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Executive Summary

Though public schools traditionally managed their own cafeterias, in recent years there has been a marked rise in the use of private food service management companies (FSMCs). This industry, dominated by corporations like Sodexo, Inc., Compass Group, and Aramark Corp., promise to increase the efficiency of food service and delivery, thereby saving money for cash-strapped schools.

While the switch from school-run food programs to FSMCs has been a growing national trend, New Jersey has been well ahead of the curve. According to a recent study, 64 percent of New Jersey school districts outsource food service to private contractors, the second highest rate in the nation.[1] A survey of New Jersey school superintendents in 1997 found that 83 percent of respondents identified saving money as a "very important" consideration when they switched to FSMCs.[2]

In light of the economic recession, ensuring that school dollars are used effectively has never been more critical. But are there hidden costs when New Jersey Public School Districts outsource their food services? To answer this question, SEIU Local 32BJ commissioned Clarion Group, a consulting firm that researches food service issues, to analyze contracts and financial data provided by ten school districts that outsource their food services to either Sodexo or Chartwells (a division of Compass). Of the ten districts, five contract with Sodexo and five with Chartwells.[3]

Our study's findings—of overcharges for insurance, the withholding of rebates, and questionable bidding practices—are explained in further detail below.

1. Charges for Workers Compensation and Liability Insurance May Represent Hidden Profits for Sodexo and Chartwells

Sodexo and Chartwells charge school districts for their workers compensation and liability insurance costs; however, it appears that these charges exceed the actual cost of obtaining insurance. For three school districts where we were able to obtain current information, Chartwells overcharged the school districts a total of $51,979 for workers compensation insurance. We don't know the precise cost of liability insurance – and Sodexo combines the two types of insurance in its financial statements – so we can only estimate the total of the overcharge amount. For the ten school districts, the estimate of total insurance overcharges comes to nearly $320,000 – money that could have been used to purchase more than 4,600 new elementary school math textbooks.[4] It bears repeating that this substantial savings comes solely from the ten districts analyzed. If the approximately 378 New Jersey school districts using FSMCs are also being overcharged at the same rate, the total amount of taxpayer money being misappropriated would come to $12 million, *or enough to pay the annual salaries of 186 New Jersey teachers.*[5]

2. Despite Federal Law, Sodexo Withholding Rebate Money Due Districts

Because of their high-volume purchasing, large FSMCs receive rebates, discounts, and other benefits from food suppliers. Beginning with the 2009-2010 school year, the US Department of Agriculture's Food and Nutrition Service required FSMCs to pass these savings along to the districts when participating in the free and reduced lunch program. In two districts contracted with Sodexo—Piscataway and Long Branch—the FSMC is permitted to retain a portion of these savings that Sodexo says is attributable to "prompt payment discounts," although federal regulations clearly state "all costs to the [school food service] program be net of applicable discounts, rebates, and applicable credits."[6] This clause in the contract creates a loophole that Sodexo can exploit and strips much-needed money from districts.

3. School Districts Discourage Competitive Bidding

In the ten New Jersey districts, all competitive RFP processes resulted in the incumbent retaining its contract, raising immediate questions about whether the bidding process is truly competitive. Additionally, in some cases the terms of the renewed contract were more favorable to the incumbent FSMC than the terms of the request for proposal (RFP). Some examples include:

- West Orange issued an undated 45-page RFP for the 2009-2010 school year that required bidders to attend a tour of the district's food service facilities on Thursday, June 25 and submit proposals three business days later, on Tuesday, June 30—for a contract that began the following day.
- When Bergenfield renewed its contract with Chartwells for the 2008-09 school year after receiving proposals from two other companies, it allowed Chartwells to more than double its fee from ten cents per meal in its proposal (the low bid) to 21 cents per meal (higher than the other two bids).
- Edison's RFP for the 2008-09 school year received only one response, from Chartwells. The $250,000 performance bond required in the RFP was not included in the contract with Chartwells, and the requirements for a guaranteed profit to the district and insurance coverage were reduced from that of the RFP.
- Piscataway, Marlboro, and Edison failed to follow guidelines issued by the New Jersey Department of Agriculture, which states that districts should "allow a minimum of 45 days for the FSMC to submit a proposal [beginning] when the FSMC receives the request, not when the RFP is advertised or sent out." [7]

The Road to Reform

Serving meals to students in school has become a big business. Even medium-sized districts like Edison serve nearly two million meals a year and have food service budgets of three to four million dollars. Companies like Sodexo and Chartwells are attracted by the lure of fees that can exceed $300,000 a year, along with opportunities to generate even more profits in ways that are not always apparent to the districts they serve.

In a time of tightened budgets, New Jersey School Districts need every dollar owed to them. Below are five measures that should be immediately taken towards that end.

1. Districts should require the FSMC to provide specific proof (such as invoices) that the charge to the district for liability insurance is only for actual cost.
2. The amount chargeable for workers compensation insurance should be reported separately from other types of insurance on the FSMC's financial statements and be limited to the actual cost to the FSMC. This cost can be found on the New Jersey Compensation Rating and Inspection Bureau website, http://www.njcrib.com.
3. The State should enforce the federal requirement that school districts cannot adopt FSMC-prepared contracts and should ensure that FSMCs are not permitted to increase the fees quoted in their proposals or change essential RFP requirements, such as bonds and insurance limits. The State also should adopt and enforce the federal recommendation that FSMCs should not be permitted to "assist in finalizing the contract provisions after the successful offeror has been identified."
4. Among the documents reviewed were several FSMC self-administered operational performance and food safety audits. Unsurprisingly, these found no deficiencies and required no remedial actions. The State should require that operational, food safety and financial audits should be administered by an independent professional firm, contracted and paid by, and reporting only to, the State to ensure there is no influence on the auditor by the FSMC.
5. The State should enforce its own standards regarding the RFP process. In particular, the State should ensure that each school district allows enough time for non-incumbents to submit bids.

References

1 Michael D. LaFaive, "A School Privatization Primer," Mackinac Center for Public Policy, pp. 10 and 14. The national average for school districts, by comparison, is only 13 percent.

2 Kenneth P. May, "An Investigation into the Role of the Privatization of Non-Instructional Services Provided by New Jersey Public School Districts" (Ed.D. diss., Seton Hall, 1998), cited in "A School Privatization Primer," p. 16.

3 The districts analyzed using Sodexo are: Long Branch, Piscataway, Southern Regional, W. Windsor-Plainsboro, and West Orange. The districts using Chartwells are: Bergenfield, East Windsor, Edison, Hamilton, and Marlboro.

4 Prices for math textbooks based on Houghton Mifflin's 2007 Math Series, which cost $62.75 per book, with an additional 10 percent included for shipping.

5 There are 591 operating school districts in New Jersey (http://www.state.nj.us/education/data/fact.htm), of which recent data shows 64% outsource their food services, or approximately 378. According to the National Education Association, the average salary for NJ public school teachers is $64,809 for 2009-2010 (http://www.nea.org/assets/docs/010rankings.pdf, p. 110).

6 Federal statute 7CFR210.21

7 NJ Dept of Agriculture department of Food and Nutrition guidelines for "Contracting for School Food Service" (Handout #355, January 2010)

New Jersey School District Documents Reviewed

District	RFP	Contract	Proposals	Financial Stmt.
Chartwells				
Bergenfield	FY 09	FYs 09 & 10	Aramark, Chartwells and Pomptonian (1st page only)	Chartwells statements not provided
East Windsor	FY 10	FY 09	Chartwells Nu-Way	FY 09 statement
Edison	FY 09	FY 09	None provided	FYs 07 & 08
Hamilton	FY 10	FY 10	FY 09	FY 08 & Jul-Jan 09
Marlboro	FY 10	FY 10	None provided	FY 07 & 08
Sodexo				
Long Branch	FY 10	FY 09 & 10	Chartwells Sodexo	FY 08
Piscataway	FY 10	FY 10	Aramark (partial) Metz & Co. Sodexo	FY 08 & FY 09 Summaries only
Southern Regional	FY 07	FY 06 & 09	None provided	FY 08
W. Orange	FY 10	FY 10 (redacted)	None provided	Summary only
W. Windsor-Plainsboro	FY 10	FY 07 & !0	Aramark Chartwells Pomptonian Sodexo	FY 07, 08, 09

Notes to above schedule:

All dates shown are for the school districts' fiscal years ending on June 30. Summer program operations are not included in any of the documents reviewed.

RFP: Request for Proposals, sent by a school district to food service management companies (FSMC) to submit proposals to manage the district's school food service program.

Contract: The agreement between the school district and the FSMC for the management of the school food service program for a fiscal year of July 1 to June 30.

Proposal: A FSMC's proposal submitted in response to a district's RFP.

Budget: A FSMC's budget or forecast for the financial performance of a food service program for the next fiscal year.

Financial Statement: The statement of income, expenses and profit or loss submitted to the district by the FSMC.

Full Report

This report covers school nutrition programs at ten New Jersey public school districts that retain food service management companies (FSMCs), identifying and commenting upon the processes the districts used to select the FSMCs, their contractual arrangements, and the financial results of the companies' performance in each district.

Five of the districts reviewed retain Chartwells School Dining, a division of Compass Group PLC, a Great Britain-based food service contractor, and five districts retain Sodexo Management, Inc., a subsidiary of Sodexo Alliance, headquartered in France. Both companies operate in multiple markets globally and are public companies in their respective home countries. Public school nutrition services are a minor but profitable segment of their total businesses, with the potential to earn substantial administrative and management fees.

Documents reviewed were provided by school districts in response to requests made under New Jersey's Open Public Records Act. Not every district provided all the documents requested. (See chart on facing page.)

Food service companies are for-profit enterprises. Their purpose is to provide specialized services that their client, school district, college, company or institution, can't (or doesn't want to) provide on its own with its employees. The FSMCs' tell their clients, "We can do it better than you can, and for less." Sometimes this is true, especially if the internally-operated service is poorly managed. Often, the FSMC is simply taking a headache, or "non-core" function off the client's hands.

In theory, the FSMC offers a school district these advantages:

- It has the organization, operating and financial systems, marketing/merchandising programs and skilled, experienced personnel to provide a better service than can the individual manager employed by the district.
- National FSMCs have huge buying power and are able to negotiate prices for food and other products the individual district can't obtain on its own.
- Their labor costs are lower than the typical districts.
- They can offer investments to upgrade facilities and purchase new equipment for the districts. Sometimes they offer college scholarships and other financial inducements to win or retain a district's contract.

On the first point, it is true that only a very innovative, energetic and resourceful independent manager can match the operational resources the FSMCs have.

As documented in our review, national FSMCs pay as much as 13% less for food than would a district buying directly. And, until federal law required them to credit the full value of their lower prices to the school districts they serve, they did not always pass on these savings to the districts. The lower prices come indirectly, in the form of rebates, discounts and credits paid by food processors and distributors directly to the FSMC. The FSMC's low labor costs are also generally true, but at a price paid by its workers. Since the food service employees aren't district employees, FSMCs can hire hourly workers at pay rates well below those typically paid by a district to its employees, while providing fewer benefits. They also often employ their workers for just the days the schools are in operation with few, if any, paid holidays, sick days or vacation time.[1] All companies need to make a profit and strive to increase their profit every year. All customers, including school districts, want the best possible products and service at the lowest price with the most favorable terms they can obtain.

In the fiercely competitive world of on-site food service management, FSMCs respond to that conflict by offering their services at the lowest possible apparent price. In New Jersey, school districts are required to select the FSMC who meets certain minimum standards and offers “the lowest proposal received.”[2]

Naturally, this encourages a “race to the bottom.” After identifying the bidders who meet the federal- and state-mandated minimum standards and some requirements of their own, district administrators focus on the financial offers: lowest management fee; highest guaranteed return to the district; lowest overall costs; and highest investment offer (typically for facility improvement). Low bid/best offer wins. If a district wants to select a company that does not offer the best overall financial package, it must get the approval of the Bureau of Child Nutrition, Division of Food and Nutrition Services, New Jersey Department of Agriculture.

So, how does a FSMC make a profit under these circumstances? The term in the industry is “indirect income”: profits in addition to its fee that the client doesn’t know exists. A second way is to, as they say in the industry, “marry the client” – become so endearing to the school district board and administrators that they want to retain the company, even through competitive rebids.

None of this is illegal unless a specific practice is prohibited by law. Most companies have sources of income not visible to the customer. Automobile dealers receive volume incentive rebates from the manufacturers. Retailers charge fees for shelf space to food companies to handle their products, passed along in the prices charged to consumers. In the case of public school districts, this extra profit is paid by the district’s taxpayers and by the school children who aren’t receiving the full benefit of the money paid by the district to support the school nutrition program. And, of course, all companies do their best to be well-loved and retained by their clients and customers.

Our review of the records of the ten sample districts identified three areas where FSMCs can gain indirect income: (1) fees charged for workers compensation insurance; (2) fees charged for liability insurance; and (3) rebates from vendors. We also found that the procedures followed by some school districts tended to discourage competitive bidding.

Insurance Charges

FSMCs pay two primary insurance expenses that they pass along directly to their clients: workers compensation insurance and liability insurance. Chartwells and Sodexo charge for these expenses differently, and charge different amounts to each district.

Workers Compensation Insurance

In New Jersey, workers compensation insurance rates are fixed by the Division of Workers Compensation of the State’s Department of Labor and Workforce Development. By law, a basic rate, expressed as dollars per $100 of payroll, is established for each type of industry (FSMCs fall under the restaurant industry category). This rate, plus a surcharge, called an “Excess Element,” is uniform for all companies in an industry category.

The rate for individual companies is adjusted by an “Experience Modification” – a discount if the company’s workers compensation experience has been favorable or a surcharge if the experience has been worse than the industry’s average. The resulting rate is charged to each company for all employees in the state. There are no exceptions for executives or other salaried employees or by locality: one size fits all. These rates and the experience modification discount or surcharge for every employer in the state is published on the website of the New Jersey Compensation Rating and Inspection Bureau, http://www.njcrib.com.

The published 2009 workers compensation insurance premiums for Compass Group/Chartwells and Sodexo are:

	Chartwells	Sodexo
Base premium per $100 of payroll	$3.11	$3.11
Excess Element	$2.48	$2.48
Total premium per $100 of payroll	5.59	5.59
Experience modification	93.6%	93.0%
Net premium per $100 of payroll	$5.2322	$5.1987
equals percent of payroll	5.2322%	5.1987%

Liability Insurance

All school districts require their FSMCs to carry liability insurance for the protection of the district from damages caused by the company. These policies include general, product, employer's and automobile coverage, usually for $2 million; in many instances with an "umbrella" policy to cover any costs above that limit, usually up to $5 million.

Unlike workers compensation insurance, there is no law regulating liability insurance rates. The premiums are negotiated between the insurer and the policy holder. Multi-billion dollar companies like Sodexo and Compass are able to negotiate very favorable rates compared to smaller companies.

Although we cannot know the precise rates for liability insurance, through audits of food service companies in other markets, we can estimate that $5 million insurance coverage costs between 0.5% and 0.55% of sales for companies of this size in the food service industry. Higher limits don't cost significantly more, because very few cases will cost more than $5 million. In some instances, the liability insurance premium is based on payroll, but works out to about the same half-percent of sales. For this analysis, we assumed these companies are actually paying 0.55% of sales for liability insurance coverage. An exception would be for a district that operates the food service at a loss; in that case, the estimated premium is based on the higher number, the total cost of operation. "Sales" include cash received in the cafeterias, vending proceeds, catering sales and reimbursements for subsidized meals.

Chartwells

Workers Compensation Insurance: In the financial documents examined, we found Chartwells

Table 1

Chartwells' Apparent Overcharges on Workers Compensation, 2008-2009

	Bergenfield		East Windsor		Marlboro	
	Salaried	Hourly	Salaried	Hourly	Salaried	Hourly
Payroll	$99,782	$256,308	$91,859	$282,350	$83,493	$361,245
WC charge	$8,966	$24,503	$9,057	$28,348	$8,072	$34,511
% of Payroll	8.99%	9.56%	9.86%	10.04%	9.67%	9.55%
Actual WC @ 5.232%	$5,221	$13,410	$4,806	$14,773	$4,368	$18,900
Apparent Overcharge	$3,745	$11,093	$4,251	$13,575	$3,704	$15,611
Total Apparent Overcharge		$14,838		$17,826		$19,315

charged the school districts more than their actual costs and charged different rates for salaried and hourly employees, although the actual rate is the same for all employees statewide.

Bergenfield, East Windsor, and Marlboro provided financial statements for the 2008-09 school year. The figures in Table 1 on the previous page are taken from Chartwells' financial statements.

For Edison, the only complete financial statement provided by the district was for 2006-2007. Workers compensation rates declined from 2007 to 2009; the 2007 rate in Table 2 below is estimated to have been 6.5% of payroll. Hamilton only provided a full financial statement for 2007-2008; the 2008 rate below is estimated to have been 6.0% of payroll.

Liability Insurance: Chartwells' financial statements show charges for liability insurance that are three times greater than its estimated actual cost and vary from district to district for the same $2 million insurance coverage. Charges ranged from 1.63% of sales at Hamilton Township to 1.93% of sales at Edison for no reason that can be determined from the contracts or other documents reviewed.

Table 3 compares the liability insurance charges in each Chartwells school district to the estimated actual cost of coverage.

Sodexo

Sodexo conceals its charges for workers compensation insurance and liability insurance by combining them on one line of their financial statements. For some districts, they show a portion of the workers compensation charge separately. Sodexo statements also show salaries and hourly wages, including overtime pay, as a single number and, on some statements, show a "wage accrual" for employees' paid time off.[1]

On the next page Table 4 compares the combined workers compensation/liability insurance charge in each school district to Sodexo's estimated actual cost of these insurances.

Vendor Rebates

Until the 2009-10 school year, the U.S. Department of Agriculture's Food and Nutrition Service (FNS) recommended, but did not make mandatory, that school districts include in their Requests for Proposals (RFP) and contracts a clause that required their FSMCs to disclose and credit all discounts, rebates and credits received from vendors. Most districts ignored the advice.[2]

Effective with the 2009-2010 school year, the FNS required all school districts to include in their Requests for Proposals and contracts with FSMCs the

Table 2

Chartwells' Estimated Overcharges on Workers Compensation, 2006-2007 and 2007-2008	Edison (2007)		Hamilton (2008)	
	Salaried	Hourly	Salaried	Hourly
Payroll	$148,075	$825,232	$170,135	$429,921
WC charge	$13,460	$75,875	$16,289	$44,939
% of Payroll	9.09%	9.19%	9.57%	10.45%
Estimated WC	$9,625 (6.5%)	$53,640 (6.5%)	$10,208 (6.0%)	$25,795 (6.0%)
Estimated Overcharge	$3,835	$22,235	$6,081	$19,144
Total Estimated Overcharge		$26,070		$25,225

Table 3

Chartwells' Estimated Overcharges on Liability Insurance

	Bergenfield	E. Windsor	Edison	Hamilton	Marlboro
School Year	2008-09	2008-09	2007-08	2008-09	2007-08
Insurance Limit	$2 million	$2 million	$2 million	$2 million	$2 million
Sales	$1,221,819	$1,333,643	$3,462,472	$3,035,533	$1,475,977
Charge to District	$22,608	$23,381	$66,862	$49,556	$25,759
% of Sales	1.85%	* 1.75%	1.93%	1.63%	1.75%
Estimated cost @ 0.55%	$6,720	$7,335	$19,044	$16,695	$8,118
Estimated Overcharge	$15,888	$16,046	$47,818	$32,861	$17,641

* East Windsor: Chartwells budget for 2009-10 shows this charge as 2.08% of sales.

following language:

> *"Only allowable costs will be paid from the nonprofit school food service account to the contractor, net of all discounts, rebates, and other applicable credits accruing to or received by the contractor or any assignee under contract to the extent those credits are allocable to the allowable portion of the costs billed to the school food service authority."* [3]

Table 4

Sodexo's Estimated Overcharges on Workers Compensation/ Liability Insurance

	Long Branch	Piscataway	Southern Regional	West Orange	W. Windsor - Plainsboro
School Year	2008-09	* 2009-10	2007-08	** 2009-10	2008-09
Sales	$2,626,908	$2,440,576	$948,512	$2,467,499	‡ $2,811426
Payroll	$755,601	$748,097	$301,149	$974,093	$801,513
Insurance Charge	$65,915	$73,217	$26,815	$91450	$78,737
Minus: Liability Ins. @ 0.55%	$14,448	$13,423	$5,217	$13,571	$15,463
WC Insur. @ 5.199%	$39,284	$38,894	(6.0%)$18,069	$50,643	$41,671
Estimated Overcharge	$12,183	$20,900	$3,529	$27,236	$21,603
Insurance Limit	$5 million	$5 million	$2 million	$1 million	$1 million

Note: Liability insurance is a percentage of sales. Workers compensation insurance is a percentage of payroll.

*** Piscataway: Data taken from Sodexo's proposal for 2009-10. No financial statements were provided.**

**** West Orange: Proposal for 2009-10 school year.**

‡ West Windsor-Plainsboro: Total costs. Food services operated at a loss.

When the rule became effective for the 2009-10 school year, the districts saw a significant reduction in food costs, a measure of how much hidden profit the FSMCs had been keeping in prior years. The FSMCs responded to this loss of indirect income by sharply increasing their management fees to compensate for the loss of rebate revenue.

Table 5 below shows the amount of rebates FSMCs disclosed in their proposals for the 2009-10 school year (and actually credited to Hamilton in prior years) and the offsetting increases in their management fees.

Sodexo has attempted to reduce the impact on its bottom line of the new requirement that it must credit all its rebates to its school district clients. Its contracts with the Long Branch and Piscataway districts include language that permits it to retain "prompt payment discounts."[4]

However, the contracts do not define the size of the discount nor how prompt a "prompt payment" must be to qualify for the discount. Usual prompt payment discounts are one or two percent for payment within 10 days of the date of invoice. There's no law that says the "prompt payment discount" can't be, say, 10% for payment within 90 days.

This exception to the requirement for crediting districts with all rebates may be not be legal, and the exception does not appear in the Chartwells contracts reviewed. The language of the law says "net of <u>all</u> discounts, rebates, and other applicable credits." It does not appear to grant an exception for prompt payment discounts. Whether Sodexo, Chartwells and other FSMCs retain prompt payment discounts at other districts, where contracts don't include the exception language, is unknown.

Noncompetitive Bidding Practices

In all ten districts whose documents were reviewed, the district awarded its most recent contract (for either 2008-09 or 2009-10) to the incumbent. The FSMC that is currently operating a district's food services always has an advantage over its competitors when a contract is rebid. It knows the actual operation, services and sales costs, while the other bidders have to make estimates and educated guesses, based on information included in the district's Request for Proposals.

The incumbent has had the opportunity to build up the confidence of the district's board and administrators in its capabilities by providing good services and keeping costs within budget. The incumbent also has the opportunity to cultivate cordial relationships among its managers and executives and the district's board members and administrators. That's what all successful companies do: provide satisfactory goods and services and develop loyalty among their customers. It's sound business practice and perfectly legal.

However, in some instances our review of districts' Requests for Proposals (RFP) – invitations to FSMCs to submit proposals – and the contracts executed be-

Table 5

Disclosed Rebates	**Chartwells**					**Sodexo**				
District:	**E. Wind.**	**Hamilton**	**Hamilton**	**Hamilton**	**Hamilton**	**Long Br.**	**W. Windsor FY 2010 Proposals ****			
Year:	<u>FY 10</u>	<u>FY 07</u>	<u>FY 08</u>	** <u>FY 09</u>	<u>FY 10</u>	<u>FY 10</u>	<u>Aramark</u>	<u>Chart.</u>	<u>Pomp.</u>	<u>Sodexo</u>
$ Rebate	$70,094	$78,397	$73,740	$39,086	No Data	$167,907	$95,385	$175,776	$0	$176,000
% of Total Food	13.2%	7.0%	6.5%	5.6%		14.3%	7.4%	12.9%	0.0%	14.1%
Increase in Fee	$67,053	n/a	n/a	n/a	n/a	$150,072	n/a	n/a	n/a	$145,296

* Hamilton FY 2009: September-December 2008

** West Windsor-Plainsboro: Aramark Corp., Chartwells and Pomptonian Food Services submitted proposals for this contract. Sodexo was re-awarded the contract.

tween the districts and FSMCs raise questions about whether the bidding processes were truly competitive. The process of issuing the RFP and receiving proposals appears to have tilted heavily in the incumbent's favor and are contrary to the recommendations of federal and state authorities. The financial terms of some new contracts are significantly more favorable to the retained incumbent FSMC than the terms included in the RFP, on which competitors had to base their financial proposals.

For example:

- **West Orange** (Sodexo) issued an undated RFP for the 2009-10 school year that required bidders to attend a mandatory tour of the district's school food service facilities on Thursday, June 25 and submit proposals responding to the detailed, 45-page RFP three business days later, Tuesday, June 30 for a contract that started the next day, July 1.

  The abbreviated schedule made it virtually impossible for companies other than Sodexo to prepare competitive proposals in just three business days (even if they worked over the weekend). Sodexo was the only bidder and was awarded the contract for 2009-10, with renewal options for four additional years.

  The reason why this $2.5 million (annual sales) contract was handled in a way that precluded competition from other FSMCs cannot be determined from the documents provided by the district in response to a Open Public Records Act request by SEIU Local 32BJ. Important financial information in the 2006-07 and 2008-09 contracts provided was deleted, including Sodexo's management fee and guarantee of a financial return to the district.

  Other documents requested but not provided include: Sodexo's proposal for the 2009-10 school year, including sales and cost projections, management fee and guaranteed financial return; the 2009-10 contract with Sodexo; Sodexo's financial statements for the prior contract years, and copies of governmental inspection reports.

  In place of the governmental inspection reports requested, Sodexo's own inspection reports of its operations and food safety procedures were provided. The Sodexo reports found no deficiencies in its own operations. The West Orange Health Department does not post its inspection reports on its website.

- **Edison** (Chartwells) issued an RFP on February 20, 2008 for the 2008-09 school year, requiring a response in 17 business days, by March 14.

  The RFP set high qualifying standards and required a $250,000 performance bond, effectively eliminating all but the largest FSMCs.[5] Sodexo, a major player in the New Jersey school food service market that would meet these qualifications, was not invited. Aside from Chartwells, the other eight companies that were invited to compete declined to submit proposals. As one company, Dowling Food Service Management, Inc., said in a letter to the district, "After taking your tour and looking at your financials, I am sorry there just isn't enough time [to prepare a proposal]."

  As a result, the sole bidder was Chartwells, the incumbent.

  The contract as executed was far less stringent that the terms required in the RFP. The $250,000 performance bond was not required. Insurance limits were set at $2 million, although the RFP said the limit would be $5 million.

  The RFP said the FSMC must refund to the district the full amount of any operating profit that is less that the amount the FSMC guaranteed. The contract limited the refund requirement to only the total of the management fee, eight cents per meal. Chartwells would retain its full administrative fee, nine cents per meal. If the number of meals served in 2009 was approximately the same as in 2008, 1,920,000, Chartwells' management fee would have been $153,600 and its administrative fee $172,800 – for a total of $326,400, compared to a guarantee of $125,000. Even if it had to refund the entire amount of the guarantee, Chartwells would still retain more than $200,000 in fees.

  Chartwells offered an investment of $500,000 for various improvements, including a district-wide computerized cash register system and a new delivery vehicle. The investment is charged to the district as an operating expense at the rate of $100,000 a year for five years.

They also offered to fund an annual $125,000 scholarship for the life of the contract, paid from its own profits. They can afford it. Their management fee, based on a little more than 2 million meals in 2009-10, is $341,600, plus an estimated $67,000 in overcharges on workers compensation and liability insurance, for a total estimated profit of about $408,000, equal to almost 11% of projected sales.[6] After deducting the scholarship payment, their profit for the year would be about $283,000, some 7.6% of sales.

- **Marlboro** (Chartwells) issued an undated Request for Proposals for 2009-10 with a response date of June 11, 2009, just 13 business days before the end of the 2009 contract year, June 30. The RFP states the contract would be awarded on June 16, three business days after proposals were received, hardly enough time to fairly evaluate competing proposals on the 20 detailed criteria listed in the RFP.

  The RFP did not show a date for a pre-proposal conference or tour of the district's food service facilities, a usual practice strongly recommended by the federal Food and Nutrition Service and essential to all bidders except the incumbent, in order to prepare knowledgeable proposals and financial projections.

  Whether any companies besides Chartwells submitted proposals is unknown. The district did not comply with our request for copies of proposals. Chartwells' new contract was dated July 1, thirteen business days after the deadline for submission of proposals.

  The insurance requirements were lower than in the RFP, and the minimum financial rating required in the RFP for the insurance carrier was omitted. (Insurers with high financial ratings by A.M. Best and other rating firms can charge more for their insurance policies than lower-rated companies.)

- **Bergenfield** renewed its contract with Chartwells for the 2008-09 school year after receiving proposals from it and two other companies, Aramark Corp. and Pomptonian Food Service.

  Chartwells offered to manage the service for a management fee of 10 cents per meal served, with no charge for administrative services (permitted under the law). Fees proposed by the other two companies were higher.

  However, in the contract Bergenfield signed with Chartwells, the company was allowed to charge an additional administrative fee of 11 cents per meal, more than doubling the fee offered in its proposal.

  The RFP required $10 million in product liability insurance coverage, but in the contract only $2 million in coverage was required, significantly reducing Chartwells' cost of insurance compared to the costs the other companies would have included in their financial projections.

- **Piscataway** (Sodexo) issued a RFP for the 2009-10 school year on Friday, February 27, 2009, providing for a mandatory pre-proposal conference and tour of the schools three business days later, Wednesday, March 4. Proposals were due on March 17, nine business days after that.

The abbreviated schedule gave a distinct advantage to the incumbent, Sodexo, which was fully familiar with the operation.

Two companies submitted proposals in addition to Sodexo: Aramark Corp. and Metz & Associates, a Pennsylvania food service company. The Metz proposal was not competitive financially. Only the first page of Aramark's proposal was provided, showing a management fee, 18.5 cents per meal, higher than Sodexo's 12 cents per meal fee, but also offering a guaranteed return to the district, $278,000, compared to Sodexo's $250,000. Whether Sodexo's financial projections were superior to Aramark's is unknown because the rest of the Aramark proposal was not provided.

The abbreviated RFP schedules are directly contrary to the recommendations of the State Division of Food and Nutrition. A document posted on its website[7] points out requirements of the federal Office of Management and Budget that "All procurement transactions . . . shall be conducted in a manner that proves maximum open and free competition . . . Proposals must be solicited from an adequate number of qualified sources to permit reasonable competition consistent with the nature and requirements of the procurement."[8]

The Division's document advises districts, "Allow a minimum of 45 days for the FSMC to submit the proposal . . . [beginning] when the FSMC receives the request, not when the RFP is advertised or sent out."

West Orange, Edison, Marlboro and Piscataway did not come close to meeting the State's 45-day recommendation.

In New Jersey, FSMCs are permitted to prepare their own contracts, provided they contain all the mandatory federal and state language. This leaves open ample areas where the companies can insert their own terms, which the districts must then find and negotiate over. This most likely is why RFP terms like performance bonds and insurance terms were reduced or omitted from the contracts reviewed and how Sodexo is able to insert its provision that prompt payment discounts are not subject to reimbursement to the district.

This practice is contrary to the requirements of the federal government. The Food and Nutrition Service says, "FSMC-developed contracts are never allowed since they would compromise open and free competition. While not recommended, a SFA may invite the successful offeror under a RFP to assist in finalizing the contract provisions after the successful offeror has been identified. Such changes cannot result in a material change to either the solicitation or contract."[9]

Permitting a successful proposer to double its fee during contract negotiations and the elimination in contracts of RFP terms like performance bonds and insurance requirements would appear to be "material changes."

The Road To Reform

While the battle over rebates, discounts and credits has been won, there are other, important areas for improvement in the outsourcing of school food service programs, as illustrated in this report. The State and individual districts can take action on their own now, without waiting for the federal government to impose new regulations.

1. Districts should require the FSMC to provide specific proof (such as invoices) that the charge to the district for liability insurance is only for actual cost.

2. The amount chargeable for workers compensation insurance should be reported separately from other types of insurance on the FSMC's financial statements and be limited to the actual cost to the FSMC. This cost can be found on the New Jersey Compensation Rating and Inspection Bureau website, http://www.njcrib.com.

3. The State should enforce the federal requirement that school districts cannot adopt FSMC-prepared contracts and should ensure that FSMCs are not permitted to increase the fees quoted in their proposals or change essential RFP requirements, such as bonds and insurance limits. The State also should adopt and enforce the federal recommendation that FSMCs should not be permitted to "assist in finalizing the contract provisions after the successful offeror has been identified."

4. Among the documents reviewed were several FSMC self-administered operational performance and food safety audits. Unsurprisingly, these found no deficiencies and required no remedial actions; the schools' food services were being operated perfectly. The State should require that operational, food safety and financial audits should be administered by an independent professional firm, contracted and paid by, and reporting only to, the State to ensure there is no influence on the auditor by the FSMC.

5. The State should enforce its own standards, as described in its "Contracting for School Food Service" document regarding the RFP process. This document says the Division of Food and Nutrition "annually reviews each contract between the LEA (Local Education Authority) and the FSMC to ensure all requirements set forth in state and federal regulations." In particular, the State should ensure that each District allows 45 days for responses to RFPs. The State should also act to ensure that contract terms do not vary from those contained in the RFP.

Adoption of these recommendations will help ensure that our school children are receiving the full benefits of parents' and taxpayers' hard-earned money.

References

1 An accrual is a reserve to pay for a future expense. Whether, and how much, of Sodexo's accruals are actually paid out to employees for holidays, sick leave or vacation time cannot be determined except by an audit of the company's books.

2 One district that took the advice was Hamilton Township. In 2006-07, the district received $78,397 in rebates, equal to 7% of purchases; in 2007-08, $73,740 (6.5%), and in the September 2008-January 2009 period, $39,085 (5.6%).

3 7 CFR Part 210,21

4 Article III, Section 3.13 (A) in both the Long Branch and Piscataway contracts: "Rebates or allowances (excluding prompt payment discounts) obtained from vendors, suppliers, manufacturers or distribution companies, including those obtained through Sodexo's regional or national purchasing or distribution arrangements based on goods procured solely for District's account shall be credited to the District as described in Section I.V.2."

5 Based on prior experience in the industry, bond issuers generally require $250,000 in cash or three to five times the amount in negotiable securities (e.g., publicly traded stocks) as security before posting a $250,000 performance bond for a small or privately held company.

6 The workers compensation insurance charge in Chartwells' proposal equaled 10.167% of payroll, vs. 5.232% actual. The liability insurance charge equaled 2.02% of total sales, vs. an estimated 0.55%.

7 Handout #355, "Food Service Management Company: Fact Sheet 1, Contracting for Food Service."

8 OMB Circular A-102 and Part 3015

9 USDA Food and Nutrition Service brochure, "Contracting With Food Service Management Companies: Guidance for SFAs [School Foodservice Authorities]," page 1-7

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