



STATE OF NORTH CAROLINA
Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

June 19, 2007

Dr. Patricia A. Sullivan, Chancellor
University of North Carolina at Greensboro
303 Mossman Building
Greensboro, North Carolina 27402-6170

Dear Dr. Sullivan:

We received a complaint through the State Auditor's Hotline concerning the process for selecting a contractor for the guaranteed energy savings performance contract at the University of North Carolina at Greensboro (University). Allegedly, the Associate Vice Chancellor for Facilities violated bidding procedures to award the contract to a preferred vendor. We have completed an investigation of this matter and are presenting the following findings and recommendations for your review and written response.

North Carolina General Statute § 143-64.17 authorizes state agencies to use guaranteed energy savings contracts to reduce the State's utility costs. Guaranteed energy savings performance contracts provide energy savings through building renovations and upgrades with costs of the project being recovered through energy cost savings over a 12-year period. The project for energy-related capital improvements is financed at no net cost to the agency. The agency contracts with an energy service company (ESCO) which guarantees savings will be achieved to cover all project costs.

With guidance from the North Carolina Department of Administration's State Energy Office, the University became the first state university in North Carolina to participate in this program. In compliance with North Carolina General Statute § 143-64.17A(a), the University posted a request for proposal (RFP) on October 13, 2004 with bids accepted from the 14 ESCO's that were pre-certified by the State Energy Office. The University received a sealed "Preliminary Technical and Cost Proposal" from eight interested companies on December 9, 2004.

Violation of Request for Proposals Conditions

The University formed a committee to evaluate the proposals and perform reference checks on the bidding ESCO's. This committee included employees from the Facilities Department as well as representatives from each of the four buildings to be upgraded. In addition, representatives from the State Energy Office and the University of North Carolina General Administration attended evaluation team meetings to observe the process and provide advice.

Dr. Patricia A. Sullivan, Chancellor
Page 2
June 19, 2007

Section I-6(5) of the RFP stipulated the University would “select (shortlist) up to three (3) of the ESCO’s on the basis of rankings of the written proposal and the client references.” On January 27, 2005, the evaluation committee selected three companies to move forward to the oral interview process. Six of the seven committee members voted for their top three companies with the Associate Vice Chancellor for Facilities abstaining. Noresco received five votes, Ameresco, Inc. tallied four votes, and Sempra Energy Solutions garnered three votes to continue in the selection process.

On the following day, the University’s Energy Engineer, who was the primary contact for this contract, sent a letter to all eight companies notifying them of the three companies selected for the oral interviews. On January 31, 2005, the Associate Vice Chancellor contacted the Energy Engineer by telephone and left a voicemail message to request that Trane Comfort Solutions, Inc. (Trane) be added to the shortlist for oral interviews “for very obvious reasons.” During a meeting the next day, the Associate Vice Chancellor informed the Energy Engineer to increase the shortlist to five companies by adding Trane and Alliant Energy/Cogenex since each received two votes from the committee. The Energy Engineer sent a letter to the five companies on February 4, 2005 informing them of the expanded shortlist at the request of the Associate Vice Chancellor.

The three ESCO’s originally selected responded with letters questioning this expansion, the fairness of the evaluation process, and the potential violation of the RFP. While acknowledging the RFP condition allowing “up to three” finalists, the University’s legal counsel concluded “we do not believe the addition of two other companies to be interviewed constitutes a material deviation sufficient to bring the process into question.” The legal counsel disputed the additions provided any company an “unfair advantage.”

The Associate Vice Chancellor said he wanted Trane added to the shortlist because he believed they presented one of the best proposals and he questioned the ability of the building representatives on the committee to evaluate the technical proposals. However, our review indicated the only two committee members to select Trane for the shortlist were building representatives while Facilities Department personnel selected the three companies that originally comprised the shortlist.

The RFP for this contract clearly indicated the shortlist should only include “up to three” companies. The Associate Vice Chancellor for Facilities circumvented this requirement by adding two companies to the shortlist thereby violating the terms and conditions of the RFP and undermining the integrity of the selection process.

Conflict of Interest / Personal Relationship with Vendor

The five remaining companies gave oral presentations on March 3, 2005. Afterwards, the evaluation committee discussed the results. By secret ballot, the eight representatives (two additional Facilities Department personnel were added to the committee) voted to select Noresco with five votes while Trane received three votes. Based on that vote, the committee members believed Noresco would be presented to the University's Board of Trustees for approval on April 7, 2005 and an action item was sent to the Trustees requesting that Noresco be approved to proceed.

However, the Associate Vice Chancellor requested another evaluation committee meeting to discuss the decision and, according to an e-mail from the Physical Plant Director, "to try to convince us to use Trane." The committee reconvened on April 4, 2005. The Associate Vice Chancellor told the committee he contacted the North Carolina Department of Administration, State Construction Office who recommended the North Carolina Office of State Budget and Management (State Budget) review the proposals from a financial perspective. Representatives from those two offices confirmed the request.

The Associate Vice Chancellor said State Budget recommended Trane and that the University's Chancellor supported that recommendation. This recommendation was not voted upon by the evaluation committee but they accepted the decision made solely by the Associate Vice Chancellor. The Associate Vice Chancellor said he followed State Budget's recommendation due to financial considerations only because Trane had submitted a good proposal and the committee vote was close. However, in our interviews, all committee members indicated financial information was only one factor of many to be considered. In addition, the State Energy Office prepared a guide which specifically stated "project cost is not the **only** criteria"¹ and the RFP lists 11 items as part of the evaluation criteria.

The State Budget Office representative who prepared the financial analysis disputed the contention that he recommended only Trane as the best financial value. Rather, he said the analysis only indicated Trane provided the "best value" financially using interest rates provided by each ESCO while Alliant Energy/Cogenex provided the "best value" financially using interest rates provided by the North Carolina Department of State Treasurer. The State Budget Office representative said he did not recommend the selection of *any* company and that his analysis only focused on financial aspects without considering the technical abilities of the companies. After approval by the University's Board of Trustees, the University presented Trane as the winning bidder to the University of North Carolina's Board of Governors for final approval on May 12, 2005.

¹ "Evaluating RFP Responses for Performance Contracting"

Other committee members said the Associate Vice Chancellor told committee members he was only attending meetings to observe and was not a voting member. The Associate Vice Chancellor told us he did not vote on the original proposals to shortlist to three companies because he had missed a prior committee meeting at which the proposals were discussed. However, he voted after the oral interviews for the final selection. In addition, he inserted himself into the process by requesting the addition of two companies to the shortlist and by making the final recommendation to select Trane based upon the State Budget Office financial analysis.

We learned the Associate Vice Chancellor for Facilities is a personal friend of the owner of the local Trane authorized company which was selected as the guaranteed energy savings performance contract vendor. Several committee members were aware of the relationship and mentioned the relationship as a potential reason for the addition of Trane to the shortlist and the change of the final selection from Noresco to Trane. The Associate Vice Chancellor told us he has been a friend of the local Trane owner for years, is a fellow member of the local Rotary Club, and has breakfast with the owner on a periodic basis.

The University adopted a conflict of interest policy in November 1993. The policy notes that a conflict of interest may arise when “personal considerations may compromise, or have the appearance of compromising, an employee’s professional objectivity in meeting University duties or responsibilities.” Further, the policy requires “employees must avoid conflicts of interest that have the potential...to compromise objectivity in carrying out University responsibilities.” However, the University’s policy does not directly address potential conflicts based on personal friendship; rather, only immediate family relationships are specified in the policy.

In view of the violation of the RFP terms and conditions to add Trane (along with another company) to the shortlist and the personal friendship between the Associate Vice Chancellor and the local Trane owner, we believe overriding the evaluation committee’s recommendations for the ESCO to perform the project created, at a minimum, the appearance of a conflict of interest.

Recommendations

University management should consider appropriate disciplinary action in response to the above findings concerning the Associate Vice Chancellor for Facilities. In addition, the University should establish standardized procedures for the awarding of all capital projects including guaranteed energy savings performance contracts. These procedures should explicitly designate how an evaluation committee should be formed, the process for evaluating proposals, and the final selection of the contractor. Further, the University should revise its conflict of interest policy to specify when personal friendships may create an actual or perceived conflict of interest.

Dr. Patricia A. Sullivan, Chancellor
Page 5
June 19, 2007

Please provide your written response to these findings and recommendations, including corrective actions taken or planned, by July 3, 2007. In accordance with General Statute § 147-64.6(c)(12), the Governor, the Attorney General, and other appropriate officials will receive a copy of this management letter. If you have any questions or wish to discuss this matter further, please contact us. We appreciate the cooperation received from the employees of the University of North Carolina at Greensboro during our review.

Sincerely,

A handwritten signature in black ink that reads "Leslie W. Merritt, Jr." in a cursive script.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

Management letters and responses receive the same distribution as audit reports.



THE UNIVERSITY *of* NORTH CAROLINA
GREENSBORO

Chancellor's Office

303 Mossman Building
PO Box 26170, Greensboro, NC 27402-6170
336.334.5266 *Phone* 336.256.0408 *Fax*

June 28, 2007

Mr. Leslie W. Merritt, Jr.
State Auditor
20601 Mail Service Center
Raleigh, NC 27699

Dear Mr. Merritt:

I am in receipt of your letter dated June 19, 2007 regarding the process the University undertook to hire an Energy Services Company (ESCO) and offer this response. There were four primary reasons why the University selected Trane Comfort Solutions, Inc. (Trane) to do this work:

1. Of the five vendors who made presentations, only Northeast Energy Services Company, Inc. (Noresco) and Trane received any votes from the evaluation committee. UNCG management was prepared, and in fact had distributed preliminary meeting materials to our Board of Trustees, to recommend that UNCG hire Noresco to do this work. In the meantime, we received information independently calculated by the Office of State Budget and Management (OSBM) that Trane, of the two finalists, offered the best financial value to the University and the state's taxpayers. The recommendation was therefore changed just before the Board meeting to contract with Trane.
2. The Trane proposal not only provided the best financial value, but it also resulted in equipment upgrades for the University that the other proposals did not include.
3. At the time of the vendor selection, Trane was in the process of installing equipment at the North Carolina Museum of Art under a similar contractual arrangement. From our conversations with the State Construction Office at that time, that project appeared to be going well. Since that time, these improvements have proved to be a success.
4. Trane had a proven track record of reliability in both equipment and service.

Additionally, we respectfully disagree with your conclusion that increasing the number of companies to be interviewed violated the Request for Proposal (RFP) or undermined the integrity of the process.

First, nothing in the authorizing legislation, N.C.Gen.Stat. § 143-64.17, et seq., or the implementing regulations, 1 N.C.A.C., subchapter 41 B, required that the State limit the number of finalists to be interviewed. The limitation of "up to three" ESCOs that was indicated in Section I-6, paragraph 5 of the RFP was included solely for the convenience of the University.

Second, and most importantly, increasing the number of companies to be interviewed was not a "material deviation" from the bid process because it in no respect gave any individual bidder an

Mr. Leslie W. Merritt, Jr.

Page 2

June 28, 2007

advantage over the other finalists. Conversely, neither did it place any bidder at a disadvantage. The requirements of the RFP were the same for each finalist, regardless of the number of finalists to be interviewed. Although at least one bidder objected to the increase, none of the unsuccessful bidders ever indicated to us or provided any evidence to show that increasing the number of finalists put their company at a competitive disadvantage. The generally accepted legal test of materiality is whether the action taken places any bidder at an unfair advantage. 64 Am.Jur.2d *Public Works and Contracts* § 58 (2004). In short, we fail to comprehend how increasing the pool of qualified bidders to be interviewed can adversely affect any interest of the citizens of North Carolina.

Third, item I-10 of the Request for Proposal (RFP) allows the University to make amendments thereto. We wrote the five vendors under consideration to come to campus for an interview that five vendors would be interviewed, not three, which was indicated in the original RFP. We acknowledge, however, the University did not specifically state that letter was an amendment to the RFP.

We also note that when we were initially contacted by your office last fall concerning this matter, the contract with Trane Comfort Solutions, Inc. had not yet been executed. Your office advised the University that we should not delay the project based on your pending investigation and therefore the contract was subsequently signed.

Finally, we respectfully question your finding that a personal relationship between the Associate Vice Chancellor and the president of the local Trane services company tainted the process. As we have noted above, there is no evidence that any of the other bidders were better qualified than Trane. To the contrary, OSBM concluded that Trane's bid provided the best financial value for the State given the project's financing was not issued by the State Treasurer. Although we agree that financial value to the State's taxpayers was only one of several factors to be considered, it is one of the primary reasons for engaging in an energy savings contract, N.C.Gen.Stat. § 143-64.10, and, in the absence of evidence that Trane's bid was deficient in any other respect, it appropriately became one of the determinative factors in Trane's favor. We also note that the Associate Vice Chancellor had no decision making authority regarding the final selection, and there is no evidence that he personally benefited from the selection of Trane.

I hope this clarifies our rationale for the selection of Trane Comfort Solutions, Inc. to do this important work.

The University appreciates your recommendations. Our conflict of interest policy is based on that of the UNC Board of Governors. UNCG volunteered to be the first university to procure ESCO services. Having never done such a project, our normal selection process to select designers did not fit that of selecting an ESCO provider. We will expand that documented process to address methods of capital project delivery such as ESCO and Construction Manager at Risk.

Sincerely,



Patricia A. Sullivan
Chancellor

AUDITOR'S NOTE

In its response, the University provided no evidence to support its contention that adding companies to the shortlist did not violate the RFP. In addition, the University offers no justification as to why a letter to the other bidders constitutes an amendment to the RFP, yet acknowledges the letter was not identified as an amendment. Further, the RFP states that "an amendment will be issued to all Pre-Certified ESCO's" but the letter was only provided to the five companies selected for the oral interviews and not all 14 pre-certified companies.

Regarding the personal relationship, the University did not refute the existence of an appearance of conflict of interest. In addition, one need not personally benefit from a conflict of interest. Instead, a conflict of interest may exist when a related party derives a benefit or, as the University's own conflict of interest policy states, when "personal considerations may compromise, or have the appearance of compromising, an employee's professional objectivity."

While it is technically true that "the Associate Vice Chancellor had no decision making authority regarding the final selection," he made the final recommendation to the Board of Trustees for approval and was personally responsible for adding Trane to the shortlist, contacting the State Construction Office due to his concerns that Trane was not selected, and presenting Trane as the "best financial value" in an effort to convince the committee to ultimately select Trane. Such assertions and actions by the Associate Vice Chancellor would reasonably be considered a substantial influence on the committee. These repeated actions suggest that Trane was the Associate Vice Chancellor's preferred vendor from the outset and some committee members expressed such a concern to us.

Further, we believe the financial analysis performed by the State Budget Office was mischaracterized by the Associate Vice Chancellor and by the University in its response. Again, the State Budget Office did not recommend any single company but rather provided a financial analysis based upon two separate scenarios without any consideration of the technical ability of any company.

Our primary concern was the process used by the University to select the vendor for the guaranteed energy savings performance contract. We did not question Trane's ability to adequately perform the project and that ability is immaterial to our concerns. Rather, we believe Trane was a preferred vendor that was reinserted into the process twice by the Associate Vice Chancellor after elimination by the evaluation committee. It appears the Associate Vice Chancellor pre-selected Trane and did so notwithstanding the contrary recommendations of the evaluation committee.