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Cafeteria Kickbacks

How food-service providers like Sodexo bilk millions from taxpayers

By LUCY KOMISAR (http://www.inthesetimes.com/community/profile/12)

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Food-service companies buy products from vendors that pay bigger rebates—or kickbacks—rather than those that offer cheaper, locally grown or higher quality food.

At the end of the 2006 school year, children's nutrition advocate Dorothy Brayley had a disturbing conversation with a local dairy representative. He had come to her office to discuss participation in the summer trade show of food providers she runs as director of Kids First Rhode Island.

At the time, the state's schools were buying 100,000 containers of milk each week. The salesman for Garelick Farms, New England's largest dairy, told Brayley that Sodexo—a food and facility management corporation that managed most of the state's school lunch programs—was paying Garelick more than competitors in order to get a bigger rebate.

State Education Department records, which are required to chart milk prices, showed that Sodexo passed on the price hike, billing schools 24 cents to 27 cents a half-pint, while milk was available from Aramark, a competing company, for 18 cents to 21 cents a half-pint — a loss to schools and families of more than $100,000 a year.

That's just a taste of the hundreds of millions of dollars of "rebates"—or kickbacks from suppliers—that Sodexo, a $20 billion-a-year global leader in the food and facility management industry, has taken while operating cafeterias and other facilities for schools, hospitals, universities, government agencies, the military and private companies across the country, according to evidence provided by whistleblowers and internal company documents.

In some cases, such rebates violate the contracting policies of federal agencies. In others, undisclosed rebates may constitute fraud.

Sodexo's deputy counsel Tom Morse declined to reveal the size of Sodexo's rebate from Garelick Farms, and he rejected the notion that rebates are abusive. Dean Foods, which owns the dairy, declined to comment.

How the rebates work

Sodexo, founded in France in the '60s to do maritime catering, now has more than 30,500 operating sites and 355,000 employees in 80 countries. It reported revenues last year of $20.4 billion, and profits of more than $1 billion. It ranks second in food services worldwide, after U.K.-based Compass Group.

The rebate system, endemic to the industry, works like this: A food management company like Sodexo signs contracts to run a client's cafeteria. The company buys supplies from vendors such as Coke, Kellogg's or Tyson. Then, chosen vendors send the management company rebates based on a percentage of sales.

Tom MacDermott, a New Hampshire industry consultant who negotiates for clients with Sodexo and others, says kickbacks date back half a century.

“In the ’50s, it was cash in an envelope slipped to the chef,” says MacDermott. “As companies grew, they were getting back 5 percent from the produce vendor, 2 percent from the meat guy, 2 or 3 percent from dry goods and dairy.”

In the United States, MacDermott estimates that management companies such as Sodexo, Compass and Aramark provide meals, catering and vending machines to virtually every federal agency, 95 percent of corporations with food service, 90 percent of universities, 40 percent of healthcare facilities, and 30 percent of schools. If you’ve eaten at a public cafeteria, you’ve probably eaten food sourced by one of these companies.

As major corporations and government institutions increasingly outsourced purchasing, kickbacks to megacorporations like Sodexo became rife — making up at least 10 percent of sales.

Contracts are typically cost-plus, meaning clients pay the cost set by the supplier, plus a percentage of that as a fee set by the food-service firm. There are generally no cost caps, so rebates—which are not deducted from what the food-service company charges clients—mean higher meal prices. They also limit food choice and quality: food-service companies buy products from vendors that pay bigger rebates rather than those that offer cheaper, locally grown, or higher quality food.

Several managers at small companies described the impact of Sodexo’s demand for rebates, but declined to speak for attribution out of fear that Sodexo would lock them out of future buys.

A manager for a small New England produce supplier describes the system this way: “Say you’re selling a case of apples at $20 and you have to pay 15 percent sheltered income [or rebate] to Sodexo. So now you have a $23 case that should be going at $20,” he says. The price increase pushes the item off the menu. “Now the food-service directors in the schools will use a frozen item to substitute the fresh produce.”

According to the manager, “They [Sodexo] squeezed hundreds of thousands of dollars away from us.” But he adds that his company had no choice but to pay Sodexo rebates: “They own a lion’s share of the market place. If we were to give up the business, someone would be dying to jump in and take it.”

In another case, an East Coast ice cream manufacturer says he stopped working with Sodexo because the 10 percent kickbacks the company demanded cut profits so much that it wasn’t worth the business.

“The school business in winter keeps us going,” he says. “Initially any school in the system that wanted ice cream products would just call us up, so we could supply them. Then Sodexo comes in. You want to deal with Sodexo facilities, you have to sign a contract. [And Sodexo] off the record says you have to send us a rebate check.

“They try to intimidate you,” he adds. “They have such a grasp on the market. They force you to work on low margin, 20 percent. If you give them a 10 percent kickback, you’re pretty much working for nothing. We lost about $30-to-$40,000 a year, which is a lot for a small businessman.”

He continues, “We had been in business since 1930, so we were entrenched in most of the schools. The PTAs would run it. They used the money to buy school equipment. When Sodexo got involved, there was no money for the PTAs, the kids, they took it all.”

‘Major changes’

Recently, a backlash has emerged against these rebates. A U.S. Department of Agriculture (USDA) audit found that, in its sample, the national school lunch program was paying hundreds of thousands of dollars a year more because food-service management companies improperly retained cash-back discounts.

In October 2007, the USDA ruled that food-service contractors like Sodexo had to provide schools with invoices showing the rebates received from food vendors — and that federal reimbursements would not pay those amounts.

The money involved is massive. Charles C. Kirby, former USDA regional director for child nutrition in Atlanta, says he ran a Mississippi Education Department cooperative buying program from 1992 to 2001. He dealt directly with companies such as Heinz and Kellogg's and received rebates ranging from 10 percent to 50 percent. In the last year, his rebates were $15 million out of $90 million in purchasing.

"You can imagine with a large corporation like Sodexo, the volume they might have on rebates," says Kirby.

The Pentagon, too, conducted audits that found overcharges for its outsourced food services. Last May, when the Defense Department called for bids, it announced a "major change." Contractors would have to identify rebates that they were pocketing. If they passed on such rebates to other clients, they would have to give the same deal to the Pentagon, which could require documentation and audit records.

Strong-arming into 'compliance'

Jay Carciero, 35, a stocky, intense man, lives with his wife and three children in a small American-flag-flying blue clapboard home in Woburn, Mass. His soft-spoken brother John, 37, divorced with one child, lives a few miles away in Reading, in a white clapboard A-frame.

The brothers worked for Sodexo for years: Jay as Sodexo's manager of food and facilities for the Lahey Clinic hospital, Peabody, Mass., and John at Massachusetts' Melrose-Wakefield Hospital, and then at Lowell General Hospital.

In 2005, they sounded alarms about Sodexo demanding kickbacks. Both were eventually fired.

In April 2005, John filed a complaint with a business abuse hotline Sodexo set up to comply with the Sarbanes-Oxley Act. He said the company was using "strong-arm techniques" to get rebates from vendors.

Sodexo attorney Tom Morse claims that John Carciero is a disgruntled employee who filed his complaint only after Sodexo began an investigation of Jay for expense-account irregularities (about which Morse declined to supply details).

The explanation lacks credibility because, months later, in January 2006, Jay was proposed by a supervisor for manager of the year. More importantly, the Carcieros supplied *In These Times* with stacks of internal Sodexo documents that bolster their claims.

According to the Sodexo contract, the company's rebate system at Lahey Clinic worked like this: Sodexo got a management fee from the clinic that amounted to 0.9 percent of invoices from regional and national suppliers. The contract with Lahey limited purchases to Sodexo-approved vendors, which in practice, eliminated most local merchants, so Sodexo's fees were effectively calculated to include all rebates. The rebates were not reported to the hospital.

"We weren't aware of Sodexo getting rebates that just went to Sodexo when they should have been coming in part to us," says Phillips Axten, the hospital's attorney.

Jay Carciero claims that the hospital should have been aware; he said he tried to show evidence of rebates to Lahey CEO Dr. David Barrett, but he "did not want to look at documents I was giving to him."

Sodexo, as the hospital's agent, had a fiduciary duty to get the best product at the best price. Instead, Jay Carciero says the company directed managers to buy food that supplied the highest rebates. He says he felt "betrayed by a company" and "felt anger at their ripping off the most vulnerable citizens of our society — children, the elderly, the sick and dying."

In These Times sent Sodexo counsel Morse copies of key internal Sodexo e-mails and documents that back up the Carcieros' charges, asking Morse if any appeared not genuine. He raised no challenge. In the documents, Sodexo uses a euphemism for rebates, calling them "volume discount allowances" (VDAs). It asks for bills "off invoice," meaning one invoice it can give clients and keep another for itself—a system that can disguise rebates. "Compliant" refers to vendors who supply rebates.

Documents show that demanding rebates is at the heart of Sodexo's business plan. Tony Alibrio, then Sodexo USA Healthcare Services president, wrote in a July 21, 2000 memo addressed to "Health Care Food Service Accounts" that "manufacturer and distributor rebates support our entire Purchasing & Procurement Department and network."

Managers were told to avoid cheaper products in favor of those that produced rebates. Director of Procurement Bob Sulick, in a Sodexho's Bulletin dated March 22, 2004, wrote, "A manager told me today how he saves money by buying cans of tomato products from his fruit and produce vendor. Please don't let this happen. People should buy the compliant products through their prime vendors. That is where the highest return is." (Sodexo dropped the "h" from its name last year.)

Another document shows top company leadership enforcing the rule that only vendors offering rebates should get Sodexo business. According to the document, Richard Macedonia, then CEO of Sodexo USA, told employees at a Feb. 19, 2004 meeting at City of Hope National Medical Center in Los Angeles, "We want to have a compliant program, because it is better for the company as a whole. So, we intend to make it harder to buy outside of the program unless our client wants a specific brand."

In addition to pressure from the top, the company set up bureaucratic roadblocks to ordering from non-preferred vendors, according to Jay Carciero. "When you go into a unit, you are given a computer," he says. "When you need to order food or supplies, you order it through a portal controlled by the company. If you want to use the farm down the street selling green beans, you couldn't do it without special approvals and lots of headaches."

According to another document, Sodexo USA President Michel Landel was asked at a 2004 managers' meeting in Vermont, "Will units [clients] ever see rebate money for being product compliant?" Landel responded instead by saying, "We have set up goals for both product and vendor compliance for each of our accounts and our success relies heavily on this."

Sodexo attorney Morse argues that working only with "compliant" vendors is necessary to assure health and safety and to guarantee supplies in case of shortages.

"When we buy from a vendor, we make a commitment to that vendor that they will be a preferred vendor or we will buy a specific quantity from them or will buy over a period of time," he says. He adds that "the first thing we vet our vendors for is safety" against food-borne illnesses and the second consideration is "if there's a food shortage, we want to be at top of their list to make sure we get it."

However, Morse could offer no evidence that either problem had occurred.

Under contract

Sodexo's U.S. government procurement program amounts to more than hundreds of millions a year. A 2005 Sodexo spreadsheet tracked rebate increases from sales to 13 regional Federal Reserve banks, the FBI Academy, the IRS, the Treasury Department, the Library of Congress, the Center for Medicare/Medicaid Services, NASA and the General Services Administration (GSA), which handles contracts for itself and for most other federal agencies. The spreadsheet showed rebate points from sales to CBS, CNN and CNBC.

The GSA declined to detail how its contracts address rebates. But little evidence exists that the agency is watch-dogging the problem. In May 2008, an investigation outsourced to the Post Office Inspector General concluded that the GSA's "Federal Acquisition Service was dysfunctional…that GSA leadership appeared to be signaling its employees to favor the commercial interests of certain large vendors."

When asked about rebates received from government agencies, Morse says they would be passed on to the federal government, but he did not provide evidence that this had occurred.

A 1997 directive from the federal Office of Management and Budget (OMB), Circular A-87, requires that rebates to contractors that reduce costs have to be credited to federal awards. However, Washington has been lax in enforcing it.

The Bush administration's OMB Deputy Comptroller Daniel Werfel told *In These Times* by e-mail, "We are not aware of any other agencies who took the step of clarifying their program rules with respect to rebates, as USDA did." Nevertheless, he added, "At this time, we do not believe it necessary that all agencies initiate a rulemaking similar to the USDA rule."

The Defense Department may have issued new, more demanding contracting guidelines, but individual services operate under their own rules, which have allowed rebates, sometimes by ignoring them. The Marine Corps has a fixed price-per-meal contract with Sodexo, so rebates are not at issue. The Air Force says it has no policy on rebates, while the Navy says its policy is under review. The Army declined to respond to queries.

The USDA 2002 schools audit shows that even when procurement documents required return of rebates earned through purchases, food-service management companies disregarded the rule and routinely kept them.

Morse says rebates were passed on to schools and cited the example of Rhode Island. However, business managers from the Newport and Coventry school districts explain that while Sodexo said it used rebates to cancel out fees the schools might have to pay, accounting was inadequate.

"It's difficult to police," says Anthony Ferrucci, business manager of the Coventry District. "We don't get invoices per item."

East Greenwich School District business manager Marianne Crawford says she, too, was aware of rebates but never got dollar figures.

A Sodexo representative told Karen Works, who manages food-service contracts for the Kansas Education Department, that accounting difficulties made it too hard for the company to return rebates to Kansas schools.

"His example was if we buy $1 million worth of chicken from Tyson, we get $10,000 back, spread out among all the Sodexo contracts," she says. "How will they identify it?"

However, as the Sodexo spreadsheet shows, and as Morse acknowledges, Sodexo has a sophisticated computer system for tracking rebates. It knows exactly what percentage of Tyson's rebate to Sodexo pertains to each client.

A corporate rip-off

The rebate system raises issues that could end up in court. For example, Sodexo serves some 1,800 hospitals, many of which fill out cost reports for federal Medicare and Medicaid reimbursements.

"Their cost is what Sodexo charges them," Morse says. "So they can fill out their reports based on the amounts Sodexo charges them. It's disclosed to the clients that we get allowances. There really isn't an issue here."

However, Jim Sheehan, New York State's Medicaid Inspector General, points out that this may violate the Medicare-Medicaid Anti-Kickback Act that mandates, as Sheehan explains, that no vendor can give "anything of value in whole or part in cash or kind in return for referral of service paid for by government." A company like Sodexo "can get a discount," says Sheehan, "so long as it's accurately reported on the cost report." But "a secret rebate would not meet that standard."

Robert Vogel, a Washington attorney who represents whistleblowers, says that if a contract calls for reimbursement of actual costs and the company is hiding a rebate, then that could constitute fraud.

"If the purchasing agent"—for example, the Sodexo staffer in a hospital or school—"is getting rebates from the seller of the product and not disclosing the rebates, it may be affecting the purchasing agent's decision on what product to buy," Vogel says. "That would be a kickback."

Law enforcers, take note.

Lucy Komisar is an investigative journalist who specializes in uncovering corporate misconduct. She deals frequently with offshore banks and corporate secrecy and their links to corporate crime; tax evasion by the rich and powerful; empowerment of dictators and oligarchs; bribery and corruption; pay-to-play politics; drug, arms and people trafficking; and terrorism. Her articles are archived at thekomisarscoop.com (http://thekomisarscoop.com/) .

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