



September 7, 2007

James E. Tilton, Secretary
California Department of Corrections
and Rehabilitation, and
Chairman, Prison Industry Board
1515 S Street, Suite 502 South
Sacramento, California 95814

Dear Mr. Tilton:


In a letter dated July 11, 2007, the Prison Industry Authority's Senior Staff Counsel, Jeffrey A. Sly, requested on behalf of the Prison Industry Authority (PIA) and the Prison Industry Board (PIB) that the Office of the Inspector General investigate allegations of misconduct made against both the PIA and the PIB¹. The allegations were made by business entities claiming that their economic interests will be adversely affected by a PIA proposal to take over the packaging of certain foods. The complainants allege that the PIA developed a proposal to start a peanut butter and jelly packaging enterprise without, among other things, following the requirements of Penal Code section 2808(i). Small businesses affected by this proposal specifically allege that the PIA and the PIB:

- "misappropriated" funds;
- failed to follow public hearing requirements pertaining to peanut butter and jelly packaging;
- violated sole source bid requirements;
- claimed to manufacture products not produced by the PIA; and
- failed to consider the proposal's impact on California businesses.

To evaluate the validity of the allegations, the Office of the Inspector General conducted a variety of procedures which included:

- interviewing PIA representatives;
- attending the PIB's June 29, 2007 public meeting;
- obtaining and analyzing PIB agendas, meeting minutes, and other records regarding the development of the peanut butter and jelly packaging enterprise; and
- obtaining and analyzing written statements and supporting records from various complainants.

¹ Mr. Sly mailed an identical request to the Attorney General's Office.


Arnold Schwarzenegger, Governor

Our findings regarding these allegations follow:

Finding 1: There appears to be no merit to the allegation that the PIA or the PIB engaged in misappropriation of funds.

The complainants allege that the PIA and the PIB engaged in “misappropriation of funds,” a crime defined in Penal Code section 424. This provision provides in pertinent part that public employees may not appropriate, loan, or otherwise utilize public funds for personal use or use of another. The complainants do not allege that any board member or PIA employee appropriated, loaned, or otherwise used funds for personal use or for the use of another. Rather, their complaint alleges that because the PIB was not legally authorized to expend funds for the liquid packaging enterprise and did not conduct public hearings, the expenditures were therefore “misappropriated.” Absent evidence that a PIA employee appropriated, loaned, or utilized these funds for personal use or use of another, the elements of Penal Code section 424 are not met. As such, there appears to be no merit to the allegation of misappropriated funds.

Recommendations:

None.

Finding 2: The PIB met its statutory public hearing requirements, but it did so only after it purchased equipment to be used in the proposed enterprise.

The complainants assert that the PIB did not conduct a public hearing for the liquid product packaging enterprise as required by Penal Code section 2808(i) which states, in relevant part,

No new industrial, agricultural, or service enterprise which involves a gross annual production of more than fifty thousand dollars (\$50,000) shall be established unless and until a hearing concerning the enterprise has been held by a committee of persons designated by the board including at least two board members [emphasis provided].

In an April 18, 2007 letter to a lobbying firm representing some of the complainants, you state that the PIB conducted a public hearing in October 2002 under an action item covering establishment of a “food packaging enterprise” at the California Substance Abuse Treatment Facility and State Prison at Corcoran, and that the item was subsequently approved by the PIB at a board meeting on October 23, 2002. In that letter, you stated that although the action item “discusses four-sliced bread as the initial product to be packaged at the enterprise, the action item clearly indicates that this was just one of several food items that potentially would be packaged at the PIA enterprise” and that the public hearing was consistent with the requirements of Penal Code Section 2808(i).

The Office of the Inspector General found that the PIA, preparatory to an October 1, 2002 public hearing, queried a vendor data base to identify food packaging vendors that might be affected by the proposed new enterprise. The data query did not identify any such vendors, so the PIA sent a notice of public hearing and the corresponding action item to entities

listed on its general mailing list, which included government agencies, political representatives, and labor groups. The mailing list did not include Walrus Sales Company, the contractor that was providing peanut butter and jelly to the department at the time.

The Office of the Inspector General also found that neither the notice of public hearing nor the action item describing the proposed food packaging enterprise mentioned peanut butter and jelly or similar liquid product items. Descriptions of specific food products associated with the "food packaging" action item were limited to dry baked goods such as cookies, crackers, wafers, and pretzels. Additionally, the PIB could not provide detailed hearing minutes, transcripts, or audio tapes from the October 1, 2002 public hearing when the Office of the Inspector General requested these items. In examining the minutes of the October 23, 2002 board meeting, the Office of the Inspector General found that the board's chairman noted for the record that there were no comments from the public at that meeting. Therefore, the Office of the Inspector General found insufficient evidence to conclude that the PIB's intent to package peanut butter and jelly was publicly noticed or discussed in October 2002.

However, the Office of the Inspector General further found that the PIB has subsequently met the hearing requirement for these items at a public hearing held on May 22, 2007, and at a board meeting held on June 29, 2007. At that June 29, 2007 board meeting, the PIB received public comment but ultimately took no action to approve the proposed peanut butter and jelly packaging enterprise. We note that the PIA had already contracted for approximately \$930,000 in specialized equipment in January 2006 in preparation for its proposed peanut butter and jelly packaging enterprise. While the PIA's acquisition of the machinery prior to official project approval does not appear to be a violation of law, it does represent poor public policy.

Recommendations:

The Penal Code does not define what constitutes a "new" enterprise. In this case the PIA and the PIB based many of their actions on the opinion that the hearing for "food packaging" in October 2002 was sufficient to cover peanut butter and jelly packaging in 2006. While both enterprises can be categorized as "food packaging," the peanut butter and jelly packaging enterprise affected an entirely different group of vendors and required a significant investment in specialized packaging machinery. The Office of the Inspector General therefore recommends that the PIA and PIB develop criteria to identify a "new" enterprise, and to define the processes it must follow to adhere to the Penal Code requirements for public hearings on new enterprises.

The Office of the Inspector General also recommends that in the future, the PIA and the PIB refrain from committing resources to a proposed new enterprise until after that enterprise has been given official approval.

Finding 3: The PIA and the PIB did not violate sole source bid requirements or falsely claim to manufacture products not actually produced by the PIA

The complainants claim that the PIA violated state purchasing rules by entering into “sole-source” contracts to purchase packaging equipment and to purchase ready-to-serve peanut butter and jelly packets (“squeezers”), and that the PIA falsely claimed to manufacture a product that it did not actually produce.

The first contract in question involves the purchase of packaging machinery to enable the PIA to begin production of peanut butter and jelly squeezers.

The Office of the Inspector General found that the PIA solicited bids to provide the machinery and received eight such bids. Only two bids were from vendors of equipment compatible with the PIA’s needs. The PIB awarded the contract on January 17, 2006 to Four In One Co., Inc., the lower of the two bidders.

The other contract in question, approved by the PIA on January 23, 2006, was a separate agreement with Four In One Co., Inc. to provide packaged peanut butter and jelly until the PIA could get its own production line running. The PIB justified this sole source contract by claiming the packaging equipment used by Four In One Co., Inc. was compatible with packaging materials already purchased by the PIA for anticipated use in its own packaging operation. Therefore, surplus packaging materials not used by Four In One Co., Inc. could eventually be used by the PIA. It was under this arrangement that Four In One Co., Inc. produced peanut butter and jelly in packets bearing PIA labeling, leading to accusations that the PIA falsely claimed to manufacture the product.

The Penal Code gives the PIB broad authority in conducting its operations. Specifically, section 2808(g) of the Penal Code empowers the PIB

[t]o establish, notwithstanding any other provision of law, procedures governing the purchase of raw materials, component parts, and any other goods and services which may be needed by the authority or in the operation of any enterprise under its jurisdiction. Those procedures shall contain provisions for appeal to the board from any action taken in connection with them [emphasis provided].

In addition, Penal Code section 2808 states in relevant part,

The board, in the exercise of its duties, shall have all the powers and do all the things that the board of directors of a private corporation would do, except as specifically limited in this article, including but limited to all of the following:

(a) To enter into contracts and leases, execute leases, pledge the equipment, inventory and supplies under control of the authority and the anticipated future receipts of any enterprise under the jurisdiction of the authority as collateral for loans, and execute other necessary instruments and documents.

Further, the Legislative Counsel of California rendered an opinion that the PIB has the authority to establish procurement procedures that do not comply with the requirements of certain contracting statutes, including preferences for small businesses as required by the

Government Code or disabled veterans business enterprises as required by the Public Contract Code. While there may be room for legal debate on the issue, under the same rationale, it appears the PIB is not required to comply with Public Contract Code requirements regarding sole source contracts.

It therefore appears that the PIA, through the PIB, has the authority to enter into sole source contracts at its discretion. Notwithstanding this, the PIA used competitive bidding to purchase the packaging equipment for its enterprise. Furthermore, its decision to sole source the contract with Four In One Co., Inc. to package peanut butter and jelly on an interim basis appears to have been a reasonable business decision.

Recommendations:

None.

Finding 4: The PIA and the PIB have yet to provide an analysis of the impact of its proposed enterprise on California industry

The PIB is required by the Penal Code to consider the impact on existing businesses when establishing a new enterprise. According to Penal Code section 2808(i), the PIB must consider “the effect of a proposed enterprise on California industry and shall not approve the establishment of the enterprise if the board determines it would have a comprehensive and substantial adverse impact on California industry which cannot be mitigated.”

Neither the PIA nor the PIB could produce any documentary evidence of an analysis considering the impact of establishing a peanut butter and jelly packaging enterprise on California industry. At the June 29, 2007 PIB meeting, however, the Office of the Inspector General witnessed the PIB soliciting information from concerned business enterprises. The PIB members queried some who testified about their businesses’ gross sales, the estimated amount of their revenue that would be affected by the PIA’s proposed enterprise, the number of employees in their workforce, whether they employed union labor, and if their businesses offered employee benefits. While such questions were asked of each respondent, it was unclear how the board members used this information or against what standard they compared it.

The Penal Code does not define what procedures must be employed when considering the impact of a proposed new enterprise on California industry. Further, the PIB itself has no formal policy or procedures to provide internal guidance regarding these matters.

While the Penal Code is ambiguous as to the requirements for measuring the impact of a proposed new enterprise on California industry, there is presently insufficient evidence that the PIB has considered the impact of its proposal to begin packaging peanut butter and jelly.

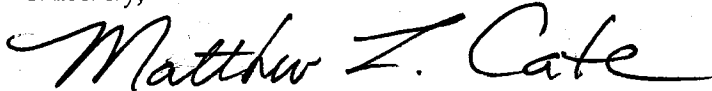
Recommendations:

At its board meeting on June 29, 2007, the PIB took no action on the proposed peanut butter and jelly packaging enterprise. Before ultimately deciding whether to approve the proposed enterprise, the PIB should follow the requirements of Penal Code section 2808 by considering whether the enterprise "would have a comprehensive and substantial adverse impact on California industry which cannot be mitigated." The board's resultant decision and reasoning should be made on the record to establish its compliance with California law.

The PIB should also establish uniform policies and procedures for addressing these issues in the future. Without standard, consistently applied policies and procedures the PIA and the PIB are at risk of future accusations of subjective decision-making. The Office of the Inspector General recommends that the PIA and the PIB implement policies and procedures for assessing the impact of proposed enterprises on California businesses. The policy should, at a minimum, require documentation of the procedures employed in making impact assessments.

We appreciate the cooperation of the PIA and the PIB during our review. Please contact my office if you have questions or if we can be of further assistance.

Sincerely,

A handwritten signature in black ink that reads "Matthew L. Cate". The signature is written in a cursive, flowing style.

MATTHEW L. CATE
Inspector General

cc: Kingston Prunty, Undersecretary, California Department of Corrections and Rehabilitation
Charles L. Pattillo, General Manager, PIA, Executive Officer, PIB
Jeffrey Sly, Senior Staff Counsel, PIA