, that may explain the differences. When asked by investigators about these discrepancies, Romano could only speculate that a computer problem might have been to blame. However, he denied that the problem had been brought to his attention by Hoffman or anyone else.

The combination of excessive estimates on the supply of normally donated items and understated estimates on everything else resulted in a windfall for low-balling companies. Whereas low-balling allowed them to win contracts, high prices on

underestimated items allowed them to make millions of dollars beyond their original bid price. Overall expenditures to Schrier, as shown in the following table, exemplified this disparity:

<u>Frozen Food Contract</u>	<u>Total Bid Price</u>	<u>Total Paid to Schrier</u>
#1F062 (3 geographic areas)	\$14,311,000	\$23,514,000
#1F064 (3 geographic areas)	\$13,268,000	\$24,139,000
<u>Grocery Contract</u>	<u>Total Bid Price</u>	<u>Total Paid to Schrier</u>
#1F061 (2 geographic areas)	\$2,337,000	\$ 8,135,000
#1F065 (5 geographic areas)	\$5,197,000	\$14,833,000

According to Weintraub, the differences between the contract bid price and actual expenditures on a contract would have no impact on the budget of OSFNS and therefore were not examined by the accounting office. Specifically, the food budget for OSFNS was based primarily on the previous year's actual expenditures, thus contract bid prices themselves were irrelevant to that process. Hoffman stated that he neither observed these disparities nor spoke with any OSFNS officials about them.

Schrier had an even greater ability to practice low-balling since it held the warehouse contracts for the storage of the DOE's donated foods. Decision Strategies pointed out in its interim report that, as a result of its warehouse contracts, Schrier had non-public information about what donated items were expected from year to year.¹³ That gave Schrier the ability to "low-ball" on items it would almost never supply and win bids, which it did frequently. During the 2002 frozen food contract year, Schrier delivered 431,715 cases of donated frozen food items, that the company had also submitted a bid on, to the three geographic areas designated by its contract. However, the company itself had to sell only 26,834 cases of those same items to the schools or only 5.9% of the total. As a result of the 2001 Decision Strategies interim report, OSFNS began e-mailing a list of the contents of the donated goods warehouse to all contracted vendors on a daily basis and publishing that information on its website.¹⁴ Unfortunately, this did nothing to rectify Schrier's inside information regarding the quantity of donated items that were expected. Only after a recommendation in the final report by Decision Strategies did OSFNS officials add the expected quantities of donated items to the website.¹⁵ In any event, public disclosure of such information did not prevent low-balling, it merely increased the number of vendors with the ability to engage in the practice.

¹³ Decision Strategies interim report, page 12, footnote 4.

¹⁴ However, the website information which is accessible to future competitors is only updated on a monthly basis.

¹⁵ Decision Strategies final report, pages 26-27.

OSFNS officials allowed the practice of low-balling to continue for years. Decision Strategies officials easily recognized the practice, identifying it in both their interim and final reports. However, DOE officials were not as observant. Kevin Gill, the former Chief Executive for Operational Support, was responsible for running OSFNS as well as some other offices for over 15 years until his retirement in February 2003.¹⁶ According to Gill, he was unaware of the practice of low-balling until 6 months after the Decision Strategies final report was issued, when it was explained to him by investigators from this office. Gill claimed that he had neither seen nor requested to see that report, despite its focus on food vendors and OSFNS. Gill claimed that the Chancellor's office would have given it to him if he had been meant to review it. Gill further claimed that he had not been briefed on its contents by his staff, including Romano, his Deputy Chief. Romano also claimed not to have seen any report from Decision Strategies. Such a claim is surprising, considering that Romano discussed several Decision Strategies recommendations with investigators from this office and was present as a representative of OSFNS at a September 2002 meeting with Decision Strategies officials to discuss their recommendations weeks after the report's release. Romano added that he believed he had briefed Gill on the Decision Strategies recommendations, though he could not specifically recall doing so. Moreover, according to Chad Vignola, Counsel to the Chancellor, the final report most likely was sent to OSFNS. Vignola's conclusion is supported by the fact that Gill discussed substantive issues contained therein with him, to the point of identifying details that Gill believed to be inaccurate.

Although OSFNS was required to prevent the practice of low-balling whenever possible, Romano attempted to divert responsibility to OPM. Like Gill, Romano could not explain why the practice had not been recognized earlier, only offering that OPM is the office responsible for examining bid prices. In fact, according to officials at Decision Strategies, at the September 2002 meeting with DOE officials, Romano stated that donated commodities are free and therefore do not cost the DOE anything. Contrary to his assertion, there are in fact a number of costs associated with providing the donated items to the schools, such as storage, warehouse handling (in/out cost), delivery, and in many cases processing. In an effort to prevent low-balling, food contracts dating at least as far back as 2000 contained the following clause:

[T]he OSFNS has stock of the following products in our warehouse. Vendors will be required to pick up and deliver these items. If the stock is depleted, then we will go to the bid price for purchased product. If a vendor bids on an item at a cost advantaged price to OSFNS, said vendor will not be allowed to deliver warehouse product. OSFNS will buy the product directly from them.¹⁷

¹⁶ Gill also ran the Office of Pupil Transportation ("OPT") and the Public School Athletic League ("PSAL"), and DIIT for a short while.

¹⁷ See page 11 of the 2002 contract (#1F064), emphasis added.

When brought to his attention, Romano agreed that this clause placed the responsibility on OSFNS, and particularly the procurement department, to conduct a comparison of vendor prices for normally donated items with the overhead costs of having the actual donated items provided to the schools. Nevertheless, he still persisted that OPM should have looked at such issues as well.

Among DOE officials spoken to by this office, only Damato concurred with Romano's position that OPM is also responsible for conducting a cost comparison of donated overhead costs versus vendor prices. When initially interviewed, Damato indicated that the contract clause referred to above gave OPM the responsibility to conduct a price analysis, which was consistent with prior instructions she received from Gill, Romano, and Hoffman that pricing was the responsibility of OPM and not an OSFNS function. More recently, she stated that, depending on the circumstances, either OSFNS or OPM was better suited to perform this task, although she agreed that OPM could not proceed without obtaining certain overhead cost figures from her office. Despite the recognition that a price comparison should be conducted, Damato indicated that she was not familiar with the practice of low-balling until it was brought to her attention by investigators. She also stated that she had not been made aware of the contents of the Decision Strategies final report by her supervisors, and received no instruction to take advantage of low vendor prices. She added that after she was promoted from Deputy Director to Director in 2002, she conducted a brief examination of the donated versus vendor prices, in conjunction with the DOE's efforts to create a citywide distribution contract, but saw no cause for concern.

Hoffman knowingly failed to uphold his responsibilities, allowing the low-balling practice to continue. He also agreed that OSFNS was responsible for conducting a comparative "review" (rather than an "analysis") of vendor prices versus the overhead costs of donated items. However, in response to questions from investigators, Hoffman:

- Claimed to be unfamiliar with the practice of "low-balling" until investigators brought it to his attention, though in a subsequent interview he recalled at least one significant complaint about it in the mid-1990's.
- Initially, could "not recall" who in OSFNS was required to conduct this review, but eventually admitted that it was his responsibility.
- Claimed to have conducted this review every year but could "not recall" the specific steps he took to carry it out.
- Stated that he would compare the cost to purchase the item from the vendor with the vendor's delivery price of the item if it were donated, but could not explain his failure to analyze additional costs, such as processing, storage, and warehouse handling costs.

- Could “not recall” documenting his analysis or how many donated items he examined on each contract, but agreed that he was responsible for reviewing every one of them.
- Would only review an item’s price if it was so low that it “jumped off the page,” and would inform Romano of his intention to make the vendor supply it.

Hoffman could “not recall” how often he had instructed a vendor to supply a normally donated product, noting that it was not a common occurrence. He also could “not recall” ever instructing the Schrier company to supply a normally donated item. Romano concurred, stating that requiring a vendor to supply a normally donated item was “rare at best” and he could not recall a single instance in which it was done.

A comparative analysis between the overhead cost of donated items, specifically certain processed items, contained in the 2002 Frozen Food Contract (#1F064) and the prices bid by the Schrier Company shows a tremendous savings to the DOE had the items been purchased directly from the vendor rather than taken from the donated stock.

<u>Item</u>	<u>From</u>	<u>Cost¹⁸</u>	<u>Quantity¹⁹</u>	<u>Total Cost</u>
Pepperoni Pizza:	Donated	\$23.52	71,793	\$1,688,571.36
	Schrier	\$20.00	71,793	\$1,435,860.00
Breaded Chicken:	Donated	\$27.16	56,029	\$1,521,747.64
	Schrier	\$19.50	56,029	\$1,092,565.50
Roasted Chicken:	Donated	\$28.01	50,640	\$1,418,426.40
	Schrier	\$23.50	50,640	\$1,190,040.00
Fish & Cheese:	Donated	\$12.94	40,908	\$ 529,349.52
	Schrier	\$11.00	40,908	\$ 449,988.00
				<u>Overall Cost</u>
				Donated
				\$5,158,094.92
				<u>Schrier</u>
				\$4,168,453.50
				Savings
				\$ 989,641.42

The donated overhead figures used here do not even include the storage cost which is unpredictable, but certainly would give rise to even greater savings by the DOE had those products been purchased directly from Schrier.

¹⁸ The cost figures reflect cost per case. With respect to the donated commodities, the cost includes the processing fee, delivery charge by Schrier, Office of General Services administrative fee, and warehouse handling or in/out fee.

¹⁹ The quantity figures reflect the actual usage in cases during the contract term, as taken from the usage reports.

Even where a vendor's cost was approximately the same as the donated item's overhead cost, DOE officials should have recognized that the vendor had no expectation of supplying the product. For example, Schrier bid \$19.00 to supply a case of French bread pizza, whereas the overhead costs, not including storage, on this item was \$19.02 a case. Such examples should have led officials to scrutinize vendor bids more carefully to ensure that the DOE was not being taken advantage of. Indeed, Brian Field, the President of Schrier, admitted that his company has bid some of the donated commodities at cost in order to lower the overall bid price.

In a second interview with investigators, Hoffman claimed that "the overall premise of the donated commodity program was that you accepted it all." He added that this policy had been discussed with his superiors Romano and Gill and that he basically carried out this policy. However, when asked why he still had the responsibility to conduct a price comparison, Hoffman replied, "I'm at a loss to answer that particular question." Romano agreed that OSFNS policy was to require vendors to deliver donated commodities in the warehouse before supplying it themselves. While this policy took effect sometime after he became the Deputy Chief to Gill, Romano did not know how it originated and did not recall ever discussing it with Gill.

Hoffman further claimed that since the donated commodities had to be shipped to the warehouse those costs were unavoidable but that assertion is without merit. However, both Hoffman and Damato agreed that vendor prices on normally donated items are known months before an allotment of donated foods is even requested from the New York State Office of General Services. Therefore, upon an accurate analysis by OSFNS, the DOE can determine whether it will save money on particular donated foods, and can then order accordingly.

Unlike OSFNS officials, OPM officials did recognize inordinately low prices on some donated items but did not ensure that OSFNS officials took advantage of them. According to Maryann Knab, the Deputy Administrator of OPM, the purchasing agent for a particular contract would analyze the bid prices to determine the lowest aggregate bid, or the projected winning bidder. The agent was then required to identify if any individual prices in the winning bid were inordinately high or low in comparison to the bids of other projected area winners. If the price was so low or looked like a "terrific bargain" the agent was required to make a recommendation to OSFNS to buy that item. However, Knab acknowledged that OPM would not analyze whether the vendor price was cheaper or more expensive than the overhead cost in supplying the donated item. She could not explain why a recommendation to buy it from the vendor would still be made without the benefit of such analysis. She also stated that OPM did not review whether OSFNS ever carried out an OPM recommendation to take advantage of a low-priced item.

There is no written record of how often OPM recommended that OSFNS take advantage of low prices. According to Lloyd Caminske, he had made numerous recommendations to Hoffman on this issue throughout his years of service. In fact, Hoffman told him, in substance, that OSFNS would take advantage of low cost bid prices by vendors whenever possible. Caminske stated that, up until 2002, such recommendations were made verbally and not memorialized. Since that time, the recommendations have been made by e-mail. However, Caminske informed investigators that the recent changeover in their computer system caused OPM officials to lose their e-mail records and they were unable to provide any documentation except those made since July 2003. When questioned, Caminske could recall only one instance in which Hoffman actually required a vendor to supply a low-priced item rather than take it from the donated stock. Although he did not recall the vendor or the type of product, he did state that it occurred prior to 1996, when he worked full-time for OPM. This would comport with Hoffman's recollection that this had occurred only a few times during his 20-year tenure in OSFNS.

OPM officials are responsible for requesting that projected winners of a particular geographic area contract give price reductions on items that are inordinately higher priced. Similar to low prices on bids, Knab stated that purchasing agents have been required to check for any high prices in a projected winner's bid. In the event that an individual item price is inordinately higher than the prices on competing bids, the vendor will be asked to give a voluntary price reduction on the item to make it more consistent with those bids. According to Caminske, the vendors generally comply with such requests to avoid an agent's recommendation to OSFNS that the school system not buy that particular product. However, there is no objective criteria used by the agents to decide when to request a reduction, or how to remedy a rejection of such a request.

In one significant instance, the failure to recognize the practice of low-balling allowed Schrier to mislead the DOE into thinking that voluntary price reductions saved the DOE over \$300,000 on the 2002 frozen food contract (#1F064). According to Robin Greene, the OPM purchasing agent on #1F064, the DOE called for a re-bid of that contract when the initial bids were thrown out because of a procedural error. Because the proposals had been opened, vendors knew the "price to beat."²⁰ The second set of bids (#1F066) included significant reductions in the total bid prices. However, following a complaint made by Schrier officials, the DOE reverted back to the first bids. Having seen the lower second bids, OPM officials requested that the projected bid winners voluntarily reduce their first bid prices to be more in line with the second. Schrier, the

²⁰ The DOE decided to re-bid the contracts when one company, U.S. Foods, alleged that it had never received a bid package, though having ordered one.

company projected to win three of the six geographic areas, seemingly complied with the request in a letter from its President, Brian Field. The letter indicated that the company would reduce its prices on 8 items for a "\$324,260 savings over our initial bid."²¹ The letter added, "Once again, we are here for the children of the City of New York and are glad to be of support." As a result of the lower bid, Schrier was awarded all three contracts.

Unfortunately, the DOE realized very little savings from the Schrier "reductions." Six of the eight items reduced were normally donated items. While Schrier ended up delivering approximately 226,000 donated cases of those items to the schools, the company itself did not supply a single one. Thus, the price reductions on those items yielded nothing in savings. The remaining two non-donated items, beef stew and onion rings, only netted a savings of approximately \$46,950, a mere 14.5% of the claimed \$324,260 reduction.²² When these results were pointed out to Greene, she agreed that Schrier's claimed reduction was misleading but defended OPM's failure to recognize it by asserting that OSFNS was responsible for ordering. Although he initially touted the savings to the DOE by these reductions, Brian Field had no response when the facts surrounding the actual reductions were presented to him by investigators.

The DOE finally rectified the problem of low-balling on donated items with the 2003 Frozen Food and Grocery contracts. In response to the practice of low-balling, Decision Strategies recommended that the DOE either force vendors to supply low-balled items or prevent the normally donated bid price from skewing a vendor's aggregate bid.²³ The DOE chose the latter course. Instead of multiplying the bid price on the donated item by the misleading usage figure, now the bid price on that item would be reflected as a contingency price. In essence, the normally donated commodities would have no effect on the aggregate bid price and would be present only as contingencies, in the rare instances that the DOE needed to buy those items from the vendor. The effect has been dramatic, as demonstrated by an analysis of Schrier's bid prices. The prices bid by Schrier on non-donated items were drastically reduced in the new frozen food (#1F071) and grocery (#1F072) contracts in comparison to the two previous years bid prices. As indicated below, had Schrier bid the same prices in those years as it bid on the current contracts the DOE would have seen almost \$7,000,000 in savings:

²¹ Schrier initially agreed to reduce its prices to #1F066 levels. However, since the company had raised some item prices on #1F066 their entire reduction was rejected. Had the reductions been accepted, Schrier's bid would have dropped approximately \$78,000 on food items and \$135,000 on delivery, or approximately \$213,000. Greene had no explanation as to why the reductions were not accepted without the increases Schrier had in place.

²² According to the usage reports, Schrier supplied 1,848 cases of beef stew at a \$7.50 price reduction per case for a savings of \$13,860. Schrier also supplied 16,495 cases of onion rings at a \$2.00 price reduction per case for a savings of \$32,990.

²³ Decision Strategies final report, pages 21-23, 28-30.

<u>Frozen Food Contract</u>	<u>Net Savings using #1F071 Prices</u>
2001 (#1F062)	\$2,088,000
2002 (#1F064)	\$2,803,000
Total Savings:	\$4,891,000
<u>Grocery Contract</u>	<u>Net Savings using #1F072 Prices</u>
2001 (#1F061)	\$ 890,000
2002 (#1F065)	\$1,102,000
Total Savings:	\$1,992,000

Moreover, a comparison of competing bids on the #1F064 contract indicates that at least three of those vendors would have beaten Schrier's bid prices on each of the three geographic areas that Schrier won had the donated commodities been treated as contingencies.

In addition to the drop in prices on the sale of food items, Schrier also dramatically reduced its delivery costs on the donated items. In previous bids, Schrier's delivery bid prices were significantly higher than average. However, Caminske believed that Schrier had never been asked for a voluntary price reduction on delivery prices.²⁴ Had its new delivery costs been in effect during the 2001 and 2002 contract years, the DOE could have saved approximately \$806,000 and \$715,000, respectively, on Schrier's delivery of frozen food donated items.²⁵ In total, the DOE could have saved approximately \$8,404,000 in the last two contract years just on Schrier alone.

The DOE's response to the practice of low-balling is not without problems. While substantially better than the previous practice, reflecting the normally donated item as a contingency item in the bid could become problematic and costly to the DOE. While vendors usually are not called upon to supply these items, they did supply almost 10% of them during the 2002 frozen food contract year. Smart vendors will raise their prices on normally donated items and make a substantial profit when they determine that it will not effect their overall bid price in a meaningful way. Indeed, our analysis revealed that several vendors, including Schrier, substantially raised their prices on most of the normally donated items reflected in the contingency list.

²⁴ The fact that Schrier, unlike other vendors, did not have to pick up donated products at another location since it controlled the donated warehouse calls into question why its delivery bid price was higher than most other vendors.

²⁵ Multiplying the delivery cost by the actual usage during the contract term reflects the savings indicated. In 2003, Schrier dropped its delivery price on cases weighing 20lbs. from \$7.00 to \$4.00. While it did increase the delivery price on cases weighing less than 20lbs. from \$1.00 to \$2.00 the overall savings was substantial.

Similar to the normally donated item bid price, the DOE, in its 2003 grocery and frozen food contracts, stopped multiplying the donated delivery bid price by the estimated delivery figure, greatly diminishing the significance of that price in the bid total. However, while vendors rarely were required to sell normally donated items, they often were called upon to deliver those items from the donated stock. Without some estimation of the quantity to be used, smart vendors could substantially raise the delivery price, without a meaningful change in their overall bid price.

Two vendors appeared to have recognized this weakness during the 2003 frozen food bidding process. In that bid, both Chef's Choice and Teri Nichols submitted substantially higher delivery prices than their competitors on donated commodity cases weighing over 20lbs. According to Caminske, in December 2002 he contacted both vendors, who were projected to win certain geographic areas, requesting a voluntary price reduction on their delivery prices. While Chef's Choice complied, an official from Teri Nichols requested two months to examine how much volume was being delivered before assessing a price reduction. Both companies were then awarded contracts. Further inquiries to Teri Nichols on this issue by Caminske in the spring and fall of 2003, were met with the following response: The company would not consider a price reduction unless the DOE could ensure that the new citywide contract proposal would not result in its current contract being canceled ahead of its expiration date.

To date, Teri Nichols has not reduced its delivery price. Had the DOE, last December, obtained a price reduction from Teri Nichols to the average of the other vendors that held contracts, the DOE would have saved approximately \$563,000 so far this contract year. In addition, as discussed later in this report, the failure to obtain a delivery price reduction caused the DOE to use unrealistic cost projections when determining the expected savings from its new citywide food distribution contract proposal.

OPM and OSFNS officials directed responsibility for this problem at each other, while the DOE continued to pay the excessive delivery price. Caminske indicated it would be the responsibility of OSFNS to consider "other means" such as the DOE's own trucking fleet, to remedy the vendor's refusal to give a reduction. However, according to Lisa Damato, in this case, as in all cases, "OPM is the office that works on requests for [voluntary price reductions] on behalf of School Food." In response to an inquiry by investigators, Olga Nieves, the Administrator of OPM, was recently informed by OSFNS that it does not have an alternative to using the vendor to deliver the donated commodities. Thus, almost one year after the initial request to Teri Nichols, and only as a result of an inquiry by this office, DOE officials realized that they have no plan to respond to a rejection of a request to reduce delivery prices. It is unclear why the vendors' rejection was not handled last December, before the contract was awarded to it.

More importantly, it is unclear, as Caminske suggested, why the DOE does not use DOE trucks to deliver the donated items to the areas serviced by Teri Nichols. This alternative seems particularly significant in light of the fact that, prior to the contract awards last January, the DOE considered using its own fleet to deliver all donated foods throughout the entire School District, going so far as to notify the projected winners of its intention to make such a change.²⁶

The change in the treatment of donated delivery prices resulted from a Decision Strategies recommendation. Decision Strategies, in its final report, indicated that estimated quantities on donated items suffered from inexplicable inaccuracies. The report recommended that the DOE “give serious consideration to applying [a] quantity of one” modification to delivery prices.²⁷ Under this proposal, donated delivery bid prices would be treated as a “quantity of one,” in that the price only was multiplied by one, rather than the estimated delivery figure. Here, as with contingency pricing, the delivery price would have virtually no effect on the bid total. Knab indicated her belief that the DOE made the change as a result of this recommendation. She agreed that the change was potentially detrimental but was not recognized initially because it was related to the change in the bidding on normally donated items. When investigators asked the DOE’s Director of Financial Operations Louis Benevento about the change, he agreed that the multiple changes may have led to some confusion. He also agreed that vendors could take advantage of the new procedure and that he would examine the issue further. Subsequently, OPM revised the next contract, the produce contract, to again utilize the estimated quantity, based on real usage figures, as a factor in the delivery price bid.

Despite their current efforts to address the problem, OPM and OSFNS officials knew or should have known about low-balling years ago. Vendors complained about the unfair practice as far back as 1994 and seemingly were ignored.

- As noted in the Decision Strategies report, a letter from an official of the one company (“Vendor A”) to the OSFNS in 1994 highlighted the problem.²⁸ An official from that company confirmed for investigators that this issue had been raised with both Hoffman and Caminske at that time, but that beyond that particular bid package being re-bid, nothing more was done to prevent future low-balling. According to Caminske, he also received a copy of the letter from Vendor A and passed it along to his supervisors and to Hoffman. Hoffman also acknowledged that this complaint had been made, but did not recall any other action being taken beyond the re-bid.

²⁶ The DOE rescinded this decision due, in part, to strenuous objections by the vendors.

²⁷ Decision Strategies final report, addendum.

²⁸ SCI received this complaint letter in 1995. At that time, according to OPM, the particular contract identified in the letter was re-bid. In addition, OPM indicated that all warehouse stock information was available to potential bidders, low bid prices were being taken advantage of whenever possible, and OSFNS was closely monitoring contract winners to ensure that contract terms were being complied with. As a result, this office closed its investigation.

- Caminske further agreed that vendors had complained to him about low-balling several times during the 1990's. Each time he passed that information along to Hoffman. According to Caminske, Hoffman had indicated that OSFNS would take advantage of low prices offered by vendors on normally donated items whenever possible. Caminske added that he was not aware of what action was taken in response to these complaints with the exception of one instance in the mid 1990's in which he recalled that a vendor was required to supply a low-priced item that was normally donated.
- The owner of another vending company ("Vendor B") indicated that in the 1990's he repeatedly complained to Hoffman and Romano about low-balling by some of his competitors.
- A letter from a third vendor ("Vendor C") in December 2001 to Knab, Gill, purchasing agent Robin Greene, and others, complained about the advantage held by those vendors with information about the donated commodities that were projected to be available for the coming year. Although Gill claimed that he was not familiar with this correspondence, Knab responded to it in a letter dated January 22, 2002, indicating that "OSFNS has informed us that they will not order through the warehouse in cases where a vendor has offered a much lower price on a bid." When asked by investigators about low-balling in general and her response letter in particular, Knab explained that "there always has been a history of vendors low-balling" and that Caminske had relayed to her Hoffman's assertion that OSFNS would take advantage of lower prices by vendors on the normally donated items.
- Joseph Key, the Director of the Inventory Control Unit in OSFNS, told investigators that sometime back in 2000, during the Antitrust investigation, he informed Romano and Hoffman that a vendor had made a complaint to him about low-balling by other vendors. According to Key, both officials told him that they would take care of it.
- Decision Strategies officials first identified the practice of low-balling in the 2000 interim report.²⁹

Non-Compliance with Warehouse Contracts

The two warehouse contracts to store the donated foods have provided the Libertoff/Schrier companies with substantial revenue for several years despite the fact that the vendor has not been in compliance with the specifications of these contracts. In particular, the vendor has used one warehouse, located at 4901 Glenwood Road, in

²⁹ Decision Strategies interim report, page 12, footnote 4.

Brooklyn with 105,000 square feet of capacity to fulfill the requirements of both contracts, which require a combined capacity of 200,000 square feet. OSFNS officials were aware of this problem, but did nothing to rectify it.

OSFNS officials failed to ensure that Libertoff was properly licensed when it was awarded its first frozen and refrigerated food warehouse contract in 1991. That contract began on January 1, 1992, and was renewed yearly until its expiration on December 31, 1999. Libertoff told OSFNS by letter that it would obtain the required warehouse license on the Glenwood Road facility from the New York State Department of Agriculture prior to the contract award. No one at OSFNS ensured Libertoff's compliance. This office, in its report entitled An Investigation into the Management and Delivery of Food Services by the Board of Education ("1995 SCI Report") identified that, in 1994, more than two years after the contract award, Libertoff still had failed to obtain the license.³⁰ Following this discovery, the vendor obtained the proper license. Gill responded to the 1995 SCI Report by asserting that since Libertoff had submitted a license number "we believed that they had a license."³¹ Of course, OSFNS officials never saw a license or verified if one existed. Had they done so, they would have determined that the information provided by Libertoff referred to another facility belonging to a Libertoff subcontractor, and not the Glenwood Road facility.³²

Libertoff/Schrier has possessed both warehouse contracts since 1992. According to OPM records, Libertoff had been awarded the 1988 dry goods warehouse contract, which expired on December 31, 1993.³³ The company then bid on and won the subsequent dry goods contract, which began on January 1, 1994, and has been renewed yearly, with an expiration date of December 31, 2004. When the 1992 frozen and refrigerated contract expired at the end of 1999, Libertoff was awarded the subsequent contract, having been the only company to submit a bid. That contract is renewable yearly, with an expiration date of December 31, 2010. Both contracts identify the Glenwood Road warehouse as the primary facility for contract purposes, with subcontracted warehouses outside of the city allegedly available for "overflow" storage. Since January 2000, the DOE has paid Libertoff/Schrier an average of approximately \$2.2 million each year for the services provided under these contracts.

³⁰ Pages 46-49.

³¹ Written response to the 1995 SCI Report by Kevin Gill, page 21.

³² July 26, 1995 Letter to Lawrence Becker, then Counsel to the Chancellor, page 21. A review team, including Becker, that was designated by then Chancellor Ramon C. Cortines to evaluate the findings and recommendation in the 1995 SCI Report, "conclude[d] that OSFNS or the Bureau of Supplies should have ensured that Libertoff had the required license and technological safeguards required by the contract and note[d] that these failures [had] been corrected as a result of SCI's investigation" (September 20, 1995, Review Memorandum, pages 5-6).

³³ OPM officials have not, as yet, been able to locate a copy of the 1988 bid package.

Inspectors with the Food Technology Unit of OSFNS have not identified any significant contract violations at the Glenwood Road facility since at least January 2000. Between that time and June 2001, one inspection report was issued on the site each month to cover both contracts. Since then, a monthly inspection report has been issued on each contract, though the inspections are done simultaneously by the same individual. Regardless of the type of inspection, every report since January 2000 has identified the size of the warehouse as being 105,000 sq. ft. in size. Both Knab and Benevento stated that OPM receives copies of the reports only when a new contract is issued, and only becomes aware of a violation if so informed of it by Food Technology.

The current frozen and refrigerated food warehouse contract cites the following requirements in consecutive paragraphs, which are virtually mirrored in the dry goods warehouse contract:

WAREHOUSE LOCATION: Bids will be considered only from bidders having a warehouse located in the City of New York in the Borough of Manhattan, Bronx, Brooklyn or Queens. However, the warehouse must be located within 15 miles of the Office of School Food and Nutrition Services, which is presently at 44-36 Vernon Boulevard, Long Island City, NY 11101
....

WAREHOUSE SPECIFICATIONS: The warehouse to be used for storage shall have a minimum of eight (8) operating bays, and be no less than 100,000 sq. ft. and be in a fire resistant building.³⁴ The warehouse shall have an adequate sprinkler system ... and be free of rodents and insects

The contract further requires that the vendor list any subcontracted warehouses when the vendor cannot handle the allotment of donated foods. "Subcontractors may only be used for overflow of the primary warehouse."³⁵

The Glenwood Road facility fails to meet the specifications in either contract, much less satisfy them both. The inspection report issued on January 3, 2000, just two

³⁴ The dry goods warehouse contract requires nine rather than eight operating bays.

³⁵ 2000 Frozen and Refrigerated Foods Warehouse Contract, page 56. The dry goods warehouse contract allows for the use of subcontracted warehouses (page 23). As with the frozen and refrigerated contract, OPM has interpreted the dry goods contract to allow subcontracted facilities only for overflow of the donated product.

days after the current frozen and refrigerated food contract began, reflects the available capacity at that facility as follows:

<u>Category</u>	<u>Sq. Foot Capacity</u>
Cooler	3,000 Sq. Ft.
Freezer	12,000 Sq. Ft.
Dry Storage	90,000 Sq. Ft.

The total frozen and refrigerated (cooler) food capacity of 15,000 sq. ft. is well under that contract's requirement of 100,000 sq. ft., as is the 90,000 sq. ft. available for dry goods. Even more obvious is the fact that Schrier's total capacity of 105,000 sq. ft. does not meet the combined 200,000 sq. ft. capacity requirements of both contracts. According to Knab, the Glenwood Road facility does not appear to meet contract specifications but the issue was never brought to the attention of OPM by Food Technology. When presented with the issue by investigators, Marty Oestreicher, Gill's replacement since February 2003, stated that the issue had not been brought to his attention by anyone in OSFNS.³⁶ He further acknowledged that Schrier may be in violation of the contract, but asserted that the new citywide food distribution contract, which would replace the current warehouse contracts, would remedy the situation.

Certain OSFNS officials were aware of this issue but declined to hold Libertoff/Schrier in violation of the contract. Hoffman agreed that the Glenwood Road warehouse did not meet the requirements of the two contracts and acknowledged that the issue arose back in 1991, prior to Libertoff being awarded the frozen and refrigerated food warehouse contract. At the time, the previous contract holder was going to withdraw from the contract and the DOE was required to find a replacement quickly. Hoffman claimed that, while not recalling all the specifics, the issue was discussed amongst OSFNS officials and it was decided that since Libertoff had additional capacity in an upstate warehouse it would be approved for the contract. He added that Libertoff was the only remaining bidder at the time, though according to the bid tabulation sheet there was at least one other bidder that was still viable at the time of the award.³⁷ In any event, Hoffman agreed that the exigency issue was not present when the dry goods warehouse contract was issued in 1993 and the subsequent frozen and refrigerated food warehouse contract was issued in 1999. He also agreed that the Libertoff warehouse could not meet the requirements of those contracts but stated that he did not recall the

³⁶ Like Gill, Oestreicher, the Chief Executive for School Support Services, also runs the PSAL and OPT. In addition, he is charged with the oversight of the Division of School Facilities ("DSF").

³⁷ The tabulation indicates that both Foremost Cold Storage Inc, and the Nick Pennacchio Co. had bid on the contract. However, Foremost, who had submitted the lowest bid, withdrew prior to the award. A fourth company had requested a bid package but did not submit a bid.

issue being discussed prior to those contracts being issued. When questioned about Schrier's compliance with the contracts, Romano concurred that Schrier did not appear to be in compliance, though he did not believe that the issue had ever been brought to his attention.

Barbara Gulotta, the current Director of Food Technology in OSFNS, suggested that Schrier may not be in violation of the contract and argued that the requirements language is ambiguous. When asked about the inspection reports indicating that the Glenwood Road facility only had 90,000 sq. ft. of dry good capacity and 15,000 sq. ft. of frozen and refrigerated food capacity, Gulotta stated that OSFNS officials found this discrepancy acceptable since Libertoff/Schrier used other facilities to make up for the shortfall. When shown the contract requirements listed above, Gulotta stated that the two paragraphs in the contracts, which refer to the location and size of the warehouse, may be applicable to two different warehouses. In her interpretation of the contract, the warehouse within 15 miles of OSFNS did not have to be the 100,000 sq. ft. warehouse. She then agreed that under her interpretation, Schrier could satisfy one contract by having a 100 sq. ft. warehouse within the 15 miles of OSFNS as long as it had a 100,000 sq. ft. warehouse somewhere else.

Gulotta further asserted that none of the items in the specifications section had to apply to the warehouse referenced in the location section. When asked whether, under her interpretation, the warehouse within 15 miles of OSFNS had to have operating bays, a sprinkler system, or be free of rodents and insects, Gulotta said "yes." Even though those requirements are only contained in the specification section of the contract, she maintained that that section did not correspond to the warehouse within 15 miles of OSFNS. When asked where, if not in the specification section, those requirements were in the contract, she agreed that they were not but still asserted that they were required.

Gulotta's position, which does not comport with a plain reading of the location/specifications sections, is also in conflict with the subcontracting specification. It defies logic to require Libertoff/Schrier to identify warehouses used only for "overflow" if, under Gulotta's interpretation, any warehouse could be used to satisfy storage requirements. In any event, the additional facility identified by Libertoff/Schrier in their frozen and refrigerated foods warehouse contract, located in Guiderland, New York, only has 75,000 sq. ft. of frozen storage space. Along with the Brooklyn facility, Libertoff/Schrier had only 90,000 sq. ft. of frozen and refrigerated storage space and only 180,000 sq. ft. when the dry goods space was factored in to comply with the two contracts.³⁸ Moreover, Gulotta indicated that Food Technology inspectors are not responsible for ensuring that subcontracted facilities are being used only for "overflow" purposes, and only determine that the facilities comply with health and safety standards. Romano indicated that compliance on this issue is the responsibility of Food Technology.

³⁸ In more recent years, Libertoff/Schrier has supplemented its available space with additional subcontracted facilities.

Gulotta stated that the warehouse size was one of a number of issues discussed by OSFNS officials pertaining to whether Libertoff/Schrier met the warehouse requirements when the frozen and refrigerated food contract was reissued in 2000. Although she could not recall the other issues discussed, she did state that Romano, her superior, participated in those discussions and informed her that Libertoff/Schrier was sufficiently in compliance with the contracts. Again, Romano indicated his belief that the warehouse size issue was never brought to his attention. No other company even submitted a bid on that contract.

Investigators also asked Gulotta how the inspectors came to the conclusion that the Glenwood facility was in fact 105,000 sq. ft. in size. Gulotta responded that the information would have come from the vendor. When asked if that information was independently confirmed, the director stated "I wouldn't know how to confirm it other than for the person who owns the facility or runs the facility to tell us what the size is."

Finally, according to Gulotta, the warehouse specifications section regarding the number of loading bays has nothing to do with the DOE's loading requirements. As stated above, the frozen/produce and grocery warehouse contracts require 8 or 9 "operating bays," respectively. Under Gulotta's interpretation of the contracts, the bidding vendor's warehouse had to have the minimum number of bays required by the contract, but did not have to have those bays available for the DOE. Despite this interpretation, she agreed that it would "make sense" for the DOE to specify its needs regarding loading bays in the contract. As a result, the inspectors from Food Technology did not verify the number of bays operational for the DOE's needs, and simply confirmed that the warehouse itself contained the 8 or 9 bays. Two separate vendors stated that the Schrier warehouse uses only two bays for the loading of donated commodities, though the warehouse contains several more. Therefore, the only practical result of the contract requiring 8 or 9 bays was to exclude vendors who did not have an 8 or 9 bay warehouse. This is evidenced by the fact that no other vendor bid on the 1999 frozen and refrigerated food warehouse contract.

Vendor Gifts to Hoffman and Romano

During the 1990's, Hoffman and Romano received several gifts from individuals doing business with OFSNS, one of whom, Vendor B, was a subsequent defendant in the Antitrust prosecution.³⁹

³⁹ Vendor B was the owner of a company that frequently won contracts to supply food to various geographic areas. Both the owner and the company pled guilty to Antitrust violations, having colluded with other companies to rig food vendor bids. Vendor B also owned a company which specialized in the processing of various food items.

Vendor B described for investigators how Hoffman and Romano solicited thousands of dollars in gratuities, after the vendor was awarded a DOE contract in 1993. For a few years prior to 1993, the vendor had been friendly with both DOE officials, playing tennis and having dinner with them a couple of times a month. In 1993, with the assistance of Hoffman and Romano, one of Vendor B's companies received a lucrative food processing contract. A short time after the awarding of this contract, Hoffman and Romano discussed the substantial profit that Vendor B expected to make on it. During that conversation, the two officials solicited "a few grand" in cash from the vendor for having assisted in his receipt of the contract, though he could not recall which official specifically made the request.⁴⁰ Vendor B agreed to give them some benefit but suggested laptop computers instead of cash, and that he would record the purchases as business expenses. Hoffman and Romano agreed. Shortly thereafter, the vendor gave both officials a brand new laptop, costing more than \$2,400 each.⁴¹

Vendor B also described to investigators how he gave Hoffman and Romano several \$200-\$300 packages of meat as gifts in the few years prior to the Antitrust investigation. Approximately one to two times a year for three to four years, the vendor gave the two officials various quantities of turkey, chicken, hamburgers or hot dogs from his warehouse. This usually occurred around the December holidays and during the spring. Sometimes the packages were delivered by Vendor B when the three played tennis. At other times Hoffman went directly to the warehouse to pick them up. On those occasions, Vendor B would tell his employees that his cousin was coming to pick up a package of meat. The vendor added that the gifts were friendly gestures and that he did not receive any specific benefit from either official as a result of his actions. However, he stated that his friendship with Hoffman and Romano "did not hurt [him]" in his dealings with the OSFNS or other DOE offices.

Hoffman and Romano initially denied receiving gifts from any vendors when questioned by agents of the Federal Bureau of Investigations ("FBI"). During the Antitrust investigation, FBI agents interviewed several DOE officials concerning their relationships to certain vendors. According to one FBI official, on November 29, 1999, both Hoffman and Romano denied any knowledge of bid rigging by vendors or any knowledge of DOE employees receiving gifts valued at more than \$100 from any vendors. In a subsequent interview on June 19, 2000, Hoffman specifically denied receiving a laptop computer or packages of meat from any vendor. However, Vendor B admitted to the FBI that he had given the gifts to both DOE officials. In fact, the FBI had recorded phone conversations between Hoffman and the vendor in which the two discussed the laptops, the need to conceal their existence from the FBI, and the fact that a third person, presumably Romano, also received a laptop.

⁴⁰ Vendor B could not identify any specific misconduct engaged in by either official that allowed his company to win the contract.

⁴¹ The purchase receipt for the computers is dated November 23, 1993.

During our investigation, Hoffman eventually admitted receiving the gifts described by Vendor B. When interviewed by SCI investigators, Hoffman initially lied about several aspects of his relationship with the vendor. In an interview conducted under oath at this office Hoffman stated that:

- He did receive a laptop from the vendor but that it was merely a loan. Moreover, he tried to give it back in 1999 but was unable to contact the vendor.
- He could not recall what ultimately happened to the computer.
- He received approximately eight packages of meat from the vendor but that they were valued at \$50.00 or less.
- Romano never received a computer or packages of meat from the vendor.

However, when confronted with portions of his phone conversations with Vendor B, Hoffman changed his story:

- He admitted that the laptop was a gift and not a loan at all.
- He stated that he got rid of it at a dump for fear of having it in his possession during the FBI's investigation.
- He estimated that half the packages of meat had a cost price to the vendor of approximately \$150.00, though he denied posing as the vendor's cousin when he went to the warehouse to pick them up.
- He agreed that Romano also received a laptop and packages of meat from the vendor, adding that he initially lied about Romano's involvement because he was "covering for a friend ... of twenty-five years."

Despite his admissions, Hoffman continued to deny that the gifts were connected to his role as Director of Procurement, or that he or Romano ever solicited cash from Vendor B.

Despite his earlier denial under oath, Hoffman eventually admitted that he and Romano received gifts from another vendor ("Vendor D") doing business with OSFNS. During the interview in which he partially admitted his dealings with Vendor B, Hoffman denied, under oath, receiving anything else that was inappropriate from other vendors. However, during a subsequent interview under oath, he admitted that during the 1990's Vendor D had given him tickets to major league baseball games on at least two

occasions. He also admitted that Vendor D had taken him and Romano out to dinner approximately four or five times. When asked if he had received anything else from Vendor D, Hoffman stated "I don't recall." Finally, he agreed that it was wrong to accept these gifts, but claimed that they were given out of friendship and had nothing to do with his position as Director of Procurement.

Apart from his admissions about Vendor B and Vendor D, Hoffman denied having knowledge of any other misconduct by himself, other DOE officials, or food vendors. However, during a phone conversation concerning the Antitrust investigation, Hoffman made the following statements to Vendor B:

"They're saying that some people spoke. ...
They're saying it's more than one. ...
I know certain people are holding fast."

Hoffman agreed that he was referring to individuals being questioned by the FBI, some of whom were being untruthful, but maintained that he did not recall who they were. When asked what information it was that these "people" were not telling the FBI, Hoffman denied having knowledge of it, claiming that he "could have been making a general statement regarding whatever position that individual was in at the time." However, his statements to the vendor, "they're saying" and "certain people are holding fast" clearly indicate his knowledge that individuals other than Romano were involved in some sort of misconduct connected to the bid rigging scheme under investigation.

Despite his initial denials to the FBI and this office, Romano ultimately admitted that he also received a brand new laptop and packages of meat from Vendor B. When first questioned about his relationship with the vendor, Romano invoked his Fifth Amendment right not to incriminate himself. After being granted use immunity and informed of his obligation to answer questions, Romano admitted receiving the gifts described by the vendor. However, he claimed that the gifts were given out of friendship and not connected to his position at OSFNS. He added that he did not recall Vendor B's lucrative contract or the profits therefrom. He also agreed that he lied when first questioned by the FBI about receiving anything from vendors, claiming that he was scared and made a mistake, while continuing to assert that the gifts were given out of friendship. Toward the conclusion of this interview, after being informed that his use immunity had been rescinded, Romano again invoked the Fifth Amendment when asked whether he had ever received gifts from other vendors. Specifically, he indicated that his answer to that question might tend to incriminate him. In a subsequent interview, Romano denied that he had ever received anything from Vendor D. He also denied ever receiving anything of value from an additional vendor ("Vendor E") who had dealings with OSFNS when he worked there.

Citywide Food Distribution Contract

In an effort to maximize its purchasing power, the DOE is currently considering awarding a three-year contract to a single vendor to deliver all of the food used by the School District, doing away with the geographic area or aggregate class system. As part of that contract, approximately 60% of food used by the schools will either be purchased by the vendor and sold to the schools or be delivered by the vendor from the donated stock. The DOE will contract directly with manufacturers for the remaining 40%, which will also be delivered by the vendor. The contract will also replace the current donated foods warehouse contracts, with the winning vendor being responsible for providing all necessary storage space. After several months of evaluation, DOE officials have discarded the initial bid proposal and vendor bids, in part, because of weaknesses in the process that were brought to their attention by this office as described below. The process is now being reevaluated for a second bid proposal.

According to Louis Benevento, the bid proposals were created by OPM and OSFNS officials, along with members of Accenture Consulting, a firm that is advising the DOE on purchasing related issues. Officials from all three entities form an informal committee, which reviews the proposal language before its release to prospective bidders. The committee is also responsible for evaluating the various bid packages to determine which vendor submits the lowest responsible bid. Benevento stated that he will consider the committee's conclusions in making an award recommendation to the Chancellor. However, it is unclear how the committee deals with disagreement amongst its members, since, according to Knab and Benevento, it makes decisions by consensus but does not vote on issues.

Schrier was in line to win the initial contract despite several questions regarding the company's status as a qualified bidder. Since Schrier submitted the lowest priced bid, the DOE examined whether the company was capable of adequately servicing the DOE's needs. Section 1.4 of the Minimum Qualifications section in the contract states that "all potential vendors must meet or exceed" the requirements addressed in the minimum qualifications form attached to the bid package in order to be considered for an award. Section 1.1 of that form states:

[The] Distributor must have the ability to successfully service the scope and size of the DOE. The DOE requires that the Distributor have experience with one client with at least 250 metropolitan locations or a customer account of at least \$80 Million.

In its response to this requirement, Schrier identified its customer as the Long Island School Food Service Directors Association ("Association"), which "continually changes in size with hundreds of participating schools." According to Maryann Knab, she was

informed by an official at the Association that it has not served more than 220 schools at any given time. A request by Knab to the Association for additional information about Schrier went unanswered, and no one at the DOE contacted Schrier about this issue. When asked what would be the likely result of Schrier's bid application if it failed to meet this requirement, Benevento indicated that in his opinion "[it] would not be eligible to receive the award." Ultimately, the DOE did not reach any conclusion on this issue since it decided to throw out the initial bid proposal.

Another minimum qualification which apparently would have eliminated Schrier from consideration had been seemingly ignored by DOE officials. Section 1.3 of the form states that:

[The] bidder must possess the financial health to sustain the contract resulting from this bid. The DOE expects to be no more than 10% of any vendor's annual sales.

According to David Johnston, a senior manager at Accenture, the 10% level, based upon the expected size of the contract, was proposed by Accenture in order to ensure that the DOE was contracting with a financially secure vendor. Based on an analysis of Schrier's bid total and its 2002 income statement, Accenture officials concluded that the DOE would be over 50% of the Schrier's annual sales if it were to win the award. Johnston raised Accenture's concern that Schrier exceeded the 10% maximum but was told by Knab and Olga Nieves, the Director of OPM, that they could not reject the vendor on this issue. Knab agreed that Schrier would exceed the 10% level but claimed that the section was "meaningless as far as [she was] concerned" in that it was only an expectation and not a requirement. She further explained her "belief" that the committee had come to that conclusion based upon its interpretation of the contract language. Yet, Marty Oestreicher and Lisa Damato, both of whom are on the committee, did not recall any discussion regarding this section. Knab indicated that the committee did not keep written records or minutes reflecting its activities, and therefore this office was unable to determine whether the 10% level had been discounted.

As a result, this section had not been reviewed until investigators from this office brought it to Benevento's attention. Upon inquiry by this office, Steven Stein Cushman, Deputy Director of the Office of Contracts and Real Estate in the Office of the Corporation Counsel, stated that there might be an issue as to the language's enforceability as a strict requirement. However, he added that if the DOE can justify the reasonableness of the 10% level it can then decide whether a vendor who exceeds that level is still a responsible bidder. In that event, if DOE sales exceeded 50% of the vendor's business, Cushman believed the DOE was in a reasonable position to reject the

vendor's bid. Johnston added that Accenture has regularly employed this section in other contracts it has worked on without its legitimacy being questioned. As a result, Benevento indicated that this issue would be properly reviewed.

Several additional issues beyond the minimum qualifications sections call into question Schrier's ability to be a responsible bidder. Currently, the Department of Citywide Administrative Services ("DCAS") finds Schrier to be a non-responsible bidder and will not allow it to win DCAS contracts. The agency based its conclusion on several factors, including:

- The relationship between the Libertoffs and Schrier: Stuart and Gary Libertoff were principals in the Libertoff company before it was convicted in the Antitrust prosecution. Stuart was also convicted under this scheme, as well as for conspiring to defraud the IRS. Stuart and Gary currently own the warehouse property utilized by Schrier, through their company, GSI Realty. In addition to the rent collected from Schrier, the Libertoffs are also paid by the company on a note they hold on the sale of the Libertoff company assets to Schrier.
- Schrier President Brian Field's former management of the Big Apple Baking Company, Inc. ("Big Apple"): During his tenure as president of Big Apple, this office investigated allegations that DOE officials allowed that company to unduly modify its bid twice in order to win a food contract. DCAS questioned the integrity of Big Apple and its subcontractors who did not meet bid specifications and gave inaccurate information as to their days of operation.
- Big Apple's prior default on a contract: In 1998, Big Apple was found in default on a bread contract with the United States Veteran's Administration. While the contract termination was ultimately revised from a default to a termination for convenience, the company's actions, including its failure to disclose the contract termination to DCAS, raised the agency's concerns as to Big Apple's integrity and performance.
- Inappropriate communications between Schrier and another vendor: During a recent DCAS contract bid, it was determined that a Schrier official had contact with an official from another bidding company about bid pricing. Again, this raised integrity questions in the judgment of DCAS.

Schrier lost its initial appeal of the DCAS ruling in September 2003 and has since appealed to the Mayor's Office of Contracts. According to Benevento, he would not recommend an award to Schrier if it remains on the DCAS non-responsible list.

Apart from integrity and performance questions surrounding Schrier, weaknesses in the proposed contract itself negatively impact the DOE's stated desire to reduce costs.

Specifically, the price adjustments section of the contract gives the vendor the opportunity to periodically request price increases from the DOE on either the cost of a product or its delivery to the schools.⁴² Upon the presentation of valid documented evidence by the vendor establishing a rise in costs, the DOE will grant the increase request. When asked whether the DOE had the ability to reject a requested increase as unreasonable, Oestreicher, Benevento, and Johnston all stated their belief that the contract intended the DOE to be able to do so but such discretion was not specified. In fact, according to Steven Stein Cushman from Corporation Counsel, the contract, as written, does not give the DOE such discretion. Cushman added that such discretion might not even be an enforceable term of a contract. According to the attorney, price adjustment language preferably should be tied to some objective standard such as the Producer Price Index. He added that not having such a connection in the contract's current language could be detrimental to the DOE.⁴³ Cushman did point out that fraudulently requested price increases could be argued against by the DOE, but that the standard of proof in such cases is difficult to achieve. As a result, the winning vendor would have little incentive to keep costs down, if such costs can be forwarded along to the DOE. For example, if the vendor's warehouse rent was increased, in the case of Schrier by the Libertoffs, the DOE would have to pay such an increase, whether reasonable or not, resulting in a windfall to the warehouse owner.⁴⁴

The DOE's only option to prevent abuse of the price adjustment section would have been to change the contractual relationship with the vendor. Johnston indicated that if a vendor claimed an unreasonable manufacturer price increase on the cost of an item, the DOE could separately contract to purchase that item directly from a manufacturer instead of paying the vendor's increase. Benevento added that the DOE could ultimately withdraw from the entire contract if a vendor took unfair advantage of this section. Finally, Nathan Green, an Accenture consultant, stated that, since the issue was first raised by this office, DOE officials are considering amending the contract language to enhance the DOE's protection against unreasonable price increases.

Certain factors have not been considered in determining how much money the DOE could save compared to what it is currently paying on its food contracts. According to a cost savings analysis done by Accenture for OSFNS, based mostly upon current contract prices and expected usage figures for the next contract year, the DOE would spend approximately \$106.2 million next year. The cumulative cost of the manufacturer bids on approximately 40% of the District's food and Schrier's bid price for the

⁴² Proposed citywide distribution contract, page 21.

⁴³ The produce price adjustment section does reflect that increases are tied to the producer price index.

⁴⁴ Warehousing costs are specifically identified in the contract as part of the vendor's delivery mark-up (page 21).

remaining supply and distribution is approximately \$96.5 million, excluding any voluntary price reductions that might be granted by that company.⁴⁵ Thus, under this formula, the DOE would have saved approximately \$9.7 million in the first year of the contract.⁴⁶ The following additional factors have not been accounted for in this analysis:

- As discussed previously, the DOE failed to obtain a voluntary price reduction from Teri Nichols on its delivery costs in the 2002 frozen food contract. As a result, the average delivery costs for the DOE reflected in the savings analysis was skewed by this higher cost (assuming the DOE planned to correct this mistake in future contracts). If Teri Nichols prices were dropped from the savings analysis, the \$106.2 million figure would certainly decrease. An analysis by this office indicated that if the average delivery price, excluding Teri Nichols, were applied to the actual usage figures for the 2002 frozen food contract (#1F064), DOE costs would have been reduced by approximately \$1.3 million.⁴⁷
- According to Accenture's analysis, the produce prices used to calculate the cost savings were derived from the prices in effect in the summer of 2003. However, those contract prices preceded the treatment of donated items as a quantity of one, which did not occur until the current produce contract began in October 2003. As occurred with both the frozen and grocery contracts, it is reasonable to conclude that produce prices may have dropped as well. According to Nathan Green, the new prices, which were not available to Accenture when the initial analysis was completed in the summer, have not yet been included in the savings analysis.
- In a January 2003 letter to Louis Benevento, Simon Vouyioklis, the President of Louis Foods, proposed that his company would deliver all of the DOE's donated commodities at \$2.50/case.⁴⁸ In comparison, Schrier's bid price for that delivery was \$2.69/case.

⁴⁵ According to the savings analysis, the competing bidders' prices would cost the DOE more than it is projected to spend under the geographic area or aggregate class system, prior to any voluntary price reductions granted by the bidders.

⁴⁶ Nathan Green clarified that this comparison does not examine the DOE's current expenditures versus those expected in the first year of the new contract. Rather it projects the DOE's costs in the first year of the new contract using its current prices, since the DOE is considering changing various school food needs, including item types and volumes. He added that additional factors have not yet been addressed in the savings analysis, such as projected labor savings as a result of changes in the frequency in which food will be delivered.

⁴⁷ The average price between Schrier's two geographic areas (\$4.00/case) and the one area held by Chef's Choice (\$5.00/case) is \$4.33. The savings analysis by Accenture, which factored in Teri Nichols price (\$7.99/case), was \$6.16. The difference of \$1.83 per case multiplied by the actual usage figures for 2002 is approximately \$1.3 million. Again, according to Nathan Green, the 2002 usage figures were used to calculate expected DOE costs, with some modifications, because they reflect the last completed contract year for frozen foods.

⁴⁸ Louis Foods has won several past food contracts from the DOE.

Conclusion

This office concludes that DOE food purchasing procedures have suffered from a lack of oversight for many years, enriching food vendor companies by millions of dollars. Such failures clearly encouraged several vendors into a collusive relationship against the DOE, resulting in the Antitrust prosecution. Beyond the findings in that case, Decision Strategies and this office discovered that certain vendors were obtaining lucrative contracts by exploiting loopholes in the bidding procedures. Our examination of these shortcomings, at a minimum, indicated negligence on the part of some DOE officials in preventing financial harm to the DOE. Even during the processing of the new citywide food contract, obvious questions regarding the contract's effectiveness and vendor qualifications, had not been adequately addressed by DOE officials.

The most significant avenue by which vendors exploited the DOE was the practice of low-balling. Not only were mechanisms designed to prevent it disregarded but repeated complaints concerning the practice were ignored. The analysis by this office on Schrier's contracts over the last two years, indicates that the DOE lost over \$8 million due to low-balling by that company alone. If the complaints accurately portray these practices as having occurred for several years, it is reasonable to put the DOE's losses in the tens of millions of dollars.

Both OSFNS and OPM officials directed blame at each other for the failure to prevent low-balling by vendors. OSFNS officials espoused, at least initially, that it was OPM's responsibility to ensure that vendors were not taking advantage of the DOE through misleading pricing. OPM officials accurately pointed out that they have not been responsible for food ordering, a task delegated to OSFNS. However, this disconnect between pricing and ordering did not relieve these offices from upholding their own responsibilities. More importantly, any analysis or communication between the offices on this issue should have resulted in action by the DOE years ago.

OPM officials, such as Caminske and Knab, failed to adequately respond to the practice of low-balling for years, despite obvious indications of its existence. While OSFNS is responsible for comparing vendor prices to donated overhead costs, OPM has overall responsibility for ensuring that the bidding process is fair to both the DOE and competing bidders. Price comparisons by OPM should have revealed the patterns by which winning bidders were submitting prices from year to year. Insufficient record-keeping and a lack of objective criteria used by that office to act upon disproportionately low or high bid prices on certain items contributed to this problem. Assuming that OPM officials are accurate and that they regularly made recommendations to OSFNS to take advantage of low bid prices, the recommendations were irrelevant with respect to donated

items since they were not accompanied by a comparison between the vendors prices and the donated overhead costs. More importantly, there was no-follow up conducted by OPM to determine whether OSFNS ever acted upon its recommendations. The numerous complaints regarding low-balling should have given OPM reason enough to question whether OSFNS was dealing with the problem. Hoffman's assertions that his office was handling the low-balling practice should have been examined in light of the frequency with which it occurred.

While OPM should have been more assertive in its policies, it is clear that OSFNS was primarily responsible for the oversight failures regarding low-balling. Both Hoffman and Romano ignored complaints about the practice. It is not surprising that both officials claimed that the practice was rare since apparently no steps were taken to identify its existence. Moreover, neither Romano nor Kevin Gill appeared to be concerned about the shortcomings of their office, as evidenced by their lack of efforts to obtain and read the Decision Strategies reports on the subject. When low-balling was explained to Gill by investigators, Gill asked why all vendors did not engage in this practice rather than ask himself why his office did nothing to prevent it. This response was particularly troubling considering that the massive bid-rigging scheme uncovered in the Antitrust investigation occurred while he was in charge of OSFNS. Hoffman, unlike Romano, readily admitted that OSFNS was responsible for conducting comparative reviews of vendor prices with donated overhead costs, although he failed to conduct such reviews. While on the surface, donated foods may be assumed to save the DOE money, an analysis shows that would not always be the case. Obviously, the DOE originally recognized that fact and inserted the OSFNS clause into DOE food contracts. Common sense dictates that had these officials examined the matter at an earlier stage they actually may have discovered the collusive practices connected to it.

In fact, it was OSFNS's own usage figure practice that actually created the conditions for low-balling by vendors. Using high usage figures for normally donated foods that had no relation to past actual usage skewed the bidding process by allowing experienced vendors to bid low-ball prices on such items and win contracts. Moreover, understated usage estimates on non-donated items and donated delivery, allowed these vendors to bid higher prices on those items with little effect on their bid total. Thus, certain vendors won contracts by low-balling on donated items and then realized profits on non-donated and delivered items far beyond their original contract bid price, which supposedly went unnoticed by DOE officials. Understandably, Damato and Weintraub could not explain the discrepancies in the usage figures, while Hoffman and Romano speculated that there must have been a computer glitch in OSFNS's system. Ultimately, this glitch was very enriching to certain vendors.

Contingency pricing on normally donated items has vastly improved the fairness of the bidding process but it is still subject to abuse. Implementing the Decision Strategies recommendation on contingency pricing saved the DOE millions of dollars in the first contract year alone. However, since vendors do purchase and sell some donated products to the schools, albeit rarely, there is little incentive for them to keep their prices reasonable when it will not effect their bid total. Indeed, as previously stated, several vendors raised prices on these items in the first contracts utilizing this procedure.

In addition to their failings as administrators, Hoffman and Romano committed direct misconduct by accepting gifts from vendors doing business with their office and by subsequently lying to cover that misconduct.

- After initially lying to the FBI, they admitted their misconduct regarding Vendor B when confronted by this office years later. Even then they maintained that the gifts, including the \$2,400 laptops, were given out of their friendship with a vendor and casual tennis partner, and were unconnected to their official responsibilities. On this point, this office credits the statements of Vendor B who indicated that the two officials initially solicited cash following the vendor's lucrative DOE contract, and accepted the laptops as an alternative.
- After denying other inappropriate contact with vendors, Hoffman subsequently admitted that he and Romano received gifts from Vendor D, in the form of several dinners paid for by that vendor. Hoffman also admitted that he received baseball tickets from Vendor D on at least two occasions. Despite Romano's denial that he received gifts from Vendor D, this office credits Hoffman's admissions on these incidents.

Their initial failure to be truthful calls into question their answers about additional misconduct. Such concerns are enhanced by the recorded conversation between Hoffman and Vendor B, in which Hoffman infers some knowledge of misconduct by others against the DOE, and Romano's refusal to answer additional questions about his relationship to certain vendors without use immunity. It should be noted that their acceptance of these gifts could also be a violation of the Conflicts of Interest provisions of the New York City Charter, which is administered by the Conflicts of Interest Board.

Schrier continued to gain preferential treatment when OSFNS officials allowed the company to obtain and hold the warehouse contracts despite non-compliance with contract requirements. The company's ability to win the two contracts despite its deficiencies potentially discouraged meaningful competition from other vendors, with no other company even bidding on the 2000 frozen and refrigerated food warehouse contract. Almost as disturbing, were the arguments used to justify it by both Hoffman

and Gulotta. Hoffman's claim that the size discrepancy was overlooked on the 1991 produce/frozen contract due to exigency concerns did nothing to justify ignoring the problem when the grocery contract was bid in 1993 and the subsequent produce/frozen contract was bid in 1999. Gulotta's attempt to argue that the two contract specifications could refer to different warehouses defies logic, and contradicts specific contract language referring to the use of subcontracted warehouses. Of similar concern is Gulotta's reliance on a vendor's word, without independent verification, that it was in compliance with a contract, as she did with respect to the size requirement of the warehouse contracts. Although she ultimately directed responsibility to her superiors, Gulotta fully supported the decision not to hold Schrier in violation of the contract. Similarly, her interpretation of the specification regarding the number of bays in the warehouse ignored a practical reading of the contract language. In any event, if Gulotta believed that the current language did not benefit the DOE, then it was incumbent upon her as the head of Food Technology to raise the issue not only with her supervisors but also with OPM, which is responsible for the contract process.

The development and the processing of the first citywide distribution bid lacked the level of formality necessary for a contract of such size and scope. The "informal committee" had no clear guidelines to follow in order to achieve its goal of vetting the bids. It also lacked clear leadership to ensure that every contract issue was properly analyzed by the committee as a whole. A lack of record keeping concerning the committee's actions contributed to this overall concern about its effectiveness. The results were questionable conclusions about the meaning of certain contract specifications and qualifications. In particular, until brought to their attention by this office, the 10% sales qualification had been ignored, as were the weaknesses in the price adjustments section which could easily translate into unreasonable but unavoidable costs to the DOE. Indeed, if Schrier won the contract the Libertoffs could have gained a windfall in rent increases on the Schrier warehouse. Moreover, it is still unclear what level of savings the DOE would achieve under a citywide distribution contract, because factors affecting the DOE's costs have not yet been taken into account.

In addition, the level of scrutiny applied in the review of Schrier's bid was inadequate. Approximately four months after the bids were submitted, the committee still had not decided whether Schrier met the minimum qualifications required by the contract. Indeed, the 10% sales qualification, however interpreted, seemed to require that Schrier be found an unfit bidder. Had the committee promptly decided these issues against Schrier, it would have declined a Schrier warehouse inspection and discontinued analysis of Schrier's capabilities to service the contract. Moreover, Schrier was given substantial time to rectify its status with DCAS to no avail, again slowing down the process of giving serious consideration to other bidders.

Recommendations

By both action and inaction, **Bruce Hoffman's** tenure as Director of Procurement at OSFNS has been marred by oversight failures and instances of outright misconduct. Therefore, it is the recommendation of this office that Hoffman be terminated from his employment, and that this matter be considered should he apply for any type of employment with the Department of Education or one of its facilities.

Similarly, **Vincent Romano's** actions, apart from his Fifth Amendment assertion regarding additional misconduct, cannot be tolerated by the DOE. Therefore, it is the recommendation of this office that Romano be deemed ineligible for employment by the DOE in any capacity.

Kevin Gill, despite his significant responsibilities at the DOE, did not exercise effective oversight of OSFNS. Not only did officials in that office fail to stop the obvious practice of low-balling, despite repeated warnings, but Gill demonstrated an unwillingness to even obtain a copy of the Decision Strategies reports or at least be briefed on the recommendations. Such conduct evinces an unacceptable disregard for his oversight responsibilities. Therefore, it is the recommendation of this office that the findings in this report be considered in the event that he re again seeks employment with the DOE.

Our findings further demonstrate the necessity for **OSFNS** and **OPM** officials to exercise meaningful oversight of food contracts. Officials in each office failed to understand the other's respective responsibilities, often directing blame at each other for some particular oversight. Indeed, in our November 2000 letter/report regarding the Big Apple contract bid, this office highlighted how various employees from OPM and OSFNS, including Gill, Gulotta, and Caminske, declined responsibility for the bid processing decisions made in that case. As a result, this office recommended that the DOE "take measures to ensure that all those involved in procurement decisions abide by one set of rules and understand who holds the ultimate responsibility for contracting decisions."⁴⁹ During this investigation, one OPM employee told investigators that, before Oestreicher was appointed to oversee OSFNS, individuals simply did not give advice to OSFNS officials regarding shortcomings in their procedures. Such a working relationship must be unacceptable to the DOE. Although the problem of low-balling has been recognized and some steps have been taken to reduce the practice, it is evident that future vendors will always seek new ways to take advantage of the bidding procedures to the detriment of the DOE. Therefore, this office again recommends that the responsibilities of OSFNS and OPM be clearly delineated and that officials in those offices maintain greater cooperation in the awarding and monitoring of food vendor contracts.

⁴⁹ November 14, 2000 letter/report on Bid#1B329 – Fresh Bread and Rolls, page 4.

In addition, it is recommended that the DOE conduct a thorough evaluation of those **officials responsible for overseeing food purchasing procedures**. In particular, the actions or inactions of Barbara Gulotta, Lloyd Caminske, and Maryann Knab raise questions regarding their judgment. Therefore, it is the recommendation of this office that the DOE re-evaluate their current responsibilities and that of any other official connected with food purchasing and make changes where appropriate.

The activities of **Schrier** must create serious concern for the DOE with respect to any current or future contracts. Not only is there a question about whether that company meets the qualifications of the citywide distribution contract, but Schrier's history of exploiting DOE bidding procedures, sometimes deceptively, is indicative of how it might act on any food contract. In addition, the DOE is well aware of DCAS's non-responsibility finding against Schrier, due in part to Schrier's continuing relationship with the Libertoffs. Even Accenture officials, who are concerned with Schrier's failure to meet the 10% sales qualification, have voiced serious misgivings about its connection to the Libertoffs. Therefore, this office recommends that Schrier be found non-responsible to bid on future DOE contracts, and that its current warehouse contracts not be renewed in the future.

Now that the DOE has discarded the initial bid proposal on the citywide contract, this office recommends that the contract be reevaluated in its entirety to eliminate any weaknesses. In particular, two issues must be addressed. First, the responsibilities of the offices involved in the process must be more clearly delineated, paying close attention to ensuring that the terms of the proposed contract are reasonable and expected to be met by the winning bidder. Second, the current cost savings analysis must be reassessed, ensuring that all relevant factors are included.

Whether the DOE awards a citywide contract or not, this office recommends additional **changes to the food bidding process**:

- Evaluate alternatives to contingency pricing on normally donated items to prevent vendors from exploiting that policy by bidding unreasonably high prices.
- Create an accurate process for estimating usage figures for future bid proposals.
- Develop objective criteria for requesting voluntary price reductions, and alternatives in the event that vendors do not comply.
- Revise the policy of accepting donated foods to include a meaningful comparison of overhead costs versus vendor bid prices.

- Ensure compliance with all contractual obligations of vendors, including warehouse specifications. Require that both the Chief Executive of School Support Services and the Director of Financial Operations be advised of any contract violations regardless of their resolution.

We are forwarding a copy of this letter and our final report to the Office of Legal Services. Should you have any inquiries regarding the above, please contact Special Counsel Tim Zirkel, the attorney assigned to the case. He can be reached at (212) 510-1418. Please notify Mr. Zirkel within thirty days of the receipt of this letter as to what, if any, action has been taken or is contemplated regarding the recommendations made here. Thank you for your attention to this matter.

Sincerely,

RICHARD J. CONDON
Special Commissioner
of Investigation for the
New York City School District

By:

Regina A. Loughran
First Deputy Commissioner

RJC:RAL:TZZ:gm

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