



DENNIS J. HERRERA
City Attorney

DIRECT DIAL: (415) 554-4748
E-MAIL: tara.collins@sfgov.org

December 21, 2009

Stephen Calkins
General Counsel
Office Depot
6600 North Military Trail
Boca Raton, FL 33496

Re: Office Depot Contract With City & County of San Francisco

Dear Mr. Calkins:

On December 18, the Controller of the City and County of San Francisco issued an audit report of the City's contract with Office Depot. A copy of the report is enclosed. The audit report concludes that Office Depot has overcharged the City by at least \$5.75 million over the course of 5 years on an \$18 million contract. On the basis of my review of the audit report, including Office Depot's written responses, and consultation with the City's Office of Contract Administration, I now write to demand that Office Depot reimburse the City the total amount of the overcharges, with interest, plus the costs the City incurred in conducting the audit, and attorney's fees.

The audit report concludes that at least \$4.4 million, the majority of the overcharges, resulted from Office Depot's failure to provide the contractually mandated discount for all items covered by the contract. The contract provides for only 2 pricing structures for items purchased under the contract: (1) a list of enumerated "Section A" items, for each of which the contract specifies a price that was to remain unchanged over the term of the contract; and (2) all other items to be purchased under the contract – "Section B" items – for which the price was to be determined by reference to a specified percentage discount off the manufacturer's list price for each of 16 categories of supplies. During the course of the contract, Office Depot unilaterally created a third, contractually-unauthorized structure for pricing a large number of items purchased by the City. These items – which constitute half of the City's total purchases under the contract – were entitled to the average weighted discount of 70% for Section B items. But Office Depot billed the City for these miscategorized items at an average of only a 46% discount. Office Depot responded to the draft audit report by asserting that it "understood that the Contract permitted the sale of items that were not part of the Contract" and "thus, Office Depot was entitled to determine a price for these items." However, both the contract and correspondence between Office Depot and the City's Office of Contract Administration firmly establish that the parties did not intend that the contract would permit such a practice. Section 21.b of the contract states that the City and its employees and officers are not authorized to request Office Depot to provide materials that are beyond the scope agreed upon in the contract unless the agreement is amended in writing, and further provides that the City is not required to reimburse the Contractor for supplies which are beyond the scope agreed upon in the contract. Contemporaneous correspondence from Office Depot representatives to the Office of Contract Administration states the parties' understanding that the on-line ordering website established by Office Depot under the contract would include only Section A and Section B items available under the contract, and that non-contract items would be purchased separately pursuant to the Office of Contract Administration's purchase order guidelines.

Letter to Stephen Calkins
General Counsel
Page 2
December 21, 2009

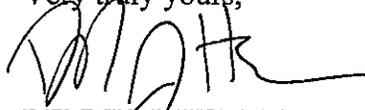
In addition, Office Depot has overcharged the City by at least \$1.3 million for Section B items by imposing an improper and undisclosed price floor that had the effect of reducing the percentage discount required by the contract. Beginning in February 2007, without notifying the City, Office Depot began imposing price floors on the items entitled to discounts of at least 70%. The City first learned of the price floors in mid-2008 when Office Depot cited them in its response to an informal audit of the City's Office Depot contract by one of Office Depot's competitors. Office Depot's response to that competitor's audit spurred the Controller and the Office of Contract Administration to initiate the audit that was released on December 18, 2009. Office Depot did not include price floors in its bid for the contract in 2004. If it had done so, the Office of Contract Administration would have taken the price floors into account when determining the low bidder for the contract, and it is possible that Office Depot would not have qualified as the low bidder and been awarded the contract. Moreover, the contract provides that imposition of "a 'floor' above cost after [bid] submittal will automatically disqualify the vendor from an award or accordingly be subject to immediate termination of the contract." Office Depot has failed to provide data to the auditors showing that the floors it imposed were not above cost.

The Controller's audit finds that Office Depot breached the contract in other ways as well, including increasing prices without proper notification to the City as required by the contract, charging higher prices for Section A items than were authorized by the contract, and failing to ensure that Section A items or acceptable alternatives remained available for purchase at Section A prices during the term of the contract. Further, the audit's figure of \$5.75 million does not include overcharges that occurred during August 1, 2009 through November 30, 2009, as the auditors did not have data for the City's purchases during these final 4 months of the contract.

Moreover, the City has incurred the cost of conducting a detailed audit of the tens of thousands of purchases made under the contract. Any resolution of this matter must include compensation to the City for the costs of the audit, and for attorney's fees, as well as full reimbursement for price overcharges, with interest. My office has asked the Controller to provide a statement of costs of the audit. I will notify you of this figure, as well as the total attorney's fees incurred to date, in a future letter.

If the City is unable to obtain a satisfactory informal resolution of this matter, I will not hesitate to pursue the matter in court. Further, if court action becomes necessary, rest assured that my office will vigorously pursue the City's claims to the fullest, including seeking civil penalties and debarment, if appropriate.

Very truly yours,



DENNIS J. HERRERA
City Attorney

Encl:

cc: Heather Stern (by first class mail & e-mail: Heather.Stern@officedepot.com)
(with enclosure)
Ben Rosenfield, Controller (without enclosure)
Bill Jones, Assistant Director of Purchasing (without enclosure)