



CITY AUDIT

OFFICE DEPOT PRICING AUDIT

October 8, 2009

INTRODUCTION

In May 2009, City Audit began an audit of City of Clearwater office supply purchases from Office Depot (OD), after hearing allegations of apparent pricing discrepancies specifically that customers were not getting the proper discounts for all purchases made under an existing purchasing agreement, the U.S. Communities Contract. Audit analyzed purchases made from March 30th, 2006 through March 30th, 2009. During this period, The City of Clearwater “piggybacked” onto a nationwide office products program known as the U.S. Communities Contract for Office and Classroom Supplies, awarded most recently (January of 2006), by the County of Los Angeles, CA (lead public agency) to OD.

Audit reviewed data provided electronically by OD via excel (spreadsheet) Usage Reports. The report received in late July 2009 contained some 23,533 individual line entries. The data consists of line-item spend information, including item #'s, and time-relevant cost information (Option 1, Option 2 and Manufacturer's List Price).

OVERVIEW OF ANALYSIS

Audit analyzed the usage reports received from Office Depot detailing the City of Clearwater's purchases from March 30, 2006 until March 30, 2009.

Additional columns were added to the spreadsheet for the purpose of analysis. They are identified clearly with Bright Yellow Headers (whereas data provided by Office Depot is in columns painted with Black headers). It is critical to note that all information is in its original format (as supplied by Office Depot) except for the previously described columns and a few individually identified cells (also painted bright yellow) that required modification because of incomplete data. Credits/returns comprise the majority of the missing data. They appear in the report in two basic ways: either with a negative number or with an actual zero in the quantity field. Mathematical errors created by using a zero have been corrected and each time painted in bright yellow. Less than 10 true pricing adjustment entries were noted, those items were left with a zero in the quantity field and a notation made in the comments column.

The report observations are subsequently detailed in the following sections:

- A. Cost of the “switch” to Option 2 Pricing vs. what Clearwater would have paid by remaining on the Option 1 Pricing.

- B. Cost of wholesaler pricing applied to some Office Depot, Private Branded items.

- C. Cost of not receiving “Most Favored Public Entity Pricing” vs. the Core items on the State of California Contract.

- D. Cost of not receiving “Most Favored Public Entity Pricing” vs. the City of Berkeley, CA Contract.
- E. Cost of not receiving overall “Most Favored Public Entity Pricing”, vs. Both the City of Berkeley & State of California pricing that should have been applied.

BACKGROUND

Office Depot has been the exclusive contract holder for the LA County/US Communities contract since the initial award in 1996. Los Angeles County, upon completion of the 2005 bid process, recommended selection of the Office Depot as the awarded vendor for Office and Classroom Supplies for US Communities.

In January, 2006, coinciding with the beginning of their third term as contract holder, Office Depot introduced a “new”, second pricing option (Option 2) as an alternative to the “usual” discount off list price format (frequently referred to as either Option 1 or List Less 45% Pricing). This 2nd option became known as Option 2 or Web Less 10% pricing. Option 1 and Option 2 programs both included an identical Core item List of approximately 500 items that received the same fixed prices. In January and July of each year, after the approval of the US Communities Lead Agency (the County of Los Angeles), Core item prices are allowed to be changed and item numbers may be modified if needed.

Option 2 pricing has come under great scrutiny over the past year. Was it a tool for saving customers money or was it a tool for increasing Office Depot profits? On the OD.com Investor’s webpage (FAQ’s for BSD Contract Customers regarding Government contracts) appears the following statement: *“Option 2 pricing was originally created based on customer requests for a price plan tied to web prices and the prices paid by customers under both Option 1 and Option 2 price plans were in compliance with the terms of the US Communities program.”*

In an October 23, 2008, memo sent by David Trudnowski (Senior VP, OD) to Joe Sandoval (Acting General Manager, LA County Purchasing), the City of Clearwater was included in a listing of some 250 agencies participating in the Option 2 program. In the memo, Office Depot affirmed to Los Angeles County (the Master Agreement holder) that each of the agencies had been contacted with regard to Option 2 pricing. Furthermore, they affirmed that each agency had opted to remain on Option 2 pricing and that each agency had signed an acknowledgement indicating they had been provided a cost comparison. The City of Clearwater has no documentation or recollection of such a meeting (documented by Office Depot as having taken place on May 6, 2008) and Office Depot has been unable (as with other agencies, i.e. City of Pembroke Pines, FL) to provide said documentation to the City of Clearwater. It clearly appears that Clearwater like other cities was placed in a different, costlier pricing program (Option 2) without our knowledge.

As of March 30, 2009, the option 2 program was abandoned by Office Depot. Again, from the investor’s webpage cited above: *“Under the new fixed pricing plan, all customers are on the same pricing plan. The new simplified pricing structure enhances the simplicity and transparency of the contract, while strengthening the US Communities program and maintaining the pricing intent of the original contract.”*

Additionally, in August 2009, Office Depot decided to stop displaying the Manufacturer List Price for items on the BSD (Business Solutions Division) Website (the one used by all US Communities customers, as well as countless other public and private commercial/contract clients). This will make it nearly impossible for the average customer to know whether they are

selecting an item that is deeply discounted, or one of the 16,000+ items that appear on-line with discounts of 10% or less.

OBSERVATIONS

Section A:

Cost of the “switch” to Option 2 Pricing vs. what Clearwater would have paid by remaining on the Option 1 Pricing.

With no verification that Clearwater requested nor approved the pricing change, the Usage Reports show only one item billed on 3/30/2006 using contract # 7200000-310 (Option 2).

Following that initial entry, an additional 620 items were billed between 3/30/06 and 4/25/06 using contract # 7060000-199 (Option 1).

All billings after 4/25/06 show either contract # 7200000-310 (Option 2) program billing or contract # 51712 (core items) or contract # 51717 (Paper Products). The latter two are common to both programs as per the terms of the agreement and appear throughout the usage report.

The Summary for Spreadsheet #1 – Workbook entitled: “Detail Usage “contains the amount of the overcharges that resulted from this unauthorized “switch”. Office Depot, when they submitted their Usage Report, determined that the “switch” from Option 1 to Option 2 resulted in an overcharge to Clearwater of \$53,754.79.

When adjustments for credits are considered, the analysis shows that the overcharge to the City of Clearwater resulting from the “switch” in pricing programs is actually \$54,249.35. This equates to an overbilling of 10% on non-core items.

This is not however, the total amount of the cost of the “switch”.

Section B

Cost of wholesaler pricing being applied to some Office Depot, Private Branded items.

The U.S. Communities Contract allows for a discount of 10% off Manufacturer List Price when an item is sourced through a wholesale catalog. There are only two viable, nationwide, office products wholesalers in this industry: United Stationers and SP Richards Company. Manufacturer List Price is a price set by the manufacturer of an item (i.e. Hewlett Packard, 3M, Avery, etc.) as a suggested or reference retail price. In today's competitive climate, merchandise is hardly ever sold at that price and customers receive significant discounts off this price. It can be called by a variety of names: Net Prices, Contract Prices or Core items being among the most popular.

Office Depot has control of the manufacturing, marketing, and distribution of their Private Brands. Office Depot Private Branded items are also marketed under the following trademarks: Office Depot, Office Depot Basics, Office Depot Green, Ativa, Foray, Real Space, Real Space-to-go, etc. These items are NEVER warehoused or sold by either wholesaler. It is NOT possible to find them in their picture catalogs, nor can they be found on their public websites: United, www.biggestbook.com or SP Richards, www.iteminfo.com .

Therefore, the above brands can NEVER be priced at the Wholesaler Discount of List Less 10%. As already stated, Office Depot, as manufacturer & sole distributor, has TOTAL control over these Private Branded items. These items therefore must ALWAYS be priced at a minimum discount level of List Less 45%.

The included spreadsheets are presented consistently. Office Depot Private Branded items have been carefully identified from either the Office Depot website or their printed materials. The item # (Sku) and description rows are clearly shown in RED type.

Spreadsheet #1 (Workbook # IV – entitled: “Depot Brand@Wholesale”)

Office Depot private brands which were labeled “wholesale” were only given a 10% discount, and being an Office Depot branded item, they simply cannot be labeled as “Wholesale”. These items should have been given the 45% discount. The result is an overcharge of \$4,674.74. This is over and above the overcharge resulting from the “switch” as outlined in Section A.

Section C, D, & E:

Background :

When an agency elects to “piggyback” onto the U.S. Communities contract, they do so without actually going through a bid process of their own. Instead they elect to enjoin themselves to a nationwide, “guaranteed” best price program. Indeed it is that guarantee that allows them comfort in their decision that they are spending their taxpayer’s money wisely and obtaining maximum value for their purchasing dollar.

The **Cover Page of the Term Contract Award** by the County of Los Angeles accepts Office Depot’s “offer to furnish (their) requirements (and such requirements as may be ordered by cities and/or districts indicated herein) of the listed commodity (Office and Classroom Supplies)...as needed subject to conditions of the stated quotation and as provided herein”. This letter was executed on 11-29-05, by Payton Price, representing Los Angeles County, as well as Robert Cetina, representing Office Depot. Of additional significance is that the cover letter itself was stamped, signed and dated (also on 11/29/05): **“Reviewed and approved as to form and legality by: Office Depot Legal Department”**.

Contained within this cover page is a paragraph entitled **“Price Guarantee”**. It states:...**“In the event of a price decline or should you (Office Depot) at any time during the life of this agreement sell the same material or service under similar quantity and delivery conditions to the State of California, or legal district thereof, or to any county or Municipality within the State of California at prices below those stated herein, you will immediately extend such lower prices to the County of Los Angeles.”**

Master Agreement # 42595 by and between the County of Los Angeles and Office Depot for Office and Classroom Supplies, clearly outlines what is expected of both parties. The issue of “best price” was important enough that it was addressed again in this second document in its own stand-alone paragraph:

Section 23.0 MOST FAVORED PUBLIC ENTITY

“VENDOR represents that the price(s) charged to (the) COUNTY in this Agreement do not exceed existing selling prices to other customers for the same or substantially similar items or services for comparable quantities under similar terms and conditions.

If VENDOR’S prices decline, or should VENDOR, at any time during the term of this Master Agreement, provide the same goods and services under similar quantity and delivery conditions to the State of California or any county, municipality or district of the State at prices below those set forth in the Master Agreement, then such lower prices shall be immediately extended to COUNTY.”

On December 28, 2006,(nearly a month later), the same Robert Cetina, VP Government & Education Services for Office Depot, executed **Attachment H**, a US Communities vendor document outlining the three commitments *expected* of each supplier. In so doing he agreed on behalf of Office Depot to the following terms:

1. *Corporate Commitment* - that US Communities has the support of vendor's senior management...
2. *Sales Commitment* – that vendor will aggressively market the US Communities program
3. *Pricing Commitment* – **“A commitment that supplier’s US Communities pricing is the lowest available pricing (net to buyer) to state and local public agencies nationwide and a further commitment that, if a state or local public agency is otherwise eligible for lower pricing through a federal, state, regional or local contract, the supplier will match the pricing under US Communities.”**

At some time since the initial award, US Communities added a 4th commitment expected of their suppliers, which is now posted prominently on its website:

4. ***Economy Commitment*** – *“A Commitment that the supplier shall demonstrate the pricing **advantage of U.S. Communities over the alternative competitive solicitation pricing** and shall proactively offer the pricing, terms and conditions of the U.S. Communities contract as a more effective alternative to the cost and time associated with such alternate bids and solicitations.”*

It should be perfectly clear that U.S. Communities is contractually seeking to provide the BEST PUBLIC SECTOR PRICE to its members. Office Depot represents to current and potential customers that the U.S. Communities Pricing is the lowest government pricing that they offer nationwide. It is this representation that is of primary importance to customers and potential customers seeking a guarantee that they are in fact receiving Office Depot's best government pricing. The public employee should be able to rely on this commitment.

Section C:

Cost of not receiving “Most Favored Public Entity Pricing” vs. the Core Items on the State of California Contract.

The State of California went out to bid in early 2006 for a strategically-sourced statewide contract for office products. The two-year contract (with three, 1 year options) was awarded to Office Depot effective 8-31-06.

The State of California contract ran on its own “year”. In order to compare Core item Prices between the State of California and the US Communities Contract, three BSD division catalogs were used:

The first catalog, BSD13 (8-06 to 8-07) was submitted with the bid and used during the first contract year.

The second catalog, BSD15 (8-07 to 8-08) was used during the second contract year.

The third catalog, BSD16 (8-08 to 8-09) was used during the extension period.

As the items in these BSD catalogs were changed by Office Depot, some Core item numbers were replaced, others were updated. We carefully crosschecked each individual Core list, noting relevant effective dates in order to create the consolidated list found in the spreadsheets below. See: [Spreadsheet #5 – California CORE List – BSD-13 - BSD15 - BSD16](#)

Spreadsheet #2

City of Clearwater matches to California Core Prices

3382 lines out of a total of 23530+ lines (or 14.3%) “matched “ to items found on the State of California Office Depot, Statewide Contract Core list.

On the 3382 lines -	Spend on Option 2 would have been:	\$125,201.30
	Spend at State of CA prices would have been:	\$ 79,389.27

For the same exact items, matching SKU # to SKU #, the State of California Core Item pricing was \$45,812.03 or 36.5% less than the prices actually charged by Office Depot to the City of Clearwater.

Section D:

Cost of not receiving “Most Favored Public Entity Pricing” vs. the City of Berkley, CA Contract.

In the spring of 2006, the City of Berkeley issued an RFP for a 3-year contract to supply 100% Processed Chlorine Free Copy Paper and Office Supplies. It also outlined the possibility of 2 additional one-year extensions. The contract was awarded to Office Depot, effective 7-1-06.

The City of Berkeley’s contract with Office Depot is actually quite simple: a very short Core list (133 items) and a 55% discount on everything else. There was no floor mentioned in any of the bid or contract documents. While this discount level has been portrayed by Office Depot as “alleged” after examination and audit by City of Berkeley staff, Office Depot presented the City of Berkeley with a refund in the amount of \$289,000...upholding the discount as specified in its bid documents. Copies of relevant pages of that proposal are included with this presentation. Additionally, effective 7-1-09, the City of Berkeley exercised and Office Depot accepted their first option year (09-10). This also comes after the \$289,000 had been received. The documents and the actions of Office Depot don’t leave any doubt as to what the City of Berkeley program is.

There is virtually a 100% match between the City of Clearwater’s usage and the City of Berkeley’s contract.

On the 23,530+ lines-	Spend on Option 2 was:	\$871,883.77
	Spend at City of Berkeley prices would have been	\$798,492.82

For the same exact items, matching SKU # to SKU #, the City of Berkeley pricing was \$73,390.95 or 8.4% less than the prices actually charged by Office Depot to the City of Clearwater.

Section E:

Cost of not receiving overall “Most Favored Public Entity Pricing” vs. BOTH the City of Berkeley & State of California pricing that should have been applied. Here we will combine both price lists to determine the best price that the City of Clearwater should have received.

In the final analysis, there is no argument that the thrice-stated intent of the US Communities contract is to provide its users the absolute best government pricing. It’s included on the Cover letter of the Los Angeles County Term Contract Award, signed by an Office Depot Vice President, and endorsed by the Office Depot Legal Department.

It’s included again as a part of Section 23.0 of the Master Agreement attached to the Term Contract Award. It is specific about the “same goods and services” (office supplies: we have specifically compared only the exact same items, using matching Office Depot stock numbers). It calls for “similar quantity and delivery conditions” (statewide or nationwide...Office Depot has delivery facilities located all over the country providing the items to support its BSD catalog and inventory). More importantly, it stipulates that “if the VENDOR’S prices decline or if VENDOR provides the items above to the State of California, or any county, municipality (Berkeley) or district of the State at prices BELOW those set forth in the Master Agreement, then such lower prices shall be immediately extended to (Los Angeles) COUNTY.

THEN...it’s included again in another paragraph of Attachment H, a vendor agreement signed by the same Office Depot VP. This time it states, “...that the supplier’s of US Communities pricing is the lowest available pricing (net to buyer) to state and local public agencies nationwide and a further commitment that, if a state or local public agency is otherwise eligible for lower pricing through a federal state, regional or local contract, that the supplier will match the pricing under the US Communities.”

This information seems very clear in its intent – best government price...Period.

In order to determine the best price, we merged the pricing extended by Office Depot to the City of Berkeley with the pricing extended by Office Depot to the State of California Core Items. Prices from both of these programs contractually should have been extended (per all the above to US Communities documents) to the City of Clearwater and All other US Communities participants. The resulting overcharges to the City of Clearwater are as follows:

On the 23,530+ lines -	Spend on Option 2 was:	\$871,792.77
	Spend at State of CA/City of Berkeley merged prices would have been:	\$764,385.82

For the same exact items, matching SKU# to SKU#, the merged City of Berkeley Pricing/State of California Core List Pricing was \$107,406.95 or 12.3% Less than the prices actually charged by Office Depot to the City of Clearwater.

Conclusion:

The City of Clearwater is seeking the following damages in repayment from Office Depot:

\$ 54,249.35 for the “switched” pricing from Option 1 to Option 2
\$ 4,674.74 for the miss-categorized as a wholesaler/Office Depot Private Branded Items
\$107,406.95 for the violation of the Most Favored Government Pricing clause (s) of the US Communities contract.

Total: \$ 166,331.04

Reasons why the City of Clearwater is seeking repayment in the amount of \$166,331.04:

All three of these contracts (US Communities, State of California and the City of Berkeley) were negotiated within the same time frame. US Communities was first, and was written with three pricing guarantee clauses to insure that it would remain the best priced government program. The US Communities/Office Depot Pricing Guarantee assures participating agencies that if any time better pricing on office or classroom supply items is offered to any non-US Community government agency, then that pricing will be immediately incorporated into the US Communities/Office Depot pricing.

Office Depot’s legal department knew of this clause in the US Communities contract and should have taken steps to make sure it was followed.

ALL three of the contracts occurred in California. ALL three of the contracts were approved by Office Depot Sales Management, even the Berkeley proposal was signed off by a Regional Sales Director.

Public entities nationwide rely on this pricing integrity. Taxpayers expect that public officials are keeping an eye on government expenditures (taxpayer money). The pricing guarantee was outlined three times – that should serve notice to Office Depot that this is a critical element of their relationship with these customers.

In light of all that has been presented herein we respectfully request reimbursement of the full amount due to the City of Clearwater no later than 30 days from the day that you receive this request.

Respectfully Submitted,

Robin I. Gomez

**Robin I. Gomez,
City Auditor**

**Karen Cunkle,
Senior Auditor**