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# PURGING CORRUPTION FROM PUBLIC CONTRACTING: THE "SOLUTIONS" ARE NOW PART OF THE PROBLEM

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## I. INTRODUCTION

New York City is one of the biggest contracting entities in the world. Each year City agencies enter into approximately 40,000 contracts worth almost \$6.5 billion, about one-fourth of the total City budget.<sup>1</sup> These contracts cover everything from pencils to legal services for indigent criminal defendants, from methadone treatment to architectural consultants, from external auditing to massive public works projects.<sup>2</sup> Awarding and monitoring these contracts is one of city government's great responsibilities.

The whole public contracting process, its law and administration, is significantly affected by the goal of preventing corruption and, more recently, even the appearance of corruption.<sup>3</sup> Money can be easily siphoned from the government's coffers by *sweetheart contracts* involving kickbacks to officials.<sup>4</sup> Public officials can award contracts to firms in

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1. NEW YORK STATE COMM'N ON GOV'T INTEGRITY, *A Ship Without a Captain: The Contracting Process in New York City*, in GOVERNMENT ETHICS FOR THE 1990S, at 461, 465 (1990) [hereinafter *A Ship Without a Captain*].

2. See *A Ship Without a Captain*, *supra* note 1, at 461; see also Martin Gottlieb, *Money and Meters: A Window on City Contracts—A Special Report*, N.Y. TIMES, Jan. 31, 1991, at A1 (discussing, as an example of City contracting, the process by which a small Kentucky company came to be New York City's chief contractor for water meters).

3. See Bruce J. Bergman, *Public Contracts: Rejecting the Irresponsible Bidder, Part I*, N.Y. ST. B.J., July 1985, at 22 (examining New York State's competitive bidding laws and policies) [hereinafter Bergman I]; see also *infra* text accompanying notes 53 & 54.

4. See Michael Mecham, *'Ill Wind' Guilty Pleas Show Pattern of Basic Corruption*, AVIATION WEEK & SPACE TECH., Apr. 3, 1989, at 24 (discussing the United States Department of Justice fraud and bid-rigging case against several major defense contractors).

which they, their families, friends, or associates have a financial interest.<sup>5</sup> Over the years, layer upon layer of reforms have been added to the public contracting process in order to immunize it from taint of corruption.<sup>6</sup>

The dilemma is that in trying to corruption-proof public contracting, corruption controllers mire the process in red tape, undermining the government's capacity to carry out essential goals and, ironically, creating new opportunities for corruption and fraud.<sup>7</sup> In this Article, we will see how, over the years, anti-corruption mechanisms, including scrupulous neutrality in choosing contractors and multiple layers of investigation and accountability, have transformed the public contracting process into a labyrinth that jeopardizes governmental efficiency and flexibility.

We do not claim that there is an easy resolution of this tension. Clearly, however, the public contracting process must be thoroughly scrutinized for structures, rules, procedures, and practices that, while adopted for reasons of corruption control, may have long since proven ineffective and even counterproductive. Corruption control ought not to be the tail that wags the public administration dog.

Part II of this Article reviews the evolution in New York City of the preferred system of public contracting—competitive bidding and award to the lowest responsible bidder—and connects that history to the politics of scandal and reform and to the continuous aspiration of good government reformers to create a corruption-proof contracting system. Part III examines the extraordinary efforts of the contemporary Comptroller's Office to police the contracting system in order to deny contracts to "disreputable" business persons. Part IV shows how the School Construction Authority has taken the anti-corruption project to new heights in its design of a contracting system that will not only assure the integrity of its contractors but will also contribute to the attack on organized crime. Part V considers the impacts of the modern-day integrity-oriented public contracting system on public administration and whether governmental efficiency and effectiveness have been sacrificed. Finally, Part VI asks whether there is any way to determine whether the more integrity-oriented contracting system has been successful on its own terms, i.e. reducing corruption and organized-crime racketeering.

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5. See, e.g., Eric Schmitt, *Guilty Plea By Unisys Is Expected*, N.Y. TIMES, Sept. 6, 1991, at D1 (describing the bid-rigging and procurement fraud perpetrated by Unisys, a Federal government defense contractor).

6. See *A Ship Without a Captain*, *supra* note 1, at 465-69 (describing New York City's contracting procedures as a "crazy quilt of inconsistent policies and procedures").

7. See *id.* at 469-81 (examining several specific requirements of New York City's contracting system and concluding that it actually deters competition for contracts).

## II. COMPETITIVE BIDDING IN NEW YORK CITY

### A. *Early History*

Competitive bidding, the preferred method of letting contracts in New York and throughout the country, was adopted in the aftermath of a corruption scandal. The most notorious scandal in nineteenth-century New York City involved the award and administration of contracts for the construction of the New York County courthouse. In 1858, the County Board of Supervisors allocated \$250,000 for this project.<sup>8</sup> Four years later, Tammany Hall boss William Marcy Tweed and his supporters gained control of the Board.<sup>9</sup> By the time the courthouse was completed over a decade later, its cost had escalated to more than eight million dollars.<sup>10</sup> Boss Tweed and his cronies steered lucrative contracts to firms that gave them kickbacks or in which they had personal financial interests.<sup>11</sup> They allowed contractors to pad their bills in exchange for a percentage of the fraudulent overcharges.<sup>12</sup> It has been estimated that, from the courthouse alone, Tweed and his friends siphoned more than seven million dollars.<sup>13</sup>

In one of the bursts of reform fervor that punctuate New York City history, reformers in the 1870s threw out the Tweed ring and eventually sent Tweed to prison.<sup>14</sup> The new administration created the Office of the Commissioner of Accounts (OCA) (the precursor of today's Department of Investigation) and redesigned the contracting system so that City officials did not have unconstrained discretion in awarding contracts.<sup>15</sup>

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8. HAROLD SEIDMAN, *INVESTIGATING MUNICIPAL ADMINISTRATION* 11 (1941) (discussing the origins of political corruption in New York City, starting with Boss Tweed and his cronies at Tammany Hall, who are estimated to have cheated the City out of 50 million (19th Century!) dollars).

9. *See generally* ALEXANDER B. CALLOW JR., *THE TWEED RING* (1966) (recounting Boss Tweed's exploits in the New York County Courthouse scandal, calling it his masterpiece of graftsmanship).

10. SEIDMAN, *supra* note 8, at 11.

11. *See id.* at 11, 12; CALLOW, *supra* note 9.

12. *See* SEIDMAN, *supra* note 8; CALLOW, *supra* note 9.

13. SEIDMAN, *supra* note 8; *see* CALLOW, *supra* note 9, at 197. For further background on Boss Tweed and Tammany Hall, *see* ALFRED CONNABLE & EDWARD SILBERFARB, *TIGERS OF TAMMANY: NINE MEN WHO RAN NEW YORK* (1967); JEROME MUSHKAT, *TAMMANY: THE EVOLUTION OF A POLITICAL MACHINE, 1789-1865* (1971); GUSTAVUS MYERS, *THE HISTORY OF TAMMANY HALL* (1971).

14. SEIDMAN, *supra* note 8, at 12.

15. *Id.* at 13.

The reformers fought for the adoption of competitive bidding, whose roots in the federal system go back to the Revolutionary War.<sup>16</sup>

### B. *The Essentials of Competitive Bidding*

Competitive bidding, sometimes called the "lowest responsible bidding system," requires the government agency seeking to purchase goods or services to publicize its specifications and invite bids from anyone wishing to provide those goods or services.<sup>17</sup> Prospective contractors submit bids specifying their prices to perform the contract.<sup>18</sup> The bids are reviewed and the contract is awarded to the lowest responsible bidder.<sup>19</sup> In theory, a city using a competitive lowest responsible bidder system benefits from (1) lowest price, (2) prevention of official corruption, and (3) providing equal opportunities to all contractors.<sup>20</sup> One of the drumbeats of anti-corruption reformers has been that a higher percentage of contracts be awarded by this competitive bidding method.<sup>21</sup>

It is important to stress that competitive bidding awards contracts, not to the lowest bidder, but to the lowest *responsible* bidder.<sup>22</sup> Under statutes and case law, "responsible" has been interpreted to mean financially and technically capable of carrying out the terms of the contract.<sup>23</sup> Some New York courts, however, have upheld agency refusals to award a contract to a low bidder because the contractor, while

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16. See JAMES F. NAGLE, *FEDERAL PROCUREMENT REGULATIONS: POLICY, PRACTICE AND PROCEDURES* 12-13 (1987) (reviewing national procurement policies of the American colonies during the American Revolutionary War).

17. See N.Y. CITY CHARTER ch. 13, § 313(a)-(b)(1) (1994).

18. See *id.* § 313 (describing the competitive sealed bidding procedure).

19. *Id.* § 313(a).

20. See Bergman I, *supra* note 3 (discussing the requirement that bidders for public contracts be "responsible" and examining cases dealing with the issue); Bruce J. Bergman, *Public Contracts: Rejecting the Irresponsible Bidder, Part II*, N.Y. ST. B.J., Oct. 1985, at 43 [hereinafter Bergman II] (same); Bruce J. Bergman, *Reletting the Abandoned or Defaulted Public Works Project in New York—To Bid or Not to Bid?*, 3 FORDHAM URB. L.J. 451, 451-53 (1975) (noting that the New York courts have interpreted contracting laws as having the purposes of preventing corruption, favoritism and reckless expenditure).

21. See *A Ship Without a Captain*, *supra* note 1, at 484.

22. See N.Y. CITY CHARTER ch. 13, § 313.

23. See, e.g., *Picone v. City of New York*, 29 N.Y.S.2d 539, 541 (1941) ("That term [responsible] does not mean one who is only pecuniarily responsible but one who also possesses moral worth.").

technically and financially capable, was not morally responsible.<sup>24</sup> The courts have also held that, since there is no right to a public contract, agencies could declare would-be contractors non-responsible without a due process hearing.<sup>25</sup>

The competitive bidding system has become an article of faith in New York City and in other local, state, and federal governmental units despite frequent charges that it generates shoddy work, delay, fraud, and corruption.<sup>26</sup> Other types of procurement—emergency, sole source, and small purchase—are seen as suspect, especially by good government reformers and moral entrepreneurs.<sup>27</sup> Interestingly enough, many bureaucrats support the competitive bidding system,<sup>28</sup> perhaps because it shields them from accusations or insinuations of corruption.

### C. Scandal and Reform of Public Contracting in the 1980s

The 1986 New York City Parking Violations Bureau (PVB) scandals reinforced distrust of and opposition to non-competitively bid contracts.<sup>29</sup> The PVB used the sole-source exception to competitive bidding<sup>30</sup> to award sweetheart contracts for collecting parking fines to companies with connections to top PVB officials and Democratic Party bosses, Donald Manes and Stanley Friedman.<sup>31</sup> Even when competitive bids were sought by the PVB, the process was corruptly manipulated. The City's contract for hand-held computers was "fixed" for Citisource, the firm in which Stanley Friedman was the controlling shareholder.<sup>32</sup> Citisource played a hidden role in writing the City's specifications. Geoffrey Lindenauer, PVB deputy director and a Citisource shareholder, approved the contract

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24. *Id.*; see also Bergman I, *supra* note 3, at 22-24 (discussing court cases so holding); Bergman II, *supra* note 20, at 43-45 (same).

25. See, e.g., *Erving v. Mayor of New York*, 29 N.E. 1101 (N.Y. 1892). See generally Bergman I, *supra* note 3; Bergman II, *supra* note 20.

26. See *A Ship Without a Captain*, *supra* note 1, at 469-80 (describing in detail the problems caused by New York City's competitive bidding system).

27. See N.Y. CITY CHARTER ch. 13, § 315 (emergency procurement); § 321 (sole source procurement); § 322 (alternative procurement procedures) (1994); see also Bergman, *Reletting The Abandoned or Defaulted Public Works Project in New York—To Bid or Not to Bid?*, *supra* note 20, at 462-63.

28. See *A Ship Without a Captain*, *supra* note 1, at 480-81.

29. See JACK NEWFIELD & WAYNE BARRETT, *CITY FOR SALE 12-14* (1988) (recounting the Parking Violations Bureau scandal).

30. See N.Y. CITY CHARTER ch. 13, § 321.

31. NEWFIELD & BARRETT, *supra* note 29, at 12-14, 17.

32. *Id.* at 104.

specifications in a way that gave Citisource an enormous advantage.<sup>33</sup> Despite criticism of Citisource by the PVB's technical unit head, Lindenauer pushed the contract through.<sup>34</sup> Indeed, he fired the technical unit head and lied to PVB's contract selection committee, telling its members that he had visited the Citisource plant and seen the hand-held computers.<sup>35</sup> In reality, Citisource was a shell company created by Manes, Lindenauer and Friedman: it had no assets, no employees, no history of operations, and no hand-held computers.<sup>36</sup>

The media and reformers blasted the contracting process that permitted officials to bypass or manipulate the competitive bidding system.<sup>37</sup> The State Comptroller testified before the Charter Revision Commission that two billion dollars, or forty percent of all City contracts, is awarded absent competitive bidding, the basic safeguard of our public contracting. This figure represents nearly ten percent of the New York City budget. Comptroller Regan also said that no-bid contract awards were an activity which had been so poorly managed and so little controlled that they had become an open invitation to steal.<sup>38</sup>

A Koch administration official told us that aversion to non-competitive bidding became so strong after the PVB scandals that several public officials were fired for failing to use competitive bidding to award a barge contract (to house jail inmates) to a company with which the agency had a good long-term relationship.<sup>39</sup> When the corruption scandals erupted in 1986, the Charter Revision Commission, appointed several years earlier to redesign City government, was already well into its deliberations about the future structure of City government.<sup>40</sup> According to one of the

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33. *See id.* at 247.

34. *See id.* at 247-48.

35. *See id.* at 248-49.

36. *See id.* at 245.

37. *Id.* at 40-45. For a final note on the PVB scandal, see Robert D. McFadden, *\$1.4 Million in Restitution in Parking Bureau Scandal*, N.Y. TIMES, Nov. 18, 1995, at 27 (noting that the 385 investors in Citisource will receive restitution totalling \$1.39 million).

38. *See* N.Y. State Comptroller Edward V. Regan, statement delivered to the New York City Charter Revision Commission (Oct. 15, 1987).

39. Anonymous interview.

40. The New York City Charter has been revised several times since it was initially adopted in 1897. The Commission's goals, as set out by the State legislature, generally include the encouragement of citizen participation in local City government, the achievement of effective local self-government, and the assurance that local City government is responsive to the needs of its citizens. *See* NEW YORK CITY CHARTER REVISION COMM'N, FINAL REP. OF THE N. Y. CITY CHARTER REVISION COMM'N: JAN. 1989 - NOV. 1989 (1990).

principle drafters, the charter's new procurement system was shaped primarily in reaction to the corruption scandals.<sup>41</sup> The 1989 charter restricts the types of contracts (principally emergency) that can be awarded without competitive bids.<sup>42</sup> In an emergency, defined as "an unforeseen danger to life, safety, property or a necessary service," contracts may be let without competitive bidding.<sup>43</sup> The charter also excuses an agency from competitive bidding where it is "not practicable or not advantageous."<sup>44</sup> The agency head must submit a written explanation to the Procurement Policy Board<sup>45</sup> for approval.<sup>46</sup> Competitive bidding may also be avoided where there is only one source for the goods or services (a sole source contract)<sup>47</sup> or where the contract is for \$500 or less.<sup>48</sup> In all other cases, competitive bidding must be used and the contract let to the lowest responsible bidder.<sup>49</sup>

#### D. *Standards of Integrity for Responsible Bidders*

In order to be deemed responsible by a contract-letting agency, contractors must satisfy integrity standards. Moreover, the charter permits the Comptroller to object to the award of a contract and to an agency's designation of a particular contractor as responsible, "if in the Comptroller's judgment there is sufficient reason to believe that there is possible corruption . . . or that the proposed contractor is involved in corrupt activity."<sup>50</sup>

The 1989 charter revision established a Procurement Policy Board (PPB) and authorized it, for the first time in New York City history, to set City-wide contracting policy.<sup>51</sup> Within a year, the PPB issued several hundred pages of regulations covering every aspect of contracting.<sup>52</sup> The preamble to this comprehensive procurement code states that one of the underlying purposes of the rules is "to safeguard the integrity of the

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41. Anonymous interview.

42. See N.Y. CITY CHARTER ch. 13, § 312(a)(2) (1994).

43. *Id.* § 315.

44. *Id.* § 312(b)(2).

45. See *infra* notes 51-54 and accompanying text.

46. N.Y. CITY CHARTER ch. 13, § 312(a)(2) (1994).

47. *Id.* § 321.

48. *Id.* § 314.

49. *Id.* § 313(b)(2).

50. *Id.* § 328(c).

51. *Id.* § 311.

52. RULES OF THE CITY OF N.Y., vol. 4, tit. 9, §§ 1-01 to 15-07 (1994).



procurement system and protect against corruption, waste, fraud and abuse."<sup>53</sup> In a "Statement of Ethics Policy," the rules explain that:

City contracting personnel work under the constant scrutiny of their superiors, their peers, contractors and prospective contractors, the press and the public. Public employees responsible for the expenditure of billions of taxpayer dollars have a responsibility to ensure that their conduct will not violate the public trust placed in them. They must make certain that their conduct does not raise suspicion or give the appearance that they are in violation of their public trust. It is not too much to say that City contracting personnel must be above reproach. Their actions must be governed at all times by the highest standards of honesty, integrity and impartiality. Rules cannot address specifically every incident or situation which may arise. But certain fundamental rules and principles apply.<sup>54</sup>

The Statement of Ethics Policy sets forth cardinal rules to guide the conduct of public officials involved in procurement, including: (1) always encouraging competition, preventing and avoiding favoritism, and obtaining the best value for the City; (2) accepting no gifts, favors, or entertainment from contractors or prospective contractors, and placing the public interest above self-interest; (3) not using confidential information obtained in the performance of City duties; and (4) reporting corruption and unethical practices, wherever and whenever discovered, to the appropriate official.<sup>55</sup>

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53. *Id.* § 1-01(b)(8). The other stated goals are:

(1) to simplify, clarify, and modernize the law governing procurement by the City of New York; (2) to permit the continued development of procurement policies and practices; (3) to make as consistent as possible the uniform application of these policies throughout New York City agencies; (4) to provide for increased public confidence in New York City's procurement procedures; (5) to ensure the fair and equitable treatment of all persons who deal with the procurement system of the City of New York; (6) to provide for increased efficiency, economy and flexibility in City procurement activities and to maximize to the fullest extent the purchasing power of the City; (7) to foster effective broad-based competition from all segments of the vendor community, including small businesses, women and minority-owned and operated enterprises; (8) to ensure appropriate public access to contracting information; and (9) to foster equal employment opportunities in the policies and practices of contractors and subcontractors wishing to do business with the City.

*Id.* § 1-01(b)(1)-(10).

54. *Id.* § 1-01(c).

55. *Id.* § 1-01(c)(1)-(7).

E. *The VENDEX System for Monitoring the Character of Public Contractors*

The procurement code requires each agency's chief contracting officer and chief administrator to determine whether a contractor or vendor is financially, operationally, and morally responsible.<sup>56</sup> The burden of proof on the issue of responsibility falls on the contractor.<sup>57</sup> In order to be deemed responsible, a vendor must demonstrate a satisfactory record of business activity.<sup>58</sup> City officials have established a computerized database, Vendor Information Exchange System (VENDEX), to assist officials in determining whether the contractor is morally qualified to do business with the City.<sup>59</sup> Firms and their principals must complete an extensive VENDEX questionnaire (twenty-seven pages for business entities and thirteen pages for principals) about the business, its principals, its tax returns, and its history of government contracting.<sup>60</sup> Former executive director of the PPB, Constance Cushman, stated that "the burden in filling out these forms is so great it can discourage small or minority-owned contractors from bidding."<sup>61</sup> The questionnaire also contains such questions as:

Has this business or any subsidiary of this business, or any current or former directors, principals, officers, or managerial employees of this business, either before or during their employment:

- been formally debarred from being awarded a contract or been informed that it could not bid on a contract by any government agency?

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56. *Id.* § 5-02(a); *see* *Picone v. City of New York*, 29 N.Y.S.2d 539 (1941).

57. RULES OF THE CITY OF N.Y., vol 4, tit. 9, § 5-02(a)(2).

58. *See id.* § 5-02(b)(2)(v).

59. *See id.* § 5-02(e); *see also* CITY OF N.Y. MAYOR'S OFFICE OF CONTRACTS, VENDOR INFORMATION EXCHANGE SYSTEM (VENDEX): POLICIES AND PROC. MANUAL (revised Jan. 1992) [hereinafter VENDEX MANUAL].

60. RULES OF THE CITY OF N.Y., vol. 4, tit. 9, § 5-02(e) (1994); *see also* CITY OF N.Y. MAYOR'S OFF. OF CONTRACTS, VENDOR INFORMATION EXCHANGE SYSTEM (VENDEX): BUSINESS ENTITY QUESTIONNAIRE (revised Jan. 1992) [hereinafter VENDEX BUSINESS QUESTIONNAIRE]; CITY OF N.Y. MAYOR'S OFFICE OF CONTRACTS, VENDOR INFORMATION EXCHANGE SYSTEM (VENDEX): PRINCIPAL QUESTIONNAIRE (revised Jan. 1992).

61. Douglas Feiden, *New Turn of Phrase Scares Off Vendors*, CRAIN'S N.Y. BUS., Mar. 2, 1992, at 3, 24.

- been a respondent before a City Board of Responsibility?
- been denied a contract despite being a low bidder or as a result of an administrative action by any administrative agency?
- been suspended or otherwise declared ineligible by any government agency?

Has this business or any subsidiary of this business, or any current or former directors, principals, officers, or managerial employees of this business, either before or during their employment:

- have any felony charges pending?
- have any misdemeanor charges pending?
- been convicted, after trial or plea, of a felony in the past 10 years?
- been convicted, after trial or plea, of a misdemeanor in the past 5 years?<sup>62</sup>

An affirmative answer to any of these questions is likely to be disqualifying.<sup>63</sup>

VENDEX must by law include all convictions, indictments, debarments, cautions and findings of non-responsibility that have been entered against public contractors, their owners, and their high-level employees.<sup>64</sup> The original idea was to include data bearing on the future performance and integrity of contractors (for example, those contractors who had defaulted on a previous public contract).<sup>65</sup> However, the only information consistently entered into the database is whether a company has been either debarred from all City contracts or found non-responsible by one or more agencies for fraud (in bidding, performance, or certification as a minority-owned business enterprise) or declared a poor

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62. VENDEX BUSINESS QUESTIONNAIRE, *supra* note 60 (Questions 12, 19, & 20).

63. See N.Y. CITY CHARTER ch. 13, § 335 (1994).

64. See N.Y. CITY ADMIN. CODE tit. 6, § 6-116.2(b)(i)(11), (22) (1994).

65. See *A Ship Without a Captain*, *supra* note 1, at 468 n.26.

performer.<sup>66</sup> According to at least one jaundiced observer, rather than ensuring that City contracts are awarded to competent, honest contractors, in practice, "VENDEX is essentially blackballing legitimate companies and adding reams of red tape and onerous paperwork."<sup>67</sup>

New York City Local Law 5 mandates that VENDEX contain "cautions" for any firm or person who has been debarred by any governmental entity and for firms alleged to be involved in criminal activity as shown by "reports of . . . the New York State Organized Crime Task Force."<sup>68</sup> In 1992, the Comptroller and the Mayor's Office of Contracts became co-administrators of VENDEX.<sup>69</sup> Under New York City Comptroller Elizabeth Holtzman, who served from 1989 to 1993, the Comptroller's staff pushed aggressively to expand the criteria and sources for VENDEX cautions so that a wider variety of allegations, investigations, and suspicious business relationships would be entered.<sup>70</sup>

Before an agency formally awards a contract to a low bidder, it must check the VENDEX computer system for cautions.<sup>71</sup> A contractor with a caution may be declared non-responsible without any agency explanation.<sup>72</sup> At the very least, a VENDEX caution will delay the letting of a contract to a low bidder pending further investigation.<sup>73</sup> The questionnaires may then be scrutinized for false or misleading statements and inquiries directed to the Department of Investigation (DOI), a unique quasi-law enforcement agency whose mission is investigating official corruption and fraud against the City.<sup>74</sup> Ironically, however, in order to avoid jeopardizing its sources and investigations, the DOI is reluctant to

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66. Even this limited information appears to be entered only sporadically. Therefore, an agency cannot be sure that a contractor who gets a clean bill of health from VENDEX has not actually been convicted of fraud or other crimes.

VENDEX is only as good as the information entered into its database and there is reason to believe that mistakes are not rare. In several cases, names of companies were entered into VENDEX by clerical personnel simply because they appeared in an investigation file. Such entries were made without any analysis of context much less any application of formal criteria defining "morally irresponsible" or "corrupt."

67. Feiden, *supra* note 61, at 3.

68. See N.Y., N.Y., Local Law 5 (Jan. 18, 1991) (amending N.Y. CITY ADMIN. CODE tit. 6, § 6-116.2(b)(i)(11), (18) which deals with creating a computerized database to monitor contractors doing business with New York City).

69. See VENDEX MANUAL, *supra* note 59.

70. See generally N.Y. CITY ADMIN. CODE tit. 6, § 6-116.2(b)(i)(1)-(23) (1994).

71. VENDEX MANUAL, *supra* note 59, at 24.

72. *Id.* at 31.

73. *Id.* at 32.

74. See RULES OF THE CITY OF N.Y., vol. 4, tit. 9, § 2-12(a) (1994).

provide information about companies that are the direct or indirect targets of its investigations or of investigations that are labelled pending, even if inactive.

### F. *The Primacy of Integrity*

If the agency's chief contracting officer believes the would-be contractor is corrupt, or "irresponsible," the contract must be denied.<sup>75</sup> The contractor can appeal to the agency head and, if unsuccessful, to the Mayor.<sup>76</sup> Even if the agency head judges the contractor morally qualified to do business with the City, the Comptroller may object to and temporarily delay the registration of the contract.<sup>77</sup> The Mayor may reject the Comptroller's objection, but this must be done in writing, in order to hold the Mayor's feet to the fire if a scandal should later ensue.<sup>78</sup>

Ultimately, agency officials and the Mayor must decide whether too many doubts about a contractor's integrity have been raised. Such decisions are fraught with political considerations. If the agency gives the contractor the benefit of the doubt, it risks being excoriated by the media, the Comptroller, law enforcement officials, and political opponents and rivals.<sup>79</sup> It is understandable that risk-averse agency officials believe that the safer course is to disqualify a contractor against whom there is *any negative entry* in VENDEX or in the files or minds of DOI and its investigators.

One contractor, who had previously done satisfactory work for the Department of Housing, Preservation and Development, left unanswered a question regarding subcontractor performance because no subcontractors had been used.<sup>80</sup> As a result of this omission, the contractor received a "U" or "unsatisfactory" designation on VENDEX.<sup>81</sup> Because of the "U" the contractor lost out on a \$500,000 contract with the City.<sup>82</sup> The contractor's lawyer stated:

Now my client is branded. The nightmare becomes Kafkaesque.  
He goes to another agency where he's worked for years and

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75. *Id.* § 703(a).

76. *Id.* § 7-03(c)(1), (4).

77. *Id.* § 5-07(h).

78. *Id.* § 5-07(i)(2).

79. See VENDEX MANUAL, *supra* note 59, at 40-45.

80. Feiden, *supra* note 61, at 24.

81. *Id.*

82. *Id.*

always got glowing reviews. He's the low bidder on a Department of General Services job. But then the "U" comes up again on the computer. One black mark, and it's all over. . . . VENDEX is like a virus, and now he's infected forever.<sup>83</sup>

The operation of VENDEX illustrates the tension inherent in regulating public contracting. On the one hand, it aims to make a contribution to more efficient contracting by identifying poor performers.<sup>84</sup> On the other hand, it makes integrity and the appearance of integrity a higher priority than efficiency.<sup>85</sup> Reflecting on the new procurement system, a social services administrator said:

Before the charter changes, negotiated contracts were allowed which gave us a good deal of flexibility. We had a very thorough internal review procedure and responsibility was on me where it belonged. After the new charter such arrangements were very rare.<sup>86</sup>

The current contracting system, substantially driven by the goals of the anti-corruption project,<sup>87</sup> overrides the judgment of the managers who know contractors and the markets for various goods and services.

### III. THE COMPTROLLER'S OFFICE: THE QUEST FOR CONTRACTOR INTEGRITY

In 1989, after voters approved the new City charter, the New York City Comptroller's Office formed a special Contract Audit Unit to determine the moral eligibility of prospective contractors. The Audit Unit took its responsibility very seriously, seeking information on City contractors from VENDEX, the School Construction Authority (SCA),

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83. *Id.*

84. *Id.* at 3.

85. See Thomas D. Thacher II, *Institutional Innovation in Controlling Organized Crime*, in *ORGANIZED CRIME AND ITS CONTAINMENT: A TRANSATLANTIC INITIATIVE* 169 (Cyrille Fijnaut & James B. Jacobs eds., 1991).

86. Anonymous interview.

87. By "anti-corruption project" we mean the laws, regulations and organizational policies aimed at identifying, preventing and punishing official corruption. The term "anti-corruption project" is not meant to imply a highly disciplined or coherent movement. Rather, it represents a sporadic, cumulative effort over time by various politicians and interest groups. See Frank Aneshiarico & James B. Jacobs, *Visions of Corruption Control & the Evolution of American Public Administration*, 54 PUB. ADMIN. REV. 465 (Sept./Oct. 1994).

and federal, state, and local law enforcement agencies. From 1990 to 1992, the Comptroller objected to dozens of contracts, primarily because of the contractors' alleged organized crime ties, but in some cases because of bad debts or having obtained a performance bond from a shady broker or sham bonding company, a common fraud in the construction industry.

In one high-visibility case, Comptroller Holtzman persuaded the City to rescind a contract held by a company run by Carmine Agnello, John Gotti's son-in-law, to remove abandoned cars from Brooklyn streets.<sup>88</sup> According to Holtzman, the C & M Agnello Company and its owner "had been implicated in a 'chop shop' operation [stripping down stolen cars] in Queens and [Carmine Agnello] was under investigation for possible jury tampering in an organized crime trial in Brooklyn involving Gotti's brother, Gene."<sup>89</sup> Agnello employees, in (admittedly self-serving) protests widely covered by the media, argued that they were engaged in a legitimate business, that Agnello was on the job every day, and that the company's employees were, in effect, being convicted and punished without trial and for alleged offenses unrelated to whether they were competently performing their City contract.

During the summer and fall of 1991, the Comptroller sparred with the Department of Correction (DOC) in another high-visibility case over an emergency jail construction contract that the DOC intended to sign with the DeMatteis Construction Company.<sup>90</sup> The DOC asserted that the contract did not need to be let by competitive bidding because of an overcrowding emergency on Rikers Island.<sup>91</sup> The Comptroller disagreed, criticizing the DOC for having entered into a contract with a company whose president owned a majority interest in a concrete company that was operated by the son-in-law of former Gambino Crime Family boss, Paul Castellano.<sup>92</sup> The DOC argued that the Comptroller was risking a public safety crisis by attacking the integrity of a company that had passed the SCA's scrutiny. After the contract became an issue in the press, Mayor David Dinkins canceled it and debarred the company from all City

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88. Selwyn Raab, *New York Halts Contract With Gotti Son-In-Law*, N.Y. TIMES, Nov. 19, 1991, at B3.

89. *Id.*

90. *In re DeMatteis Constr. Corp.*, N.Y. L.J., Oct. 16, 1992, at 22 (N.Y. Sup. Ct. Oct. 15, 1992) [hereinafter *DeMatteis I*], *aff'd mem.*, *DeMatteis Constr. Corp. v. Dinkins*, 594 N.Y.S.2d 167, 167 (1st Dep't 1993) [hereinafter *DeMatteis II*].

91. The controversy over the emergency jail construction contract is documented in *DeMatteis I*, *supra* note 90; see also Richard Korman, *News Construction Manager Denies Ties to Mob*, ENGINEERING NEWS, Apr. 20, 1992, at 21.

92. See *DeMatteis I*, *supra* note 90.

work.<sup>93</sup> DeMatteis sued the City claiming that the Comptroller's and Mayor's determinations of non-responsibility were unfounded.<sup>94</sup> The court agreed and held that "[o]ther than innuendo, speculation, and guilt by association, particularly by one with an Italian surname, there is simply no evidence of a probative value to show a link between [DeMatteis] and underworld figures or a link between [DeMatteis] and corrupt activity."<sup>95</sup> The City appealed and lost.<sup>96</sup> The appellate court, in affirming the lower court decision, characterized the City's debarment as "arbitrary and capricious."<sup>97</sup>

Comptroller Holtzman objected to numerous other contracts on "integrity" grounds. In October, 1991, Holtzman urged Mayor David Dinkins to overrule his chief procurement officer's decision to let a contract to EMD Construction Corp., a construction firm which had failed to report that it had once been investigated by the Occupational Safety and Health Administration (OSHA) for a workplace safety violation.<sup>98</sup> The Mayor refused on the ground that an OSHA investigation is not the kind of (corruption-type) investigation that must be reported to VENDEX.<sup>99</sup> Ultimately, Holtzman prevailed in her battle against EMD. In August, 1992 the Parks Department, urged on by Holtzman, canceled a contract to repair the Orchard Beach Bathhouse roof.<sup>100</sup> The Parks Department

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93. *See id.*

94. *See id.*

95. *Id.*

96. *DeMatteis II*, *supra* note 90, at 167.

97. *Id.*

98. *See* Karen Freifeld, *Parks Dept. Cancels Bathhouse Contract*, N.Y. NEWSDAY, Aug. 11, 1992, at 25.

99. N.Y. CITY MAYOR'S OFFICE OF CONTRACTS, N.Y. CITY CHIEF PROCUREMENT OFFICER, DECISIONS REGARDING COMPTROLLER 328(C) OBJECTIONS AND APPEALS OF AGENCY NON-RESPONSIBILITY DETERMINATIONS 29-34 (April 1993) (328(c) Objections from 9/01/90 to 9/29/93) (reprinting the October 16, 1991 letter from Michael C. Rogers, Director of the Mayor's Office of Contracts, to Comptroller Elizabeth Holtzman explaining why the Mayor's office disagreed with the Comptroller's objections) [hereinafter COMPTROLLER OBJECTIONS].

The New York City Charter provides that all procurement contracts must be filed with the City Comptroller. N.Y. CITY CHARTER ch. 13, § 328 (a) (1994). The City Comptroller, however, has the right to file an objection to any contract, and unless the Mayor responds to the Comptroller's objections in writing, the contract cannot be implemented. *See id.* § 328 (c). If the Mayor does respond in writing and describes any corrective actions that will be taken in light of the Comptroller's objections or gives the reasons why the Mayor disagrees with the Comptroller, then the Comptroller is required to register and implement the contract. *Id.*

100. Freifeld, *supra* note 98, at 25.



claimed that EMD "has a long history of unsatisfactory business integrity," including failing to pay taxes owed the City, violating labor laws, defaulting on a Transit Authority contract, and failing to disclose that "it was integrally connected to Atlantic Contracting Corporation, another contractor deemed a 'non-responsible bidder'"<sup>101</sup>

In another case, Holtzman challenged the award of a contract for paving work because the firm, Yonkers Contracting Company, had been indicted, although acquitted, of bid-rigging in Westchester County and at the time the contract was pending was a defendant in a civil suit based on similar allegations.<sup>102</sup> She also objected to doing business with HHM Associates based on its failure to report OSHA violations and to file and pay federal, state and city taxes on time.<sup>103</sup> Holtzman also alleged that HHM was a "front" for Carl Capasso, a convicted tax evader.<sup>104</sup> In still another case, Holtzman attempted to block a New York State Department of Transportation repair contract with John C. Picone, Inc. because of alleged mob ties to the Luchese and Colombo crime families.<sup>105</sup> Although the state, not New York City, awarded the contract, Holtzman claimed that her objection was proper because the project was partially funded by the City.<sup>106</sup> Holtzman stated that, "[n]o City money should go to contractors of questionable integrity."<sup>107</sup>

The current trend is unmistakable. For contractors wishing to do business with New York City, character and integrity are now relevant.<sup>108</sup> Would-be contractors must fully disclose personal and company finances: thus the VENDEX database is expanding.<sup>109</sup> Dozens of City agencies and independent authorities are investigating would-be City contractors and making independent judgments about whether they are honest enough.<sup>110</sup> A negative determination by any agency casts a shadow over the company's future as a City contractor since agency heads want to avoid media criticism for doing business with "racketeers" who

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101. *Id.*

102. Richard Korman, *New York City Clarifies What is Corruption That Bars Contractors*, ENGINEERING NEWS-RECORD, June 29, 1992, at 21.

103. COMPTROLLER OBJECTIONS, *supra* note 99, at 49.

104. Kevin Flynn, *Holtzman Blocks Sewer Contracts*, N.Y. NEWSDAY, Feb. 26, 1992, at 24.

105. Mitchell Moss, *Shaky Foundations*, N.Y. NEWSDAY, Feb. 8, 1993, at 23.

106. *Id.*

107. *Id.*

108. *See* Feiden, *supra* note 61, at 3.

109. *See id.* at 24.

110. *See id.* at 3.

have been disqualified by other government agencies.<sup>111</sup> A single agency's favorable finding, however, will not qualify a firm to do business with every City agency because each agency (and the Comptroller) is responsible for making its own responsibility determination.<sup>112</sup>

#### IV. THE SCHOOL CONSTRUCTION AUTHORITY RATCHETS THE INTEGRITY PROJECT ONE STEP FURTHER

##### A. *The School Construction Authority Model*<sup>113</sup>

The law enforcement community has sought to enlist the assistance of City agencies in the war against organized crime by denying public contracts to firms that are owned or strongly influenced by Cosa Nostra.<sup>114</sup> The School Construction Authority's organization and operation indicates the direction in which the anti-corruption project is evolving.<sup>115</sup>

Corruption was uppermost in the minds of those who created the SCA to take over the Board of Education's school renovation and building program.<sup>116</sup> SCA's founders were determined not to have the multi-billion dollar school construction effort derailed by the kind of corruption scandals that had afflicted the Board of Education's building

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111. *Id.* at 24.

112. See RULES OF THE CITY OF N.Y., vol. 4, tit. 9, § 2-05(a) (1994).

113. For an in-depth description of the SCA's anti-corruption efforts, see Thomas D. Thacher II, *Combating Corruption And Racketeering: A New Strategy For Reforming Public Contracting In New York City's Construction Industry*, 40 N.Y.L. SCH. L. REV. 113 (1995).

114. See NEW YORK STATE ORGANIZED CRIME TASK FORCE, CORRUPTION AND RACKETEERING IN THE N.Y. CITY CONSTRUCTION INDUSTRY: FINAL REP. TO GOV. MARIO M. CUOMO (1989) [hereinafter TASK FORCE FINAL REP.] (describing in detail the Cosa Nostra's racketeering and bid-rigging schemes in New York City's construction contracting system and suggesting procedures to eliminate it). See also JAMES B. JACOBS ET AL, BUSTING THE MOB: U.S. V. COSA NOSTRA (1994).

115. Thomas D. Thacher II, currently the Inspector General and a Vice-President of the New York City School Construction Authority, has spearheaded these efforts. Mr. Thacher participated in the symposium sponsored by the New York Law School Law Review in conjunction with the New York Law School Center for New York City Law on March 30, 1995 entitled *Police Corruption, Municipal Corruption: Cures at What Cost?*

116. See Thacher, *supra* note 85, at 169-82.

program.<sup>117</sup> Therefore, the SCA included a state-of-the-art inspector general's office with a staff of sixty.<sup>118</sup> As inspector general and vice president, the SCA's Board of Directors appointed Thomas Thacher II, formerly head of the New York State Organized Crime Task Force's initiative against corruption and racketeering in the New York City construction industry.<sup>119</sup> Thacher moved aggressively to protect the SCA's \$4.3 billion construction program from the taint of corruption by implementing, among other strategies, a prequalification procedure for would-be contractors.<sup>120</sup> The first step in the prequalification process for would-be contractors was a 30-page questionnaire which, among other things, asks:

In the past ten years has the applicant firm, or any of its current or past key people or affiliate firms . . . taken the Fifth Amendment in testimony regarding a business related crime? . . . given or offered to give money or any other benefit to a labor official or public servant with intent to influence that labor official or public servant with respect to any of his or her official acts, duties or decisions as a labor official . . . [or] agreed with another to bid below the market rate?<sup>121</sup>

Penalties for a false answer include disqualification from bidding on SCA contracts and criminal prosecution for providing false information to a government agency.<sup>122</sup> As part of the prequalification process, the SCA has adopted a stringent forfeiture policy.<sup>123</sup> Prequalification forms must be signed by all principals of the firm so that, in the event of a false or misleading answer regarding criminal activity, all payments to the

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117. *See id.*; *see also* N.Y. SENATE COMM. ON INVESTIGATIONS, TAXATION, AND GOV'T OPERATIONS, SCH. FOR SCANDAL: A STAFF REPORT ON THE N.Y. CITY BOARD OF EDUCATION'S MISMANAGEMENT OF SCH. CONSTRUCTION, REPAIR AND RENOVATION (1987).

118. *See* Thacher, *supra* note 85, at 169-82.

119. *See Today's News*, N.Y. L.J., Oct. 19, 1989, at 1.

120. *See* Thacher, *supra* note 85, at 180-81.

121. N.Y. STATE SCH. CONSTR. AUTH., PREQUALIFICATION APPLICATION: CONSTRUCTION CONTRACTORS 26-29 (1990).

122. Feiden, *supra* note 61, at 21.

123. *See* Selwyn Raab, *52 Companies Banned from School Construction Bids*, N.Y. TIMES, Aug. 27, 1991, at B1.

contractor, even for work legitimately and competently performed, must be returned to the SCA.<sup>124</sup>

An example of this type of a forfeiture action occurred in a case involving The New York City Housing Authority (NYCHA) and a contractor, Hi-Tech Mechanical, Inc. In 1992, NYCHA awarded Hi-Tech a contract for plumbing and other repairs at a Bronx housing project. Although no questions were raised about the competency of Hi-Tech's previous work for NYCHA and the Sanitation Department, Councilwoman Carolyn Maloney, chair of the City Council's Subcommittee on Contracts, urged NYCHA to reconsider its award.<sup>125</sup> When three Hi-Tech directors were indicted by a federal grand jury for money laundering, NYCHA moved to terminate all Hi-Tech contracts.<sup>126</sup> NYCHA took the position that all money owed to Hi-Tech for services rendered should be withheld and that \$9.6 million *previously paid to the firm for completed work* should be returned not because the company failed in performing its contractual obligations, but because it engaged in criminal activities.<sup>127</sup>

In August, 1991, Thacher announced that the SCA was disqualifying, for up to five years, more than fifty construction firms.<sup>128</sup> Nearly half the SCA's disqualifications were based on purported mob ties or criminality, not on past poor performance on government contracts or inability to perform future contracts.<sup>129</sup> Even more novel, the SCA requires some contractors, whose integrity is in doubt, to hire independent investigative auditing firms as a condition precedent to getting SCA work. The consulting firm's task is to implement an in-house corruption prevention program, including a code of business ethics for the contractor, and to monitor the contractor's compliance with both the program and the code. The SCA requires the consulting firm to report to both the contractor's top management and to the SCA's inspector general.<sup>130</sup>

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124. Interview with Thomas Thacher, II, SCA Inspector General (Apr. 25, 1991); see N.Y. CITY SCH. CONSTR. AUTH., MANUAL OF POL'Y AND PROC., at CA-1 to CA-4 (describing the contract administration procedure of the School Construction Authority).

125. Selwyn Raab, *Housing Agency Contractor Named in Fraud Indictment*, N.Y. TIMES, Feb. 28, 1992, at B3.

126. *Id.*

127. *Id.*

128. Raab, *supra* note 123, at B4.

129. See *id.* at B1. Francis X. McArdle, Managing Director of the New York City General Contractors Association, warned against arbitrary action by contracting agencies and called for the creation of an appeals board to protect contractors from the use of "subjective reasons" in the exclusion of bidders. *Id.*

130. See New York City Sch. Constr. Auth., Off. of Inspector Gen., Discussion Notes of Meeting of the Board of Trustees, Mar. 2, 1995 (copy on file with the *New York Law School Law Review*).

## V. IMPLICATIONS OF ANTI-CORRUPTION EFFORTS FOR PUBLIC ADMINISTRATION IN NEW YORK CITY

The negative impacts on public administration of the competitive lowest responsible bidder system, the principal anti-corruption strategy for public contracting, although much written about, are difficult to exaggerate.<sup>131</sup> By removing the public official's discretion over choice of contractor, competitive bidding eliminates the official's ability to obtain superior goods and services, especially for construction projects.<sup>132</sup> In effect, the City does not choose its contractors; the contractors choose themselves by their bids. Not surprisingly, the quality of goods and services suffers.<sup>133</sup> Less obviously, costs are not necessarily controlled nor completion promoted.

### A. *Poor Quality of Contractor Performance*

Under the lowest responsible bidder method, contracts are awarded according to lowest cost, not performance record. Even a contractor who does a shoddy job must be awarded future contracts if it is the lowest bidder, unless it is found non-responsible. Consequently, many firms with terrible performance records continue to win City contracts. Several City officials told us that they knew that they were going to get shoddy, even fraudulent, work from certain contractors but felt powerless to do anything about it:

The feeling is that under current rules, disqualification of a contractor for bad performance is too heavy a penalty. Contract officials think, 'who will defend me in court when contractors sue when they're called poor performers?' The charter revision fought the last war—the PVB scandal. It doesn't address the problem of performance.<sup>134</sup>

The Comptroller's 1990 investigative report on Diversified Products of New York, Ltd., illustrates how an incompetent and unscrupulous contractor can continue to obtain City contracts despite an appalling performance record. The report documents how, over a seven-year period,

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131. For a trenchant critique of the competitive lowest responsible bidder system and suggestions for its reform, see STEVEN KELMAN, *PROCUREMENT AND PUBLIC MANAGEMENT: THE FEAR OF DISCRETION AND THE QUALITY OF GOVERNMENT PERFORMANCE* (1990).

132. *See id.*

133. *See id.*

134. Anonymous interview.

Diversified Products and other companies owned by the same principals repeatedly failed to perform adequately under their contracts, and in some cases failed to perform at all. Despite having been cajoled, threatened and even declared non-responsible by one City agency, Diversified and its predecessor company continued to win numerous contracts. As the report observes:

This is a case study of official indifference and the costs of that indifference to New York City taxpayers. This interim report reveals that several apparently unscrupulous contractors have obtained millions of dollars from the City's treasury over a seven and one half year period despite a contemporaneously-documented pattern of their poor performance, their failure of performance, and their persistent misrepresentations.<sup>135</sup>

The secondary and tertiary effects of the competitive bidding system can also be dysfunctional: indeed, they go a long way toward explaining New York City's difficulty in completing public works. First, many quality contractors refuse to bid on public projects because they cannot compete with politically-savvy but poorly-performing contractors who know how to manipulate the system by bidding low and then piling on costs through (questionable) change orders.<sup>136</sup> Second, many contractors refuse to subject themselves to the red tape and onerous VENDEX questionnaires.<sup>137</sup> Third, some contractors who do bid on City jobs have become cynical and rationalize shoddy work and dishonest practices.<sup>138</sup> Finally, competitive bidding may have reduced corruption at the contract letting stage only to increase fraud at the contract performance stage.<sup>139</sup> The low bidder may feel justified in doing everything possible to enhance its remuneration by manufacturing costly change orders.

The Kings County Hospital construction fiasco is a good example of the problems that beset the contracting system.<sup>140</sup> In 1984, the City embarked on a \$1 billion project to build a new hospital in an

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135. N.Y. CITY OFFICE OF THE COMPTROLLER, SECOND INTERIM REP. ON DIVERSIFIED PRODUCTS OF NEW YORK, LTD. (1990).

136. See *A Ship Without a Captain*, *supra* note 1, at 472.

137. See *id.* at 474.

138. See *id.* at 480-81.

139. *Id.* at 481.

140. See William Bunch et al., *Costly Oops: Bid Fiasco Just Latest Hospital Woe*, N.Y. NEWSDAY, Feb. 19, 1994, at 3.

impoverished Brooklyn neighborhood.<sup>141</sup> Ten years and \$119 million later, the New York City Health and Hospitals Corporation (HHC) had an administrative building, a food service building, a couple of holes in the ground and a few parking spots.<sup>142</sup> This debacle led to a fusillade of accusations and criticism from the community's political leaders and the Mayor.<sup>143</sup> Luis A. Miranda, Jr., chair of the HHC Board of Directors, acknowledged that his agency (but not his administration) had "completely screwed up."<sup>144</sup> Notwithstanding this confession, he blamed the construction managers, Turner/Santa Fe, for not properly discharging their responsibilities.<sup>145</sup>

Santa Fe, chosen in 1987 to jointly manage the huge project with Turner Construction Company, encountered continuous problems, including faulty architectural plans and difficulties in finding qualified minority subcontractors.<sup>146</sup> Gerry Rizzi, a former project supervisor for Turner Construction, stated, "We did everything we could. Seven days a week, 14 hour days. It was a never ending battle. The problem is the system and the system doesn't work."<sup>147</sup> In April, 1992, for instance, Turner/Santa Fe awarded an excavation contract to the second-lowest bidder because the lowest bidder did not properly complete the necessary paperwork.<sup>148</sup> The lowest bidder then sued the City and was awarded the contract only to be fired ten-months later when the agency discovered that the subcontractor failed to report its criminal record. After a nineteen month delay, the contract was finally awarded to the third-lowest bidder.<sup>149</sup> Despite repeated warnings from Coopers & Lybrand, an independent auditing firm, that Turner/Santa Fe was mismanaging the project, HHC approved a \$16 million supplement to the management company's original \$19 million bid.<sup>150</sup>

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141. David Firestone, *New York Hospitals Chief Calls Brooklyn Plan a Giant Failure*, N.Y. TIMES, Feb. 11, 1994, at A1.

142. *Id.*

143. Alan Finder, *Managing to Fail: How a Hospital Wasn't Built*, N.Y. TIMES, Apr. 3, 1994, at A1.

144. Firestone, *supra* note 141, at A1.

145. *Id.* at B2.

146. David Firestone, *Manager Says New York Let Hospital Fail*, N.Y. TIMES, Feb. 12, 1994, at B21, B22.

147. Bunch et al., *supra* note 140, at 3.

148. Firestone, *supra* note 146, at B22.

149. *Id.*

150. Wendel Jamieson, *HHC Defers \$16M Extra Payout to Contractor*, N.Y. NEWSDAY, May 29, 1992, at 21.

Meanwhile, conflict of interest allegations arose concerning three contracts worth \$2.5 million awarded by HHC to Darryl E. Greene & Associates.<sup>151</sup> The first contract was awarded in 1988 despite its being a high bid; the third and most recent contract was obtained without a competitive bid.<sup>152</sup> It was alleged that Greene was a law partner of Assemblyman Clarence Norman, Jr., a supporter of the Kings County Hospital project.<sup>153</sup>

### B. Public Contracting in Crisis

The New York State Commission on Government Integrity, which was created in 1987 by Governor Mario M. Cuomo to investigate corruption by city and state officials, recognized that the corruption controls imposed on City procurement are crippling the contracting process.<sup>154</sup> Its scathing report, *A Ship Without A Captain: The Contracting Process in New York City*, began with this blunt assessment:

The problems facing New York City's contracting system have reached a state of crisis, no less real and no less serious than the more conspicuous problems facing the City. A twelve-month review has convinced this Commission that the City's labyrinthine contracting system wastes millions of taxpayer dollars—dollars which otherwise could be spent fighting crime, drug abuse, and homelessness. It is mired in red tape, scares away vendors and remains vulnerable to corruption.<sup>155</sup>

The Commission examined 798 competitively bid Human Resources Administration (HRA) service contracts (accounting for 75% of the dollar value of all HRA contracts) and found that 49% of these contracts were

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151. James C. McKinley Jr., *Payments to Consulting Firm Frozen in Kings Hospital Work*, N.Y. TIMES, Mar. 12, 1994, at B24.

152. *Id.*

153. *Id.*

154. *A Ship Without a Captain*, *supra* note 1, at 480-81. The New York State Commission on Government Integrity is also known as the Feerick Commission, after its chairperson, Fordham Law School dean, John D. Feerick.

155. *Id.* at 461. Just three years earlier, the State-City Commission on Integrity in Government (the Sovern Commission) reviewed the City's contracting problems and warned that failure to address fragmentation and complexity of contracting operations was an open invitation to corruption. See STATE-CITY COMM'N ON INTEGRITY IN GOV'T, REP. AND RECOMMENDATIONS RELATING TO CITY PROCUREMENT AND CONTRACTS 67 (1986).



awarded with *fewer than a bare minimum of three bids*.<sup>156</sup> "HRA was unable to attract more than two bids for a wide range of services. For instance, only two vendors bid on a \$5.2 million contract to provide cooked meals for the homeless in City shelters, although 30 companies had been invited to bid."<sup>157</sup>

The same pattern appears throughout City government. "All too often, the City is faced with a small number of 'niche' bidders, firms whose expertise lies in threading their way through the City contracting maze and who have adapted themselves to its peculiar and confounding logic."<sup>158</sup> The Commission stressed the overall negative impact of layer upon layer of checks, balances, and anti-corruption reforms and summarized the bleak state of the City contracting process:

The problems of the City's contracting system have been compounded by the City's reaction to municipal corruption scandals which began to unfold in late 1985 and early 1986. As a result, the contracting process has been saddled with an ever increasing burden of paperwork requiring review and approval by many different oversight agencies.

To be sure, each added layer of oversight originates in well-intentioned response to a particular scandal or crisis. Together, however, they add up to a blueprint for paralysis. Instead of a clear vision of what constitutes good contracting practice, the City has pieced together a patchwork of checkpoints and barriers. Their cumulative effect is to slow the City's business to a crawl and to deter vendors from bidding on City business.<sup>159</sup>

The Commission made five recommendations for improving the City contracting system. First, the City should place increased emphasis on attracting more contractors, rather than identifying bad contractors.<sup>160</sup> Second, the Mayor should appoint a temporary deputy mayor whose sole responsibility would be to oversee and reform City contracting.<sup>161</sup> Third, each agency should appoint a chief contracting officer with a

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156. *A Ship Without a Captain*, *supra* note 1, at 470.

157. *Id.* at 471.

158. *Id.* at 472.

159. *Id.* at 469.

160. *Id.* at 464.

161. *Id.* at 464-65.

professional procurement background.<sup>162</sup> Fourth, the City must train contracting personnel so they have “the skills and the tools necessary to get the best possible deal for the City.”<sup>163</sup> Finally, in order to cut down on delay, the City should review contracts on “a selective post-audit basis” after they are awarded, rather than before, to make sure City contracting rules are followed.<sup>164</sup>

Costs tend to swell during City projects; final project costs bear little resemblance to the original bid price. Many construction contractors who bid low to obtain a City contract try to hold the City as closely as possible to the original contract specifications. For any deviation from the specifications, contractors request “change orders” that result in an increase to the final contract price. Disputes over change orders can lead to contractors walking off the job and to work stoppages. They also generate opportunities for project managers to solicit or accept bribes.<sup>165</sup> In a 1987 report, the Institute for Public Administration (IPA) stated:

The fallacies of low bid restrictions in complex projects have been proven nationwide time and again. Managers involved in contractor selection must develop the skills and must be encouraged to exercise the discretion to weigh low bids against realistically estimated costs, against the quality and past performance of a potential contractor, against the needs for innovation and flexibility in implementation. New York’s ratio of change orders to original bids is high. In the case studies, the IPA did not find much awareness of how final project costs related to original bids. Nor was anyone reviewing the relationship between various contract selection methods and project results.<sup>166</sup>

Change order disputes do not end with the completion of the job.<sup>167</sup> Construction projects spawn lawsuits by contractors challenging the denial of requests for change orders.<sup>168</sup> A small bar of specialty lawyers,

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162. *Id.* at 465.

163. *Id.*

164. *Id.*

165. *See* INST. FOR PUB. ADMIN., CONTRACTING IN N.Y. CITY: FINAL REP. AND RECOMMENDATIONS (1987).

166. *Id.* at 38.

167. *See* Feiden, *supra* note 61, at 3 (noting that a cottage industry of lawyers has arisen to deal with the New York City’s contract procurement procedures); *see also* *A Ship Without a Captain*, *supra* note 1, at 488-90 (describing the need for anti-corruption measures after a contract has been awarded to a particular contractor).

168. *See* Feiden, *supra* note 61, at 3.

operating on a contingent-fee basis, represent contractors in post-project litigation.<sup>169</sup> Given the City's frequent inability to defend its specifications and project management competently, these lawyers rely on their ability to force the City into lucrative settlements.<sup>170</sup> The City charges that much of this litigation is frivolous.<sup>171</sup>

In recent years the City has tried to anticipate post-project lawsuits by inserting protective clauses into its construction contracts.<sup>172</sup> One of the most controversial of these provides that in the event of delays caused by the City (a frequent claim made by contractors), the contractor is not entitled to any monetary damages.<sup>173</sup> This clause outrages contractors, who argue that dilatory City decisionmaking imposes serious, sometimes devastating, costs.<sup>174</sup> The use of the clause compounds their disrespect, cynicism, and possibly their proclivity to cheat the City.

The organized crime ties or associations of many construction contractors only makes the relationship between public employer and public contractor more complex. Historically, mob-dominated construction unions have established and enforced employer cartels which assign contracts and dictate prices.<sup>175</sup> Any company foolhardy enough to challenge the system found itself without workers or under constant threat of sabotage.<sup>176</sup>

The negative effects flowing from the competitive bidding system snowball. The perception that greedy, dishonest contractors are poised to exploit any contractual or managerial opportunity to defraud the City has led to more oversight, double checks, stringent contract terms, slow payments, and lately, the screening of contractors for integrity. In turn, this leads to increased cynicism among contractors who feel that they are treated like quasi-criminals, and provides them a rationalization for further dubious practices. This, in turn, is likely to spawn more safeguards and

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169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

173. John Grubin, "No-Damage-For-Delay" Clauses: Fair or Foul?—The Owner's Perspective 6 (1988) (unpublished paper presented at the Fourth Annual Meeting of the American Bar Association Forum Committee on the Construction Industry in Tampa, Florida on April 28-29, 1988) (on file with the *New York Law School Law Review*); see also, James P. Griffin & John F. Grubin, *Kalisch-Jarcho—Simple Applications of Old Principles*, N.Y. L.J., May 12, 1983, at 1.

174. *A Ship Without a Captain*, *supra* note 1, at 473-80.

175. TASK FORCE FINAL REP., *supra* note 114, at 37-51.

176. *Id.* at 30, 45-51 (describing several specific instances of sabotage and its effect on the contract bargaining process).

greater suspicion. One City Council staffer told us that in her opinion "all contractors are crooks."<sup>177</sup> It is hard to see how the City could effectively carry out desperately needed capital construction and competent service delivery while operating under such an assumption.

In such a grim situation, one of the only ways that crucial public works can proceed is by turning them over to public authorities (e.g., the Port Authority, Dormitory Authority, Urban Development Corporation, School Construction Authority), which are not constrained to the same extent as City agencies by the rules that govern City contracting.<sup>178</sup> Again the irony—reformed and sanitized so that it is corruption-proof, fair and equitable public administration has become unworkable. Essential responsibilities have to be farmed out to public authorities. These authorities, however, are not immune from the pressures to fight corruption.<sup>179</sup> Therefore, they are also in danger of succumbing to the same administrative disease.

## VI. ARE CORRUPTION AND RACKETEERING DOWN?

Unfortunately, it is virtually impossible to determine whether the anti-corruption reforms embedded in public contracting have reduced corruption. Because corruption is generally a secret crime, there are no data with which to compare corruption rates over time.<sup>180</sup> True, historians of nineteenth and early-twentieth century New York paint a picture of pervasive corruption in which some politicians were openly contemptuous of law and integrity.<sup>181</sup> Today's corrupt politicians are not so openly contemptuous, but modern corruption scandals reveal a good deal of contemptuousness. Operation "Double Steel," an FBI sting operation, conducted from 1985 to 1987 in municipalities and counties throughout New York State, revealed pervasive corruption in procurement

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177. Anonymous interview.

178. Compare James C. McKinley, Jr., *Banned Unit of Lockheed May Get Pact*, N.Y. TIMES, Nov. 22, 1994, at B1, B4 and Larry Olmstead, *2 Managers Held in Bidding Scheme at School Agency*, N.Y. TIMES, Apr. 21, 1993, at A1, B9 with Alan Finder, *Mismanagement is Found in Youth Agency Grants*, N.Y. TIMES, Mar. 22, 1995, at B3.

179. N.Y. STATE COMM'N ON GOV'T INTEGRITY, *Underground Government: Preliminary Report on Authorities & Other Public Corporations*, in GOVERNMENT ETHICS REFORM FOR THE 1990S, at 340, 378 (1991).

180. John T. Noonan, *Bribes*, excerpted in 1 ENCYCLOPEDIA OF CRIME & JUSTICE, at 119, 123 (1983).

181. See, e.g., sources cited in *supra* note 13.

and contracting.<sup>182</sup> Forty-four New York municipal officials, including highway superintendents, parks managers, and public works commissioners from forty towns outside New York City were approached by undercover agents posing as vendors of snowplow blades, street signs and other products.<sup>183</sup> Of 106 bribe and kickback offers, 105 were accepted.<sup>184</sup> The one rejected bribe was refused because it was too small!<sup>185</sup>

Even if it somehow could be shown that payoffs, kickbacks, and self-dealing have declined over the twentieth century, they nonetheless remain a basic feature of urban life in New York City and other cities. And the regulatory reforms put in place to achieve that reduction (if it is a reduction) have generated their own corruption vulnerabilities. There has probably been an increase over time in the amount of fraud against the government. In part, contractor fraud is a consequence of policies that have produced a dysfunctional relationship between the City and contractors who know how to exploit a labyrinthine, suspicion-ridden, and inefficient contracting system.

Several examples illustrate the persistent nature of corruption in the contracting process. Since the 1960s, extensive corruption has been revealed in the granting and administration of human services contracts.<sup>186</sup> There are numerous examples of human services contractors billing the City for services that have not been provided, for costs that were not incurred, and for treating patients who did not exist.<sup>187</sup>

In another area, inspectors general told the New York State Organized Crime Task Force that they believe there is significant fraud on every

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182. Ralph Blumenthal, *FBI Says Public Officials Accepted 105 of 106 Bribes Offered in 2-year Operation*, N. Y. TIMES, Aug. 12, 1987, at A1, B4.

183. *Id.* at A1.

184. *Id.*

185. *Id.*

186. See, e.g., Ralph Blumenthal, *Companies Cited in Payoffs for Co-op Work are Named*, N.Y. TIMES, Oct. 26, 1994, at B3; Alan Finder, *Dangerous Parking*, N.Y. TIMES, Apr. 11, 1993, at A5; George E. Jordan & Mitch Gelman, *PVB Mess: Breakdown of Scrutiny; Lockheed slipped through DOI's Screening Oversight*, N.Y. NEWSDAY, Aug. 29, 1993, at 6; Kevin McCoy, *Firm, 4 Execs To Be Indicted*, N.Y. NEWSDAY, Nov. 7, 1991, at 5; Richard Perez-Pena, *Investigators Ask: Did Lockheed Clean House?*, N.Y. TIMES, Sept. 8, 1993, at B9; Selwyn Raab, *52 Companies Banned from School Construction Bids*, N.Y. TIMES, Aug. 27, 1991, at B1; see also George J. Jordan, *Privatizing Isn't Always Improving City Services*, N.Y. NEWSDAY, Dec. 30, 1993, at 35 (noting then Mayor-elect Rudolph Giuliani's plan to privatize several major city services in an attempt to combat corruption and cut costs).

187. See sources cited in *supra* note 186.

major construction project.<sup>188</sup> Nevertheless, the City has no way to quantify the extent (either in frequency or magnitude) to which it has been defrauded. In 1981, for example, the State Commission on Investigation received allegations of fraud and corruption in the multi-million dollar repair program in Co-op City, a state-financed 15,000-unit housing complex in the Bronx.<sup>189</sup> The Commission's hearings, held between 1981 and 1983, revealed widespread corruption.<sup>190</sup> The Commission found that "prior to October, 1981 there was widespread abuse characterized by mismanagement, waste and corruption and that subsequent to October, 1981, progress in accomplishing repairs . . . virtually ceased."<sup>191</sup> Non-competitively bid emergency contracts were awarded at costs much greater than competitive rates.<sup>192</sup> Inspections were inadequate, and contractors' payments were not audited.<sup>193</sup>

As a result of the Commission's final report, twenty people were indicted and sixteen convicted.<sup>194</sup> George Steiner, the general manager of the Co-op City construction repair program was convicted of extortion and tax evasion involving more than \$1.2 million in kickbacks and bribes received from contractors.<sup>195</sup> The following letter, filed with Steiner's sentencing, provides a telling commentary on the extent of corruption in public works:

George Steiner took advantage of an environment at Co-op City which was an incubator for corruption. The State did not provide adequate resources to protect the expenditure of its money. The [Co-op City] Board of Directors, management and professional advisors were more interested in spending State funds first and later determining whether the expenditures were appropriate. The total lack of effective controls over state funds which were used to pay for construction defects permitted contractors to make a fortune even after having made payoffs to Steiner and others.<sup>196</sup>

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188. TASK FORCE FINAL REP., *supra* note 114, at 13.

189. See STATE OF N.Y. COMM'N ON INVESTIGATION, THE CO-OP CITY REPAIR PROGRAM 1-15 (1983) (describing the background to the scandal and how it surfaced).

190. *Id.*

191. *Id.* at 3.

192. TASK FORCE FINAL REP., *supra* note 114, at 110-11 (describing the Co-Op City repair corruption scandal).

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.* at 111.

Implicit in the effort to exclude corrupt contractors is the belief that denying public contracts to mob-influenced firms will weaken the financial base of organized crime and ultimately its power. Further, mobilizing government contracting to aid law enforcement is based on the belief that threatening to deny contractors a significant portion of their business will deter them from dealing with racketeers. These assumptions must be carefully examined.

It is not easy to eliminate mob-influenced or otherwise non-responsible companies from government contracting. The New York City construction industry is a tough industry. Scrupulous firms have long ago been driven away or voluntarily departed. Those who now bid regularly on City contracts have learned how to make money in dealing with the City and its arcane contracting rules. They also have learned how to deal with corrupt building inspectors, incompetent site supervisors, mob-dominated labor unions, and, in some cases, dangerous crime-ridden neighborhoods. Whether these firms can be purged from the field and, if so, whether ethically responsible firms will replace them remains to be seen.

Debarred companies can and have continued to bid on government contracts under different corporate identities and through different officers (fronts without criminal records) or as subcontractors. It is extremely difficult to prove that a new firm is the alter ego of one previously excluded.

There is no hope of excluding mob-influenced firms without extensive, expensive, and time-consuming investigation and monitoring. While there are no systematic cost figures on the exclusion process, the SCA has generated some rough estimates based on lengthy questionnaires and investigations of approximately 3500 contractors over a five-year period.<sup>197</sup> Investigating a typical applicant costs approximately \$2000; a complex case can reach \$10,000.<sup>198</sup> If the same kind of effort was implemented across all City agencies (and there is reason to believe that nothing less would be adequate), the costs would probably be prohibitive and the process would certainly increase the crippling delays that already plague the contracting process.

Costs are also generated by penalizing and/or barring contractors who are doing or have done acceptable work, but are under suspicion of racketeering activity.<sup>199</sup> Even if policymakers determined that these

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197. Thacher, *supra* note 113, at 133.

198. Interviews with Joseph DeLuca, Assistant Inspector General, New York City School Construction Authority, in New York, N.Y. (Sept. 25, 1991 & Nov. 18, 1991). Investigation costs are adapted from private sector estimates.

199. See Thacher, *supra* note 113, at 134 (pointing out the costs associated with canceling a partially performed contract).

costs were worth bearing in order to weaken organized crime, protect the City from fraud, and maintain "purity" in contractual relations, it is hardly clear that such a policy would work. The argument that legitimate businesses will be deterred from becoming involved with racketeers if their public contracts are at risk assumes that contractors have substantial freedom to enter and exit such relationships and that, if properly motivated, they can resist the racketeers. In many cases—and the New York City construction market is a good example—contractors have had no real option to refuse to deal with mobsters and racketeers. Failure to cooperate has meant being put out of business by mob-influenced labor unions that can bring a contractor to his knees by withholding labor, fomenting labor unrest, or sabotaging his project.<sup>200</sup>

## VII. CONCLUSION

Public officials must strike a delicate balance when formulating contracting policy. On one hand, public contracts must be carefully monitored lest the City be defrauded by corrupt public officials and contractors. On the other hand, the contracting system must be efficient and flexible in providing goods and services. Unfortunately, it is difficult to determine which anti-corruption controls in public contracting, if any, prevent corruption. In fact, many contracting laws and other reforms put into place over the years have themselves increased corruption vulnerabilities. When the drive to prevent corruption in public contracting is not carefully considered, it makes the implementation of public works and the delivery of public services even more difficult and costly.

Each fiscal year, New York City expends about one-fourth of its budget on contracts with private-sector suppliers of goods and services. Such a vast amount of money dispersed in thousands of *ad hoc* transactions presents innumerable opportunities for corruption. The City's main defense against fraud is competitive bidding, which was originally aimed at preventing City officials from accepting or extorting kickbacks in exchange for sweetheart contracts. This system has not stopped the

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200. Meyer S. Frucher, former President of the Battery Park City Authority, was able to save several million dollars in construction costs by using a labor consultant who persuaded the Teamsters on the job to forego their usual gateway charges on non-union haulers. It turned out later that the labor consultant had been acquitted of a gangland murder. Frucher's achievement in completing the project and raising money through the Authority for low-income housing elsewhere was impugned by a report of the State Investigation Commission, because of his use of the labor consultant. The effect of such criticism may be to deter public entrepreneurship like Frucher's. See STATE OF N.Y. COMM'N OF INVESTIGATION, INVESTIGATION OF THE BUILDING AND CONSTRUCTION INDUS.: REP. OF CONCLUSIONS AND RECOMMENDATIONS 27-38 (1986).



payoffs and kickbacks, but it has broken down any kind of on-going working relationship between agencies and their contractors. The fear of official corruption and the appearance of corruption makes it impossible to vest City officials with the discretionary authority to choose to work with those contractors in whom they have the most faith and confidence, as a private individual would do in building a private home or office. The competitive bidding system has contributed to a contracting system that makes it difficult to accomplish basic contracting goals and continues to be abused by corrupt officials and contractors.

In the corruption-sensitive political environment that has dominated New York City since the mid-1980s scandals, the Charter's new contracting provisions direct City officials to give more attention than ever before to the integrity of contractors. Consequently, City officials have designed comprehensive disclosure forms for contractors to fill out on pain of perjury and debarment for false statements. Furthermore, City officials are busy entering all sorts of information about contractors into the VENDEX database, which is supposed to warn agency officials about contractors' lack of integrity. Even the non-mayoral agencies and public authorities are competing to appear holier-than-thou in their contractual relationships. According to an official in the City Comptroller's office, in the rush to ferret out "bad actors," lack of evidence does not stand in the way:

[It is] appropriate to not do business with a shady contractor even if there is not enough evidence to prove a violation of law and prosecute. New York City should be able to make market choices about who it does business with as it has in the past by barring contracts with South Africa and Northern Ireland . . . .<sup>201</sup>

The drive to rid New York City contracting of corrupt influences is similar to other contemporary social control movements such as the war on drugs. The overreach of various drug war strategies is said to be the price that must be paid for a drug-free society. Likewise, the goal of a corruption-free City would require a war on corruption, the costly investigation and monitoring of thousands of contractors, subcontractors and vendors (not to mention unions), and the debarment of an indeterminable number. The whole enterprise bristles with questions of practicality and fairness.

An entire system of norms, rules, and procedures, nourished by greater resources and personnel, will ultimately be necessary to implement a fair and comprehensive system to assess the integrity of government contractors. Ironically, the higher the moral ground taken by government,

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201. Anonymous interview.

the higher the standard that it will be held to and the greater the criticism to which it will be subjected when it becomes known, as it inevitably will, that a particular contract is being performed by a firm associated with some "gangster."<sup>202</sup> That kind of exaggerated ambition will ultimately reinforce the cycle of scandals and reforms.

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202. In the winter of 1994, the media blasted the City's snow removal effort. The problem was not that the city was over-charged when it awarded these emergency contracts or that the work had not been performed competently or expeditiously, but that eleven of the snow removal companies had "checkered pasts, ranging from suspected mob ties to criminal convictions." Kevin Flynn, *Plow Now Anyhow, Buried City Hired Tainted Contractors*, N.Y. *NEWSDAY*, Feb. 28, 1994, at 7.

