Expanding Drug Treatment: The Need For Fair Contracting Practices

New York State Commission on Government Integrity

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EXPANDING DRUG TREATMENT:

THE NEED FOR
FAIR CONTRACTING PRACTICES

New York State Commission On Government Integrity
December 1989
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THE NEED FOR

FAIR CONTRACTING PRACTICES

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Additional copies of this report are available from the Commission's office

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INTRODUCTION

As part of its investigation into New York State government contracting systems, the Commission on Government Integrity investigated how one large New York State agency, the Division of Substance Abuse Services ("DSAS"), awarded contracts to certain New York City drug addiction programs.\(^1\) This report is divided into two parts, the first of which (pp. 7-21) sets forth the Commission's conclusions from that investigation and its recommendations for reform of DSAS' contracting system. The second part (pp. 23-88) sets forth the Commission's factual findings that support its conclusions and recommendations.\(^2\)

DSAS is responsible for providing a wide variety of drug education, prevention and treatment services.\(^3\) The agency funds services such as community and school-based prevention programs, drug-free therapeutic treatment programs, and methadone maintenance programs. Eighty percent of DSAS' funds for these services are expended in New York City and Long Island.\(^4\)

Like other state social service agencies, DSAS grants funds (either directly or through local government agencies) to private service providers, usually not-for-profit businesses, rather than providing the services itself. This method of service delivery, sometimes referred to as "contracting out," has become increasingly common as governments have concluded that it

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\(^1\) The Commission's investigation began in October 1988 and DSAS employees and officials were first contacted by Commission staff in November of that year.

\(^2\) The Commission's investigation and report are predicated upon the Commission's mandate to investigate weaknesses in laws, regulations and procedures regarding "the solicitation of government business, permits, franchises, and the like and determine whether such weaknesses create an undue potential for corruption, favoritism, undue influence or abuse of official position or otherwise impair public confidence in the integrity of government." Executive Order No. 88.1, ¶ 2(4).

Recent reports of the Governor's Office of Management and Productivity and the Office of the State Comptroller have also discussed DSAS' management problems and have mentioned some, but not all, of the matters discussed in this report. See Governor's Office of Management and Productivity, "Division of Substance Abuse Services Local Contracting Process, A Management Analysis," September 1989; Office of the State Comptroller Report No. 88-S-57, "Division of Substance Abuse Services, Oversight of Community-Based Programs." This report complements those by discussing how management problems of specific programs reflect on the integrity of the agency's contracting process.

\(^3\) DSAS is one of two divisions comprising the Office of Alcoholism and Substance Abuse Services (the other is the Division of Alcoholism and Alcohol Abuse), which is a component of the N.Y.S. Department of Mental Hygiene. See Mental Hygiene Law §§ 5.01 and 19.05(a).

\(^4\) Armstrong Tr. at 15 (references in this format are to the pages of the private hearing transcript of the witness named).
permits a higher quality of services at lower cost. In recent years, state agencies have awarded hundreds of millions of dollars to private organizations for a wide array of social services.\(^5\)

The state's obligation to monitor the expenditure of taxpayer funds is not diminished simply because it has shifted the service delivery function to private entities. To the contrary, because monitoring the quality and cost-effectiveness of an outside contractor's product is often more difficult, the government's monitoring obligation is increased.

In exploring how well one state agency, DSAS, awards funds and monitors performance, this investigation focused on four New York City drug-free treatment programs:

(1) La Nueva Raza Institute ("LNRI"), which has received over $2 million in DSAS funding since February 1981 to operate an ambulatory drug-free treatment program in Queens, and nearly $974,000 in additional funding from July 1986 to June 1989 for an unsuccessful effort to open a residential treatment program, the Young Adults in Transition Center ("YATC");

(2) Prospect, Inc., a program that received nearly $175,000 in DSAS funding between July 1985 and March 1987 in unsuccessful efforts, first, to open a detoxification program in The Bronx and then, later, to open a residential drug-free program in East New York, Brooklyn;

(3) National Expert Care Consultants, Inc. ("NECC"), a for-profit business that received over $4 million in DSAS funding between July 1986 and March 1988 to operate both outpatient and residential treatment programs in midtown Manhattan; and

(4) El Regreso, a residential program in Brooklyn that has received over $1 million in DSAS funding since July 1986 and has not yet begun operations.

The contracts with these programs were part of DSAS' effort to expand both the number of service providers and the number of residential treatment beds in New York City in response to the explosion in drug use in the mid-1980's. While the funding authorized for these programs represents a small portion of the money awarded by DSAS to treatment programs in the

---

\(^5\) For example, in the three-year period from April 1985 through March 1988, the New York State Department of Health approved over 1,500 grants worth almost $370 million; the New York State Office of Mental Retardation and Developmental Disabilities awarded over 3,000 grants worth almost $360 million; and DSAS awarded 630 grants worth almost $330 million. In fiscal year 1989-1990, DSAS' budget for local services is nearly $194 million.
New York City area, the combined funding for the four programs' first contract year represents about 40% of the first-year funds awarded to all new treatment providers in the area since 1985.

6 The value of the contracts awarded to these programs since 1985 (which is somewhat more than the amounts actually spent by the programs) is less than $10 million, as compared to $467 million awarded to all drug-free treatment programs in New York City during the same time period.
SUMMARY

DSAS' contracting process in New York City lacks adequate rules and procedures necessary to ensure objective evaluation of both proposed and established treatment programs. Even those rules that do exist are often rendered meaningless by agency officials, including the Director, who tolerate (and sometimes encourage) disregard for rules and lines of authority whenever expedient. The result is an ad hoc process vulnerable to subjective decision-making, manipulation for personal objectives, and the vicissitudes of personal rivalries. These weaknesses have caused the agency to waste its resources, created skepticism that agency funds are distributed in a neutral manner, and damaged agency morale.

Each of the four programs investigated by the Commission illustrates these weaknesses. While DSAS' flawed contracting process is not responsible for all of the problems afflicting these programs, it has allowed personal agendas, including the Director's, to interfere with and sometimes dominate the agency's funding decisions and oversight of the programs. In each case, the weaknesses contributed to the squandering of agency funds and, in some instances, helped to ensure the program's failure.

The Commission's investigation does not establish the extent to which the four programs are typical of other DSAS-funded programs. However, the favoritism and waste of agency resources found in each program result from systemic weaknesses which can undermine the effectiveness of every DSAS-funded program. Nothing less than a substantial overhaul of the agency's contracting procedures and practices is required.
PART ONE
CONCLUSIONS

DSAS' efforts to expand drug-free treatment services in New York City have been plagued by weaknesses in procedures and practices that impair the morale and effectiveness of the agency's staff and cause the agency to spend its limited financial resources on costly or unproductive programs. At the root of these weaknesses is the agency's informal and unstructured contracting process, which is described in Part Two, Section I, of this report. Decisions are often made without benefit of established rules and procedures, thus permitting subjectivity and favoritism while reducing accountability and precluding effective auditing.

Where rules and procedures do exist, they are often vague or unwritten and thus easily ignored or manipulated. Even clearly written rules and procedures are sometimes disregarded when it is expedient. These problems are exacerbated by an agency management that tolerates and sometimes encourages ad hoc decision-making and discourages both adherence to rules and the imposition of sanctions for their violation.

I. DSAS' CONTRACTING PROCESS LACKS NECESSARY RULES, PROCEDURES AND STANDARDS

Various steps in the DSAS contracting process lack rules, procedures or standards for decision-making. For example, DSAS has only general criteria by which agency staff are to evaluate requests for renewed funding by existing service providers and no criteria for evaluating new program proposals. Nor is there any requirement that decisions to grant, continue or terminate funding, or to reverse decisions made by other staff members, be justified in writing. The absence of firm criteria and documentation makes objective and comparative evaluations of treatment programs and proposals difficult, while it facilitates post-hoc rationalizations for whatever action is taken.

The lack of procedures and standards is especially acute with respect to new programs. The agency eschews the use of a competitive process or even a uniform deadline for the receipt of applications, virtually ensuring that each proposal is considered in isolation. Further, once DSAS decides to fund a program, no firm criteria exist by which the agency may judge its development and progress. No target dates are imposed for such important steps as securing a site, achieving a full client census or attracting outside sources of revenue. In the absence of such
guidelines, even an unsuccessful program enjoys a presumption of continued funding as DSAS "throws good money after bad" in the hope that the program will eventually improve.

Those performance standards which do exist are sometimes so minimal as to be meaningless. For example, as the Commission's investigation into LNRI revealed (see Part Two, Section II(F)), effective treatment dictates that clients in an ambulatory program visit the program at least three or four times a week. Nonetheless, DSAS' standards permit such a program to include in its monthly census report any client who visited the program once in the previous 30 days.

II. SUCH AGENCY RULES AND PROCEDURES AS EXIST ARE TOO VAGUE

DSAS does have some rules and procedures which govern the contracting process. However, they are not always in writing and, even when they are, they are stated only in general terms. Thus, the rules are easily manipulated or disregarded.

For example, regarding proposals from new providers seeking DSAS funding, the agency's Local Services Manual states that DSAS' Bureau of Contract Management and Fund Allocation ("Contract Management") is responsible for evaluating service provider funding applications and preparing recommendations concerning the "acceptability" of program proposals. However, nowhere is specified the factors which comprise an "acceptable" proposal or the Contract Management staff member responsible for making and justifying a decision to provide financial support for a new program.

III. CONTRACTING RULES AND PROCEDURES ARE DISREGARDED

Even when clearly specified in writing, many DSAS rules and procedures are simply ignored. For example, as shown by the Commission's investigation into Prospect, Inc., and El Regreso (see Part Two, Sections III and V), even though the Local Services Manual specifies that funding applications are to be handled by Contract Management, other agency officials and employees handle or facilitate program proposals and make funding commitments for the agency when they choose to do so.

Other examples abound: the Local Services Manual's requirement that troubled programs be discussed at meetings of the agency's Problem Program Committee is meaningless since the Committee was dissolved in 1985 (see Part Two, Section I(B)(3)). As both NECC and El Regreso illustrate (see Part Two, Sections IV(F) and V(D)), the requirements that subcontracts be competitively bid and that certain expenditures be pre-approved are ignored or waived retrospectively. Moreover, as detailed in the case of NECC (see Part Two, Section IV(G)), DSAS
has permitted programs to form alter-ego corporations to buy treatment sites, then lease them back to the programs at a rent equal to or exceeding the mortgage payment, thereby circumventing the Mental Hygiene Law’s prohibition on using state funds to pay more than 50% of a program’s capital costs.

Disregard for the rules is possible because agency decision-makers are not held accountable. There is no requirement that the steps in the decision-making process be documented. Without documentation, neither agency staff nor outside auditors can later determine who made the decisions or why they were made.

IV. ADDITIONAL AGENCY CONTRACTING WEAKNESSES

As discussed in the Commission’s findings with respect to agency management, see Part Two, Section I(C), and as illustrated by all four programs investigated by the Commission, the above weaknesses are compounded by an environment fostered by DSAS’ executive management, and Director Martinez in particular, that discourages staff adherence to procedures. Through his own actions, Director Martinez, however well-intentioned he may be, sends a message to his staff that the ends justify the means and the agency’s rules and procedures are not important. He does so by intervening on behalf of certain programs, usurping the role of Contract Management, tolerating friends within the agency who do the same in his name, and expressing displeasure with those who adhere to the contracting rules. That message is also heard by officials of treatment programs who find it beneficial to circumvent the normal chain of command and ignore agency requirements.

This environment is also fostered by the agency’s reluctance to penalize problem programs. Because there are so few treatment providers, DSAS is reluctant to withhold funds or close programs. That reluctance, however, makes the agency hostage to the programs it is supposed to regulate. For example, the concern that no replacement could be found for LNRI’s ambulatory program in Queens has for many years been used to justify continued DSAS funding of the program despite its inadequate performance and failure to comply with various DSAS requirements (see Part Two, Section II(F)). Similarly, because NECC met DSAS’ need for increased treatment services, DSAS tolerated its nearly constant failure to comply with agency rules (see Part Two, Section IV(J)(3)). Only after scrutiny by the media and the State Comptroller’s Office did DSAS terminate NECC’s funding.

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7 DSAS attributes the scarcity of contractors to the many difficulties that confront potential treatment providers, such as low wages and community opposition. While these problems cannot be minimized, DSAS has not aggressively sought to increase the pool of service providers by widely advertising the availability of funds and soliciting competitive proposals. Instead, DSAS has relied largely on the existing community of service providers familiar to the agency to expand treatment capacity, thereby preserving the insular nature of the treatment community.
Directors of treatment programs have little incentive to comply with agency rules and procedures because they know that DSAS' overworked staff is unlikely to uncover violations and may be persuaded to ignore them if they do. Moreover, since, as a practical matter, the most severe penalty imposed is recoupment of unauthorized expenditures from succeeding years' budgets, DSAS' auditing program has little deterrent effect.

The agency's reluctance to close or penalize programs that fail to perform reflects the conflict between DSAS' dual functions in New York City as regulator of treatment programs and advocate for increased services: the enormous pressure to meet an overwhelming demand for treatment is simply inconsistent with the oversight function. DSAS is compelled to assume both roles in New York City because there, unlike other localities, no local government agency identifies community treatment needs and selects service providers. Requiring DSAS to substitute for a local government agency and oversee compliance requires the agency to pursue contradictory objectives, increases the agency workload, and makes more difficult the successful performance of either function.

V. THE EFFECTS OF DSAS' WEAK RULES AND PROCEDURES

DSAS' ad hoc contracting practices make responsibility diffuse or impossible and expedience the guiding principle. In these circumstances it should not be surprising and may be inevitable that personal relationships and private agendas dominate some of the agency's contractual relationships with service providers.

The evidence concerning all four programs under investigation indicates that a personal connection to Director Martinez or other executive staff members smoothed the way for DSAS funding. As described in more detail in the Commission's factual findings in Part Two below:

1) La Nueva Raza Institute, Executive Director
   Rafael Cantellops (Part Two, Section II)

   Cantellops had direct access to Martinez, which not only helped him secure initial funding for LNRI in 1981, but also was instrumental in avoiding de-funding in 1982 and in obtaining additional funds for his residential program in 1986 and subsequent years.
2) Prospect, Inc., Executive Director
Arnold Freeman (Part Two, Section III)

The usual process for evaluating and approving proposals was circumvented by Martinez and Charles LaPorte (DSAS Deputy Director for Chemotherapy Services), who created the impression that the project was a priority initiative of the Governor's office and instructed Contract Management to provide funding. In fact, the project was the private initiative of Ben Fernandez, a friend of Martinez and LaPorte, and the Governor's office was disinterested. Once under contract, Prospect enjoyed special attention and protection from LaPorte because of LaPorte's friendship with and desire to please Fernandez.

3) National Expert Care Consultants, Inc.,
President Don Russakoff (Part Two, Section IV)

By virtue of his direct access to Martinez, Russakoff was able to secure a $4.2 million funding commitment for NECC without any competition, even though a competitive process probably would have yielded the most efficient allocation of those funds. This is particularly true since DSAS was prepared to provide the money to a profit-making business; an RFP process would have yielded guidelines for appropriate profit margins and the contractor willing to provide services for the least profit.

4) El Regreso, Executive Director
Carlos Pagan (Part Two, Section V)

Pagan's funding proposal was handled outside of Contract Management by his friend and Director Martinez's assistant, Franklin Soto, who effectively committed DSAS to funding El Regreso.

Where DSAS officials have a personal interest in a program, objective evaluation is impaired. For example, in deciding to fund NECC (see Part Two, Section IV(C)), Director Martinez dismissed or ignored his staff's and another agency's concerns about the program, thus evincing a vested interest incompatible with objective decision-making. Similarly, Deputy Director

8 Witnesses contend that Russakoff's advantage was his possession of a site for his program. However, an organized bid solicitation process that publicized the contract terms that were provided NECC, such as a grant for the purchase of midtown Manhattan real estate and a profit margin on personnel and lease expenses, may have yielded other for-profit businesses with sites.
LaPorte's persistent support of Prospect impeded Contract Management's assessment of the program and caused Gerard Armstrong (Deputy Director of Contract Management) to hesitate urging its closure (see Part Two, Section III). Contract Management's unsuccessful attempt to close LNRI in 1982 and Martinez's continuing support for the program (see Part Two, Section II(E) and (F)) is perhaps the best illustration of Armstrong's observation that "it is a lot more difficult for Contract Management to act objectively" when there is a personal connection between a program and DSAS executive management. ⁹

Finally, DSAS' ad hoc contracting process also results in dangerously low staff morale. Contract Management staff see rules bent or ignored and their authority usurped by others. In such an atmosphere, they believe that their work is irrelevant; their initiative and sense of professionalism and common purpose is undermined. Feeling helpless to alter the course of events, Contract Management staff come to believe that their role is simply to "process paper." The fear of reprisal for following rules render staff members unwilling to make difficult decisions and thus encourages inertia. Ultimately, the staff's sense of futility erodes vigorous enforcement of the agency's already deficient rules and procedures.

⁹ Armstrong Tr. at 352.
RECOMMENDATIONS

As long as DSAS continues to contract out for the provision of treatment services, greater objectivity and accountability in its decision-making process is imperative. Toward that end, the agency should adopt more specific and stringent procedures governing all aspects of the contracting process. Section I below sets forth recommended changes in DSAS' contracting process.

Some of the agency's weaknesses could be ameliorated by government action that goes beyond changing DSAS' contracting practices. For example, the creation of a local government substance abuse agency in New York City would help reduce the heavy burden that DSAS currently shoulders and ease the conflict between the agency's several missions. This and other recommendations that require action by other agencies or levels of government are discussed in Sections II, III and IV below.

I. DSAS MUST ADOPT MORE SPECIFIC AND STRINGENT CONTRACTING PROCEDURES TO BRING MORE OBJECTIVITY AND ACCOUNTABILITY TO ITS DECISION-MAKING PROCESS

Although some discretion is both inevitable and desirable in the contracting process, the efficient management of limited resources and public confidence in government require that agency decision-making be channeled through well-defined procedures, guided by standardized criteria, and thoroughly documented.

A. A Written, Competitive Funding Process

Each year, DSAS should identify funds available for new and expanded treatment services and award them by a competitive process. The availability of funds should be widely advertised, uniform deadlines should be set for submission of funding applications, and the receipt and evaluation of proposals should be routinized. Existing programs should be required to compete in this process for any funding increase over the previous year's level, other than increases necessary to maintain existing service levels.

To ensure that all funding proposals are handled identically by the agency, the competitive process should be set forth in clearly written regulations or procedures. Such regula-
tions should specify that all funding applications must be sent to the Deputy Director for Contract Management.10

The regulations or procedures should also specify, by job title, the individual(s) to whom the Deputy Director is to refer proposals and establish each individual's responsibility (e.g., evaluation and recommendation) with respect to the proposal.11

B. An Evaluation Form For Identifying

Appropriate Criteria And Their Respective Weight

An evaluation form should be developed for rating funding applications, and the written guidelines or procedures must require completion of the form by a specified DSAS staff member. The form should identify all criteria appropriate for consideration in determining whether a program is to receive DSAS funding, such as whether the contractor is experienced or otherwise qualified; will serve a geographic area or population that has insufficient treatment services; and meets predetermined guidelines for treatment cost per client.12

The evaluation form should assign a value or "points" to each criterion so that the application can be graded. This grading system will ensure that each criterion has a predetermined weight and is given appropriate consideration. It will also facilitate objective comparison of the merits of competing funding applications. No application should be funded unless it meets a predetermined minimum score, and no application should be funded before another receiving a higher score.

The regulations or guidelines should require the individual responsible for completing the evaluation form to prepare and sign a written recommendation indicating whether funding should be approved or denied. This recommendation should contain an explanation of how each criterion was scored and identify anyone who contributed information or advice used in scoring and making the recommendation.

10 The regulations also should require that all officials and employees of the agency so instruct any prospective contractor, and that an application received by anyone else in the agency should be forwarded immediately to the Deputy Director with a cover memo indicating when and how it was received. The cover memo should be preserved in the Deputy Director's files.

11 A routing slip should be used by the Deputy Director to show when he received the proposal, the individual(s) to whom it was then forwarded, and receipt by the individual(s). If anyone other than the individual(s) specified in the guidelines is involved at this preliminary stage of the process, that person's name and the nature of the involvement should be noted on the routing slip.

12 The State Department of Social Services has successfully used an evaluation form, similar to the one recommended herein, for awarding Homeless Housing and Assistance Program grants.
At each successive level of the decision-making process a similar document should be prepared and signed, specifying any additional or different considerations taken into account. A decision to reverse a recommendation made at a previous level in the process should be explained with particularity.

C. Standards And Timetables For Program Development Grants

Pre-established standards and timetables should govern program development grants which cover the pre-operational phase of a program. During this phase, salaries and staffing levels should be standardized, and target dates should be imposed for securing title or a lease, beginning operations and achieving minimum client census.

A program that fails to meet a target should be ineligible for further DSAS funding without written justification demonstrating that the failure will be corrected by a date certain. DSAS should develop criteria governing the suspension or reduction of funding for programs that fail to meet a required target. These targets and sanctions, if enforced, will provide incentive for new programs to act expeditiously and achieve objective standards, and at the same time help DSAS to avoid committing more and more money to projects that cannot get off the ground.

Further, DSAS should adopt a policy similar to that of the State Department of Social Services, under which funding is not released to a service provider until anticipated funding commitments from outside sources have been obtained (see Part Two, Section II(H)). Where DSAS expects other agencies to contribute to a program’s budget, as with LNRI’s residential program and Prospect’s initial proposal to acquire Prospect Hospital (see Part Two, Sections II(H)(1) and III(C)), the service provider should prove its ability to tap the other sources before DSAS begins spending its own limited funds.

If a treatment provider is expected to decrease its dependence on DSAS funds by securing funding from other sources, the amount of that funding and a predetermined schedule for its receipt also should be identified at the outset. Programs that fail to keep to the schedule should be ineligible for further DSAS funding unless the service provider documents to DSAS’ satisfaction that the required level of outside funding will be achieved by a date certain.
D. Meaningful Performance Standards And Penalties For Non-Compliance

DSAS should establish its own written performance standards governing such matters as client census; frequency of client visits; client turnover; and group, individual and family counseling. These standards should require a level of performance deemed necessary by DSAS to provide effective treatment, and failure to meet the standards should trigger a target date by when performance must be improved or funding reduced or terminated.

Also essential are stringent reporting and disclosure requirements and penalties for failure to meet performance standards or to submit accurate reports. Programs that persistently fail to submit required and accurate documentation must be subject to penalties.

Similarly, DSAS must develop and impose penalties for failure to comply with existing rules such as those requiring competitive bidding of subcontracts and advance written approval of certain expenditures. DSAS must establish by regulation that under no circumstance will any rule be waived retrospectively, and that no reimbursement can be made for an expenditure incurred in violation of such a rule.

Exemption from any rule should be possible only with prior written approval of the program’s contract manager and the Deputy Director for Contract Management, with an explanation of the compelling circumstances justifying the exemption. DSAS should identify in its regulations or guidelines those factors justifying exemption; expedience should not be one of them.

E. Objective Procedures For Evaluating Problem Programs

The regulations or guidelines should include criteria for determining whether a "problem program" should be de-funded and to establish staff responsibility for that determination.

The regulations or guidelines should define "problem programs" and require a written statement of the reasons for the program’s failure to satisfy DSAS performance standards and whether the problems are amenable to improvement with a reasonable level of assistance from the agency. Termination of funding should be required unless the contract manager can articulate in writing a reasonable basis to conclude that the problem is temporary and can be remedied with agency assistance.

The regulations or guidelines also should specify all appropriate steps that Contract Management may take to assist a program. DSAS should encourage "problem programs" to accept DSAS guidance by routinely imposing a probationary period by the end of which the program must demonstrate improvement. A second evaluation at the end of the probationary period should
describe in detail the problems prompting the probationary period, Contract Management’s efforts to remedy the problems, and the extent to which those efforts have been successful.

If the program has not sufficiently remedied its performance problems to be removed from "problem program" status, funding should be terminated unless Contract Management can demonstrate that a brief extension of the probationary period will be sufficient to remedy the problems.13

DSAS also should develop criteria governing continued funding for programs that cannot sustain their performance after having been removed from "problem program" status. Recidivist programs such as LNRI (see Part Two, Section II (F) and (H)) should not be treated the same as new "problem programs": they should not be granted the same probationary periods nor command the same amount of DSAS’ assistance, unless DSAS documents that the newest problems are unrelated to the earlier ones and, if remedied, are not likely to be succeeded by still more substandard performance.

F. Greater DSAS Authority Over The Management Of Treatment Programs

Where failure to achieve performance standards is attributable to poor program management, DSAS should have as an option the power to insist that a program’s management be replaced. That power is inherent in the agency’s authority to terminate funding, and DSAS should establish it and procedures for doing so in the agency’s regulations and service provider contracts.14

Since finding and obtaining sites for the operation of treatment programs is difficult, consideration should be given to allowing DSAS to retain the right to take control of property purchased or leased with DSAS funds in the event that the funded service provider fails to perform adequately or to follow DSAS requirements.15 For example, if program problems are the result of poor administration and program executive management or the board of directors is unresponsive to DSAS’ demands for reforms, DSAS could be authorized to assert control over the property and substitute a different service provider.

13 In some circumstances, a reduction in DSAS funding may be more appropriate than termination. DSAS should specify such circumstances in its regulations or guidelines.

14 To the extent that a program receives substantial funding from other sources, it will be less easily influenced by DSAS’ funding decisions. However, the poorly managed programs appear to be the ones most dependent on DSAS funds.

15 Such a right could be established either by securing an interest in the title or lease, or by contract with the service provider.
The power to assume the lease or title to program sites also would be useful when service providers change location or go out of business for reasons unrelated to poor performance. For example, when the Veritas program moved from the site that NECC later rented (see Part Two, Section IV(C)(1)), if DSAS could have acquired the building instead of NECC then DSAS could have sought competitive proposals to run a treatment program there.

G. Better Record-Keeping Practices

DSAS should establish rules requiring that all contracting decisions and their explanations be reduced to writing. All documents relating to each program should be maintained in a central file system. These requirements will ensure that the contracting process can be audited and the reasons for decisions and the identity of the individuals responsible for them discovered.\(^\text{16}\)

H. Disclosure And Certification Requirements

All applicants for DSAS funding should be under a continuing duty to disclose the identity of all shareholders, directors, officers and employees of the corporation; any personal or professional relationships each may have with DSAS officials and employees; and any outside employment that would interfere or conflict with the performance of any full-time duties. Any other actual or potential conflicts of interest, such as a financial interest in property to be acquired with DSAS funds, also must be disclosed.

Similarly, when a treatment provider seeks DSAS approval of a subcontract, the request for approval should include disclosure of the subcontractor's principals and employees and the existence of any personal or professional relationships they may have with DSAS employees and program officials and employees. The service provider should be required to certify that DSAS procedures, such as competitive bidding requirements, were followed and that the proposed subcontract is the product of arm’s length negotiations. Failure to make required disclosures and the provision of inaccurate information must be subject to specified penalties.

I. Leadership That Encourages Adherence To Rules

No enhanced rules, procedures and sanctions will be effective without leadership that supports their enforcement. Agency management must demonstrate commitment to the contracting process through words and actions. Respect for procedural regularity can also be

\(^{16}\text{Contract managers should also maintain a daily log of their activities with respect to each program under their jurisdiction. Such a record should include a brief description of any conversations they have with program personnel and other DSAS staff.}\)
fostered by agency seminars and workshops aimed at educating staff about the workings and importance of contracting procedures.

II. A NEW YORK CITY SUBSTANCE ABUSE AGENCY SHOULD BE ESTABLISHED

The creation of a New York City agency to identify treatment needs and service providers, such as exists nearly everywhere else in the State, would be of substantial benefit in eliminating the problems encountered by DSAS in its efforts to administer and expand treatment services in New York City. A local government agency would reduce the burden on Contract Management staff and permit DSAS to exercise a larger and more effective oversight role. Moreover, the involvement of two independent levels of government, accountable to separate constituencies, would provide the necessary checks and balances to ensure that each acts with objectivity.

III. THE STATE OR NEW YORK CITY SHOULD LOCATE AND ESTABLISH ITS OWN TREATMENT FACILITIES

Since one source of DSAS' difficulty in expanding treatment services is the dearth of organizations and individuals willing to provide such services, DSAS should consider a limited return to the direct provision of treatment either by itself or by a New York City agency.

With the substance abuse problem at crisis levels, particularly in New York City, the provision of necessary services should not be left exclusively to a private sector that is unwilling or unable to meet the need. Providing treatment for substance abusers cannot be handled in the same manner as building highways or even caring for the elderly, where private contractors are more plentiful. The client population simply does not attract sufficient private sector providers.

Government operated treatment services would ensure that treatment is provided in neighborhoods where existing programs and potential contractors are reluctant to do business. Moreover, such programs would generally enhance DSAS' resources and flexibility in fighting drug addiction. These additional resources would create competition with existing programs so that DSAS is not completely dependent upon them.

Similarly, since finding and obtaining sites for the provision of services is particularly difficult, the State or the City should directly purchase and renovate treatment sites even for
programs that will be privately operated. While problems such as community opposition will not be eliminated, the government can exercise eminent domain to acquire property and tap the resources of such agencies as the New York State Facilities Development Corporation. Perhaps more important, DSAS would avoid expending its own limited financial resources on drawn-out and often unsuccessful efforts to acquire treatment sites by individuals and organizations who lack the skills and knowledge necessary for such an endeavor.

IV. STATE AND LOCAL GOVERNMENT AGENCIES SHOULD POOL INFORMATION ABOUT SOCIAL SERVICE CONTRACTORS

Because some social service providers contract with and receive funds from more than one government agency, more formal inter-agency coordination would enable each agency to draw upon the experience of others. A computerized central registry of contractors should be created and each agency should be required to file an annual standardized report on each service provider with which it has contracted. The report should contain information regarding the type of service provided, the contract period and budget categories (e.g., rent, capital improvements, equipment) for which funding is received, any problems that the agency encountered in its dealings with the contractor, and whether the contract was terminated for any reason.

All agencies should be required to check the central registry before contracting with a service provider in order to make sure that the contractor is reliable and is not paid twice for the same materials, services or space. Such a requirement would help avoid situations like those encountered by DSAS when it decided to fund NECC (see Part Two, Section IV(C)(3)). If DSAS Contract Management had checked with a central registry and learned the details surrounding NECC’s prior contract with the State Division of Parole; had evaluated the Division of Parole’s problems with NECC and the advisability of contracting with NECC in light of them; and developed a plan for avoiding similar problems in its contract with NECC, then the history of DSAS’ relationship with NECC might have been much different.

Likewise, if DSAS had filed yearly reports on its problems with LNRI, and if the Department of Social Services had reviewed those reports before deciding to award its funds to LNRI’s residential program, then substantial state funds might not have been wasted on that project (see Part Two, Section II(G)).

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Adoption of the procedural recommendations outlined above in Section I will impose some additional requirements on DSAS staff. However, many of the problems in DSAS’
contracting process stem in part from the agency’s focus on immediate expansion of treatment capacity without concern for the long-term consequences of its lax contracting process. Faithful adherence to more rigorous procedures will improve the integrity of the process, yield more effective and productive treatment programs, and attract more treatment providers. Adoption of the other Commission recommendations will reduce some of the agency’s burdens and permit it to perform its important responsibilities more fairly and effectively.
PART TWO
FACTUAL FINDINGS

I. AGENCY STRUCTURE AND CONTRACTING PROCESS

A. Agency Organizational Structure

DSAS is comprised of twelve bureaus, each of which is headed by a Deputy Director who reports to the First Deputy Director and the Director.17 A principal focus of this investigation is the agency's Bureau of Contract Management and Fund Allocation ("Contract Management"), which has primary responsibility for funding and monitoring local service providers through a staff of contract managers in eight regional offices.18 This investigation focuses on Region 7, comprised only of New York City.19

Julio A. Martinez has been the Director of the agency since 1979. Norwig Debye-Saxinger has been the First Deputy Director since 1984, when he was promoted from his position as Deputy Director of Contract Management. Gerard Armstrong has been Deputy Director of Contract Management since Debye-Saxinger's promotion, and previously was the Downstate Chief of Contract Management. The current Downstate Chief of Contract Management is Carleton Deming.

B. Agency Contracting Procedures And Practices

DSAS' contracting process in New York City is unique because of the absence since the mid-1970's of any local government agency with responsibility for substance abuse services. Outside New York City, DSAS generally contracts with county social service agencies,

17 The twelve bureaus are: Administration and Fiscal Management; Counsel; Communications; Prevention and Educational Services; Chemotherapy Services; Government and Community Relations; Program Development; Field Audit and Program Review; Evaluation and Research; Contract Management and Fund Allocation; Program Services; and Laboratories and Testing.

18 DSAS Local Services Manual, Items 1501 and 1503. See also Armstrong Tr. at 152.

19 Regions 1-6 include all counties north of New York City and are supervised by the Upstate Chief of Contract Management in Albany. Region 8 covers Nassau and Suffolk Counties; Regions 7 and 8 are supervised by the Downstate Chief of Contract Management at the agency's regional office at 55 West 125th Street, New York City. The Upstate and Downstate Chiefs report to the Deputy Director for Contract Management who is located at the agency's executive offices at 250 Broadway, New York City.
which are responsible for identifying service needs and providers. New York City's Addiction Services Agency used to perform that role, but was dissolved during the City's fiscal crisis; since then, DSAS has assumed direct responsibility for managing all service provider contracts in the five boroughs and finding and contracting for new and expanded services.

Contract Management's responsibility to evaluate proposals and negotiate contracts is described briefly in DSAS' Policy and Procedure Manual for Local Service Providers and Local Services Manual. These guidelines are general and provide little detail concerning how the agency's funding decisions are made.

1. Existing Treatment Providers

Existing treatment programs annually submit applications for renewed funding and, as long as a program seems "cost effective" and has good client utilization, it is virtually assured of receiving funding at least at the same level as the previous year. Each year, after DSAS evaluates the new state budget, it usually informs existing programs whether and to what extent they can increase their funding proposals over the previous year's contract.

DSAS does not require existing programs to compete for funding. When a program applies for renewed funding, its contract manager is supposed to complete a "Workscape and Budget Proposal Review" form which contains a small space for "Summary/Recommendations." However, because of understaffing and heavy workloads in the New York City office, the form is not completed for as many as half the programs handled by that office. In any event, the

20 Armstrong Tr. at 75; Deming Tr. at 46. DSAS has occasionally entered into direct contracts with service providers outside of New York City. See, e.g., Armstrong Tr. at 406-07.

21 Armstrong Tr. at 75-76, 89; Deming Tr. at 46; Debye-Saxinger Tr. at 18.


23 Armstrong Tr. at 76; Deming Tr. at 32-35, 43; Memorandum of Interview with Gerard Armstrong, dated June 22, 1989. DSAS' Policy and Procedure Manual for Local Service Providers, Item 2100.2, contains a list of "factors" to be considered in reviewing an application for renewed funding. These include such matters as "a continuing, demonstrated need for services," "prior and current year utilization," and "service cost." The manual does not indicate how DSAS staff should determine the extent to which a program satisfies these factors, or each factor's relative weight.

24 Deming Tr. at 34-39, 56.

25 Armstrong Tr. at 89.


27 Id.
form does not call for any comparison of the applicant's costs or programmatic effectiveness with other existing treatment providers.

2. **New Treatment Providers**

DSAS' contracting process for new or expanded programs in New York City is informal, varying from program to program. With only one exception, DSAS has not issued a request for proposals ("RFP") for new or expanded programs unless a competitive process is specifically required by the legislative appropriation, and legislatively required RFPs in this field have been scarce.

Although DSAS management has expressed interest in increasing the number of service providers, and Armstrong believes that an RFP process is a useful means of doing so, agency officials have been reluctant to use RFPs because of the time and staff necessary to complete the paperwork. They consider a competitive process not worth the effort required to overcome the difficulty in attracting new treatment providers.

When DSAS determines that it has sufficient funds to finance new or expanded programs, it advises providers of the availability of the funds by word of mouth or by circulating an administrative bulletin. However, unsolicited funding proposals for new or expanded services are

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28 Deming Tr. at 179-81, 185-87, 190-91; Ringer Tr. at 114-15.

29 The one exception occurred in 1986 and involved an effort to increase vocational services for drug programs and their clients. Armstrong Tr. at 81-83, 90. Although others in the agency opposed the idea, Armstrong made the decision to use an RFP because "it had never been done before" and he liked the objective, competitive process. Id. at 82, 88. The response was "overwhelming." Id. at 82.

30 Armstrong Tr. at 76, 78; Deming Tr. at 182-84. The DSAS Local Services Manual, Item 3110, contains a detailed RFP procedure that the agency "may" use, when it deems "appropriate," for funds that are "allocated or appropriated ... for specific local program purposes."

31 In 1985, funds for homeless substance abusers were required to be distributed through an RFP process, as are certain federal funds and funds distributed through a State task force for projects sponsored by more than one agency. Deming Tr. at 183-84; Armstrong Tr. at 83, 90-91. Starting this year, State funds for capital projects (i.e., facility acquisition and renovation) must be expended through an RFP process. Armstrong Tr. at 83.

32 Armstrong Tr. at 85, 89.

33 Id. at 91. See also Deming Tr. at 191-93; Debye-Saxinger Tr. at 292.

34 Armstrong Tr. at 87. A computer print-out provided by DSAS to the Commission indicates that, since 1979, DSAS has increased the number of all drug-free treatment providers in New York City from 34 to 51, and the number of residential treatment providers from 19 to 26.

35 Armstrong Tr. at 91-93; Deming Tr. at 179-82.

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received by DSAS throughout the year.\textsuperscript{36} Although proposals may arrive at any level of the agency, they are supposed to be forwarded to the Deputy Director for Contract Management (Armstrong) for an initial review to determine if they have merit and can be accommodated within DSAS’ budget.\textsuperscript{37}

If Armstrong concludes that a proposal warrants further consideration, he forwards it to the appropriate regional office for evaluation by a contract manager.\textsuperscript{38} There are no written criteria by which a proposal may be evaluated, except that funding priority is given to proposals to serve "high need areas" and which have a local government funding commitment.\textsuperscript{39}

The contract manager is supposed to make a recommendation which is communicated to his or her regional office supervisor, to the Downstate or Upstate Chief, and finally to Deputy Director Armstrong.\textsuperscript{40} Armstrong then decides whether to fund a program, but might consult with Director Martinez and/or First Deputy Director Debye-Saxinger before doing so.\textsuperscript{41}

Sometimes the contract manager's recommendation will be made in writing, but often an informal discussion is all that takes place.\textsuperscript{42} Since 1986, new funding proposals are supposed to be evaluated using the "Workscope and Budget Proposal Review" form,\textsuperscript{43} but, as with applications for renewed funding, the form is used as little as 50% of the time in the New York City office.\textsuperscript{44}

\textsuperscript{36} Debye-Saxinger Tr. at 113.

\textsuperscript{37} Armstrong Tr. at 77-79; Deming Tr. at 200.

\textsuperscript{38} Armstrong Tr. at 93-94, 97; DSAS Local Services Manual, Item 1501. If DSAS has insufficient funds for a proposal, or if the proposal is "outlandish" in cost or purpose, the Deputy Director does not send it on for further review and so informs the applicant either by letter or by telephone. Armstrong Tr. at 78-80. A reasonable proposal that cannot be accepted due to lack of funds will be saved for no more than a year. \textit{Id.} at 125.

\textsuperscript{39} DSAS’ Policy and Procedure Manual for Service Providers, Item 2100.1, p.1 ("Criteria").

\textsuperscript{40} Armstrong Tr. at 94, 100-01.

\textsuperscript{41} \textit{Id.} at 101-02.

\textsuperscript{42} \textit{Id.} at 101. If the staff disagrees, "then it's carefully written up." \textit{Id.} However, Armstrong could not recall a situation where Contract Management staff was unable to reach a consensus on a funding decision. \textit{See} Memorandum of Interview with Gerard Armstrong, dated June 22, 1989.

\textsuperscript{43} \textit{See} above, p. 24-25.

\textsuperscript{44} Memorandum of Interview with Gerard Armstrong, dated June 22, 1989.
3. **Recoupment And Termination Of Funding**

DSAS does not require service providers to routinely document that their expenditures were consistent with budgetary restrictions or regulatory requirements, such as competitive bidding. When DSAS discovers that a program has spent money improperly or without required authorization, the funds are normally recouped by withholding payments under contracts in later years.

Programs with serious problems and the possible termination of funding must be discussed at a meeting of the "Problem Program Review Committee." However, that committee was disbanded in 1985 because it was considered ineffective. Programs that violate any statute, rule or regulation relating to the operation of a substance abuse program may be fined up to one thousand dollars, but the Commission's investigation disclosed no case in which such a penalty was imposed.

Indeed, because of the scarcity of treatment providers, DSAS is reluctant to defund or penalize problem programs and "bends over backwards" to help them. The most problematic programs tend to be the smaller ones which have the fewest resources and are most dependent on DSAS funding, and for those programs DSAS is reluctant even to disallow unauthorized expenditures.

A recommendation to terminate funding usually originates with the contract manager responsible for the program, although on at least one occasion Armstrong decided to cut off funding without the contract manager's input. Armstrong will not de-fund a program

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45 Deming Tr. at 78-80, 85-86.

46 Id. at 72-75.

47 DSAS Local Services Manual, Item 4302. The Problem Program Committee is composed of the First Deputy Director, Counsel, Deputy Director for Contract Management, Deputy Director for Field Audit and Program Review, Deputy Director for Government and Community Relations (community problems), Deputy Director for Prevention and Education Services (school programs), Deputy Director for Methadone Services (methadone services), and "other Unit Heads as appropriate." Id.

48 Armstrong Tr. at 25.

49 Mental Hygiene Law § 23.03(a).

50 Armstrong Tr. at 86-87, 149.

51 Id. at 159; Deming Tr. at 73-74, 150-51.

52 Armstrong Tr. at 160.
without first writing a justification for the action and discussing it with Director Martinez and First Deputy Director Debye-Saxinger.53

C. Agency Management

Contract Management’s ability to carry out its responsibilities objectively and effectively is impaired by the personal involvement in the contracting process of Director Martinez and, to a lesser extent, First Deputy Director Debye-Saxinger, and by the relationship between the two men.

1. Executive Management’s Personal Involvement In The Contracting Process

Director Martinez views the agency’s contracting procedures as an obstacle to the quick expansion and delivery of treatment services.54 In order to cut through "red tape," he sometimes takes a personal role in the contracting process.55 In doing so, he disregards Contract Management staff and agency procedures, relying instead on certain trusted advisers who have no official roles in the contracting process.56

For example, Charles LaPorte, DSAS Deputy Director for Chemotherapy Services, is a close friend of Martinez and is seen by agency staff as influential with the Director and as exercising the Director’s authority.57 LaPorte pressures Contract Management staff to give certain programs special treatment by going to staff directly when Armstrong is not there.58 Invoking Martinez’s name, LaPorte urges the staff to accommodate a program financially, to give it more assistance or higher priority, or to approve the hiring of a particular individual; in short, "to move whatever he wants moved."59

53 Id. at 57, 161.

54 Damm Tr. at 15; Armstrong Tr. at 1327. See also Debye-Saxinger Tr. at 100-01.

55 Debye-Saxinger Tr. at 15-16, 100.

56 Id. at 62 (Martinez "clearly has gone outside of the normal expected channels to either help generate programs or he has countenanced providers that somehow came to him to go outside of the normal channels"). See also id. at 36-40, 72-73, 146, 153, 161, 221, 254, 259-60; Damm Tr. at 11-12.

57 Debye-Saxinger Tr. at 62, 70, 105; Armstrong Tr. at 1176-77.

58 Armstrong Tr. at 1177, 1438-39.

59 Id. at 1176-79. See also Debye-Saxinger Tr. at 38-39, 105, 404-05. Martinez once distributed a memorandum entitled "Julio Says," warning staff not to use his name in their effort to advance pet projects within the agency. Armstrong Tr. at 1436. However, the memo did not change either LaPorte’s behavior or the staff’s reaction to it. Id. at 1437.
Franklin Soto, who has held a variety of positions within the agency, also is a close friend of Martinez and acts as the Director's agent to advance certain projects. Soto reports to Martinez in detail about the staff's activities and therefore is widely seen as the Director's "eyes and ears." Because Soto takes direction only from Martinez, others in the agency find him disruptive and difficult to work with.

Because Director Martinez prefers informality and believes that he should be accessible to people in the treatment field, he tolerates and even encourages program directors who go around Contract Management to contact him directly, whether in regard to an established or a proposed program. Program directors who are personally or professionally close to Martinez have more access to him than others. According to Debye-Saxinger, in seeking to expand services Martinez seems to rely on people he already knows or who approach him directly, rather than on an established, systematic process.

First Deputy Director Debye-Saxinger also sometimes takes a personal role in the contracting process and bypasses the usual Contract Management procedures. Although Debye-Saxinger did not come to DSAS from the treatment field, he developed ties to certain programs that he worked with when he was head of Contract Management, and these programs tend to deal directly with him.

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60 Armstrong Tr. at 1188-90, 1211-12, 1220-23; Soto Tr. at 3-7. See also Debye-Saxinger Tr. at 36. Soto considers Martinez to be one of his "best friends" and they socialize together when Martinez is in New York or Soto is in Albany. Soto Tr. at 16.

61 Armstrong Tr. at 1190, 1220-21.

62 Id. at 1189-90, 1220-21. Armstrong has told Martinez about Soto's disruptive effect, but the Director's response was that he found Soto useful. Id. at 1221.

63 Id. at 42, 44-45, 357, 819-20; Damm Tr. at 29; Debye-Saxinger Tr. at 62, 84-85, 118-19, 151, 261.

64 Armstrong Tr. at 46. Before becoming Director of DSAS, Martinez developed close relationships in the New York City drug-free treatment community, first as a client in a treatment program, then the founder and director of Project Return, a residential program, and then as the head of the New York City chapter of Therapeutic Communities of America. Id. at 357. See also Debye-Saxinger Tr. at 156-57.

65 Debye-Saxinger Tr. at 84-85. See also id. at 161-62, 221, 265, 267, 280. Debye-Saxinger described Martinez's efforts at expanding services in these terms: "a kind of daily ... I know you, you look good, do it, here's some money." Id. at 77.

66 Armstrong Tr. at 220, 230, 399-401, 410-11.

67 Id. at 42, 49-50, 353, 361, 362, 399-401, 408-09. See also Debye-Saxinger Tr. at 576-78.
2. The Relationship Between Director
Martinez And First Deputy Director Debye-Saxinger

Armstrong testified that Director Martinez and First Deputy Director Debye-Saxinger have a difficult relationship which stems from the 1970's, when Martinez ran Project Return and Debye-Saxinger was head of Contract Management. During that time, they had differences of opinion on DSAS funding for Project Return and how its contract was handled.

Martinez views Debye-Saxinger as too bureaucratic and overly concerned with procedures. If Debye-Saxinger expresses concerns about a particular course of action, suggests a different way to handle the matter, or does not seem fully supportive of one of Martinez's projects, Martinez feels challenged and may eliminate him from discussions and decision-making and handle the matter himself. The two co-exist by allowing each other to handle autonomously the programs with which each has close relationships; they "have a sense of resignation, or helplessness about the other's territory."

3. The Consequences For Contract Management
Of Executive Management's Personal Involvement

When a program director has a personal connection to DSAS executive management, staff believe that they must accord the program every possible accommodation and give it priority over all others. For example, Contract Management has been able to "terminate funding of programs more expeditiously" when there is no personal link to Martinez or Debye-Saxinger.

68 Armstrong Tr. at 48.
69 Id. at 48, 1328.
70 Damm Tr. at 13-14. For his part, Debye-Saxinger sees Martinez as a poor manager and believes that he could administer the agency better than Martinez. Armstrong Tr. at 232.
71 Damm Tr. at 7-8. Indeed, Martinez views Debye-Saxinger with great suspicion: he believes that the First Deputy Director is the person responsible for complaints to this Commission, the Inspector General, and to the newspapers about the programs under investigation. Armstrong Tr. at 219-20, 1331-32; Debye-Saxinger Tr. at 34.
72 Armstrong Tr. at 413-14.
73 Id. at 352, 358, 819. See also Damm Tr. at 30; Debye-Saxinger Tr. at 61.
74 Armstrong Tr. at 352. See also id. at 353, 361, 362.
Moreover, Martinez’s direct dealings with program directors makes Contract Management staff feel excluded from the process, and creates the impression that deals have been struck at the top of the agency and that staff are simply supposed to process the paperwork.\textsuperscript{75} Thus, objective decision-making becomes difficult.\textsuperscript{76} The problem is exacerbated as the program directors come to believe that they are not accountable to Contract Management and do not have to follow the usual rules and procedures.\textsuperscript{77}

Staff who insist on following procedures or raising questions about a program are viewed as creating roadblocks and are sharply rebuked or, like Debye-Saxinger, isolated by Martinez.\textsuperscript{78} Thus "sent to Siberia," the staff member feels outcast, useless and anxious whether his or her work has any effect.\textsuperscript{79} When the outside treatment community learns that a contract manager is in disfavor, they skirt that manager, increasing the sense of isolation.\textsuperscript{80}

Not surprisingly, on projects where the Director has a particular interest or personal relationship with the program director, Contract Management staff members are afraid to ask questions or insist on procedures and feel that their authority and even their positions are at risk.\textsuperscript{81} In such circumstances, staff would rather wait for someone else to raise the question or objection.\textsuperscript{82} Indeed, Chief Counsel Damm has heard from Contract Management staff expressions such as "you have got to stop putting roadblocks here, Julio wants this funded" and "the Director wants this moved along, so don’t give it so much attention."\textsuperscript{83}

The rivalry between Martinez and Debye-Saxinger has similar adverse effects on agency staff. Not only does Martinez deprive himself of the benefit of Debye-Saxinger’s judgment,
but sometimes Debye-Saxinger withholds his input deliberately. Apparently believing that he could resolve agency problems if he were the Director, he instead keeps his ideas to himself, once saying to Armstrong "I think that I have the deus ex machina solution to this problem, but I'm not going to tell you."\(^{84}\)

Moreover, staff feels caught between the two and must be careful not to appear to be taking sides in the rivalry. After Debye-Saxinger promoted Armstrong to Downstate Chief of Contract Management, Armstrong had to be careful not to seem to be taking Debye-Saxinger’s side in a disagreement with the Director.\(^{85}\) Likewise, Chief Counsel Damm’s ability to approach Martinez about issues can be affected by whether the Director perceives her as siding with Debye-Saxinger.\(^{86}\)

\(^{84}\) Armstrong Tr. at 236-37.

\(^{85}\) Debye-Saxinger Tr. at 152-53.

\(^{86}\) Damm Tr. at 13, 17-18.
II. LA NUEVA RAZA INSTITUTE/YOUNG ADULTS IN TRANSITION CENTER

A. Introduction And Summary

Rafael Cantellops is the founder and Executive Director of La Nueva Raza Institute ("LNRI"), an ambulatory drug-free treatment program which has received at least $2.2 million in DSAS funding since it was created in February 1981.

Since its inception, the program has been plagued with serious problems, many of which Contract Management staff attribute to Cantellops' poor administrative skills. From the outset, Martinez was kept informed of the program's poor performance, Cantellops' shortcomings and the many difficulties experienced by DSAS and LNRI staff in working with him. Nevertheless, in 1985 Martinez committed additional DSAS funds to LNRI to enable Cantellops to develop and operate a residential treatment program called the Young Adults in Transition Center ("YATC").

Because DSAS endorsed YATC, the New York State Department of Social Services ("DSS") co-sponsored and committed $800,000 to the project. However, because of DSS' dissatisfaction with YATC's progress, it never disbursed any of the committed funds. DSAS was also dissatisfied and terminated its support in June 1989, having spent $973,525 on the project and anticipating that it would have to spend at least another $687,123 before the program could open its doors.

Martinez's decision to fund LNRI, his abiding tolerance of its poor performance, and his decision to fund YATC are attributable, at least in part, to his longstanding relationship with Cantellops.

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87 Cantellops Tr. at 2-3.

88 See LNRI Monthly Statement of Expenditures, June 1982; LNRI Monthly Statement of Expenditures, June 1983; LNRI Monthly Statement of Expenditures, June 1984 (these statements, submitted by LNRI for the last month of each funding period, contain cumulative expenditure data for the entire contract year). DSAS did not provide LNRI expenditure statements for February 1981 - June 1981, during which period LNRI had a $75,000 contract with DSAS. Expenditures for the years July 1984 - March 1989 are taken from summary information provided to the Commission by DSAS.

89 See Memorandum to Michael Dowling from Gerard Armstrong, dated June 29, 1989.
B. Director Martinez's Relationship With Rafael Cantellops

Martinez first met Cantellops in 1966 or 1967 at Manhattan General Hospital, where Martinez was in a drug rehabilitation program. Cantellops, himself a rehabilitated addict, was then working for an earlier incarnation of the now defunct New York City Addiction Services Agency ("ASA").

After Martinez left Manhattan General in 1967, he helped establish Phoenix House. Cantellops, still employed by ASA, saw Martinez during visits to Phoenix House. During that period, Cantellops considered Martinez one of his protégés and Martinez viewed Cantellops as his mentor.

In 1969, Martinez left Phoenix House and went to work at ASA. Martinez and Cantellops began to socialize. Among other things, they and their families took some vacations together. However, their social activities became less frequent when Martinez left ASA in 1970 to establish Project Return. Their relationship became more active in 1974 or 1975 but slowed down again in 1978 or 1979. Since then, they have continued to socialize from time to time.

Martinez still regards Cantellops as a friend. According to Cantellops, every time the two of them meet Martinez expresses gratitude to Cantellops for having helped him kick his drug habit. Cantellops believes that he helped Martinez get to where he is today.
C. The Origins Of LNRI

Sometime in 1980, after Cantellops had left ASA, he contacted DSAS about funding for a drug program by phoning Martinez. That Fall he followed up with a letter to Martinez, proposing to establish an "attitudinal" training program.

In response, Martinez met with Cantellops in early October 1980 and referred him to DSAS' training department. The department informed Cantellops that no funds were available for the type of project he proposed. Cantellops and Martinez then set up a second meeting at which Martinez personally rejected Cantellops' proposal for the same reason. During that meeting, Martinez recommended that Cantellops instead start either a treatment or a prevention/education program for youth. Cantellops proposed a residential program, but Martinez persuaded him to begin with a less ambitious ambulatory program.

Thereafter, Martinez received a new proposal from Cantellops that, according to Martinez, "made a little more sense." He forwarded the proposal to Debye-Saxinger, who was then Deputy Director of Contract Management. Martinez personally introduced Debye-Saxinger to Cantellops, telling him: "help these people get a program started." At Martinez's

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101 Id. at 17-18.
102 Martinez Tr. at 427, 433.
103 Cantellops Tr. at 126. Cantellops testified that he wanted Martinez to help him with his plans. Id.
104 Martinez Tr. at 434, 437-38; Cantellops Tr. at 17, 24-25, 127-28.
105 Martinez Tr. at 438, 458-59; Cantellops Tr. at 127-28.
106 Cantellops Tr. at 131; Martinez Tr. at 438-39, 444, 457. Martinez testified that the proposal "wasn't worth fifty cents." Martinez Tr. at 437-38.
107 Martinez Tr. at 435. However, later in his testimony Martinez denied making such a recommendation. Id. at 447, 456-57.
108 Armstrong Tr. at 366-67, 462.
109 Martinez Tr. at 443-44.
110 Id. at 444-45.
111 Debye-Saxinger Tr. at 456, 458. Cantellops made no reference to Debye-Saxinger in his testimony regarding the application process. According to him, Martinez told him to meet with Armstrong, and either Martinez or Armstrong told him that he would have to submit a new proposal for a program to provide services to children. Cantellops Tr. at 25-27, 33. Shortly thereafter, he submitted his LNRI proposal which he developed with assistance from DSAS staff. Id. at 33-34.
request, Debye-Saxinger guided Cantellops through the early part of the application process and
generally advocated for the program.112

However, friction arose between Cantellops and Debye-Saxinger because
Cantellops acted as if Martinez had already committed DSAS funds to LNRI and Debye-Saxinger
was simply supposed to rubber-stamp and implement the decision.113 At the same time, Martinez
also became wary that Debye-Saxinger, who had a reputation as a "fairly hard-nosed contract
manager," was applying his "strict" approach toward LNRI.114 Consequently, Martinez transferred
responsibility for the program to Armstrong, who was then Downstate Chief of Contract
Management.115 Debye-Saxinger remembers LNRI as the first time that Martinez distrusted his
handling of a program.116

Martinez remained personally involved in his friend's proposal. He told Armstrong
that a funding application would be coming from Cantellops; that he had already met with
Cantellops and knew him; and that Armstrong should let him know if the proposal was sound
because he was interested in doing something for the Hispanic community in Queens.117
Martinez's strong personal interest in funding Cantellops was not lost on Armstrong.118 After
reviewing the application himself, Armstrong agreed to provide Cantellops with a start-up contract
to develop LNRI.119

112 Debye-Saxinger Tr. at 459-61.

113 Id. at 458.

114 Id. at 253.

115 Id. at 457-58.

116 Id. at 457.

117 Armstrong Tr. at 365.

118 Id. at 373-74, 427.

119 Id. at 374, 427. Armstrong testified that from the day he met Cantellops, he knew that LNRI was going to need a lot
of attention. Id. at 375, 427. Therefore, and because of Martinez's interest in the program, Armstrong hand-picked Gerard
Houser to be LNRI's contract manager, knowing him to be capable. Id. at 375-76.
D. The First Year Of LNRI's Operations

DSAS began funding LNRI in February 1981. Between then and June 1982 the program was allocated $319,000\textsuperscript{120} to pay for start-up costs such as site location, equipment and salaries.\textsuperscript{121}

However, LNRI's start-up period, particularly site selection, dragged on for an "exorbitant amount of time."\textsuperscript{122} Cantellops was permitted to operate LNRI from his apartment for most of the first year, although "Contract Management was uncomfortable with that and ... Houser [the contract manager] was pushing him, almost daily to find a location to begin operations."\textsuperscript{123} After eleven months, LNRI finally moved to its rented program site on Crescent Street, Long Island City.\textsuperscript{124}

E. Martinez Overrules Contract Management's Decision To De-Fund LNRI

In early July 1982, Armstrong put LNRI on probation because the program had not yet served a single client and was suffering from extraordinarily high staff turnover.\textsuperscript{125} After informing Martinez, Armstrong gave Cantellops two months to improve the client census at LNRI and "to establish within the program and its current employees an atmosphere which is conducive to the successful treatment of clients."\textsuperscript{126}

\textsuperscript{120} Contract between DSAS and LNRI for February 1, 1981 - June 30, 1981, and three amendments thereto. LNRI's actual expenditures are more difficult to determine. DSAS did not produce any documents showing LNRI's actual expenditures during the period February 1981 - June 1981. LNRI's monthly statement of expenditures for June 1982, containing cumulative information for the period July 1981 - June 1982, indicate that it spent approximately $283,000 during that contract year. A memorandum to Julio Martinez from John Randall and Gerard Armstrong, dated September 23, 1982, indicates that by June 30, 1982, LNRI had spent $367,250.

\textsuperscript{121} Houser Tr. at 29-32.

\textsuperscript{122} Id. at 21.

\textsuperscript{123} Armstrong Tr. at 377-78; Cantellops Tr. at 35-36.

\textsuperscript{124} Cantellops Tr. at 36; Armstrong Tr. at 378.

\textsuperscript{125} Memorandum to Contract Management staff member Vernon Sylvester from Gerard Houser, dated September 23, 1982. LNRI did not begin reporting client census to DSAS until July 1982. Id. "Client census" is the number of clients actually attending the program. Griffin Tr. at 116-19.

\textsuperscript{126} Armstrong Tr. at 380. DSAS did not provide the Commission with Armstrong's letter. The quoted text is from a later DSAS memorandum that quotes the letter. Memorandum to Vernon Sylvester from Gerard Houser, dated September 23, 1982, p. 1.
LNRI did not improve during the probation period.\textsuperscript{127} During the entire two-month probationary period, LNRI served only three clients.\textsuperscript{128} Further, at least three out of six staff members resigned in late July 1982.\textsuperscript{129}

Because the probation period was due to expire in September 1982 when Martinez would be on vacation, John Randall, then First Deputy Director, consulted with Martinez about LNRI before he left.\textsuperscript{130} Martinez told him to take appropriate action if LNRI did not meet DSAS standards.\textsuperscript{131} Randall, Debye-Saxinger, Armstrong and Houser all agreed that the program should be de-funded because of its extremely low client census and extremely high staff turnover rate.\textsuperscript{132}

On September 23, 1982, while Martinez was still on vacation, a letter was sent to Cantellops stating that DSAS would discontinue funding LNRI.\textsuperscript{133} Because of Martinez’s special relationship to the program, Armstrong and Randall believed that it was important to terminate funding while Martinez was still away; otherwise, they believed, Martinez would have kept funding the program despite his pre-vacation instructions.\textsuperscript{134}

\textsuperscript{127} Armstrong Tr. at 381.

\textsuperscript{128} Memorandum to Vernon Sylvester from Gerard Houser, dated September 23, 1982.

\textsuperscript{129} The three staff members complained of, among other things, "deplorable and inhumane working conditions" and nonpayment of wages. They went to DSAS offices to register their complaints with Martinez personally. Memorandum to the Board of Directors of LNRI from Haydee N. Colon, Martha Torres and Carmen Palomino, dated July 30, 1982, p. 3; Memorandum to Vernon Sylvester from Gerard Houser, dated September 23, 1982; Martinez Tr. at 466-67, 482-83.

\textsuperscript{130} Houser Tr. at 36-37; Armstrong Tr. at 381-82; Debye-Saxinger Tr. at 482-83; Randall Tr. at 10. At first, Martinez testified that he was "well aware" that LNRI had been placed on probation, Martinez Tr. at 482-83, but then he testified that he did not remember that the program was on probation, that he was away on vacation in Hawaii in September 1982, or that Randall had spoken to him about the program before he left. Id. at 491-93.

\textsuperscript{131} Randall Tr. at 10.

\textsuperscript{132} Id. at 10, 21; Debye-Saxinger Tr. at 481-82; Armstrong Tr. at 381; Houser Tr. at 38-40, 47. See also Memorandum to Norwig Debye-Saxinger from Gerard Armstrong, dated September 22, 1982; Memorandum to Vernon Sylvester from Gerard Houser, dated September 23, 1982; Memorandum to Julio Martinez from John Randall and Gerard Armstrong, dated September 23, 1982. These documents show that LNRI had a staff turnover rate of 230%, and a counselor position turnover rate of 360%, during its first 20 months of operation.

\textsuperscript{133} Letter to Rafael Cantellops from Julio Martinez, dated September 23, 1982. Although the letter was sent out in Martinez’s name, Martinez did not actually sign it. Martinez Tr. at 493-95.

\textsuperscript{134} Armstrong Tr. at 389, 432.
Martinez returned a few days after the letter was sent and almost immediately met with Angelo Giordani, Chairman of LNRI's Board of Directors. Then, on September 28, 1982, Martinez met with Cantellops, with Armstrong present, and informed Cantellops that he was going to continue LNRI's funding and give the program until December 15, 1982 to build an acceptable client census.

Martinez's revival of LNRI had a major and lasting impact on DSAS staff at all levels. Randall was furious at Martinez for overruling him and rescuing an unworthy program. This episode impaired Randall's ability to manage DSAS and was a factor in his decision to leave the agency the following May.

Armstrong believed that extending the probation period was, at best, a temporary solution, since, as far as he was concerned, the essential problem at LNRI was Cantellops himself. Nevertheless, he resigned himself to Martinez's rescue of the program as "a fact of life." He has never again formally recommended that DSAS de-fund LNRI's ambulatory program, despite continued poor performance, because he does not believe that Martinez would support him. Nor does Armstrong believe that Martinez would seek Cantellops' removal because Martinez sees the program as Cantellops' "baby" and wants to keep him there.

LNRI's contract manager also made no subsequent de-funding recommendations, because he realized that LNRI was a "fait accompli ... We were going to have LNRI." Even Bill Griffin, who did not have any responsibility for LNRI until four years after the incident, thought

135 Id. at 389-91. Giordani was Chairman of LNRI's Board from its inception until December 1986. Giordani Tr. at 20-21. He and Martinez have known each other since childhood. Id. at 8.

136 Martinez Tr. at 495-96. Martinez testified that he was unaware that the termination letter had been sent or that he was effectively reversing his staff's decision. Id. at 493-97.

137 See, e.g., Houser Tr. at 47, 66, 71-72.

138 Debye-Saxinger Tr. at 483-85.

139 Randall Tr. at 5-6, 9-10.

140 Armstrong Tr. at 436-39.

141 Id.

142 Id. at 314, 345. However, Armstrong has continued to inform Martinez that the problems with LNRI are serious and has suggested that DSAS consider not doing business with Cantellops. Id. at 344-45.

143 Id. at 349-51.

144 Houser Tr. at 63-64.
that any decision to de-fund LNRI "would probably fall on deaf ears," because of the relationship between Cantellops and Martinez.\textsuperscript{145} As a consequence of that relationship and the staff’s perception of it, LNRI has been treated more leniently than other programs.\textsuperscript{146}

F. LNRI’s Continuing Problems

The problems which prompted Contract Management to recommend de-funding LNRI in 1982 persisted after Martinez revived the program. While client census increased in the last few months of 1982, it dropped again in the following year.\textsuperscript{147} LNRI’s census has continued to fluctuate, occasionally reaching satisfactory levels, but then always falling below standard.\textsuperscript{148}

Since 1986, LNRI has reported an average monthly census of 30.7 clients, 77\% of the program’s contract capacity of 40.\textsuperscript{149} This is significantly below the 90\% rate that DSAS considers to be the minimum acceptable, at a time when most programs are over capacity and have waiting lists.\textsuperscript{150}

Moreover, LNRI’s reported client census, as poor as it has been, may well be inflated. DSAS’ on-site reviews of LNRI’s client records since 1986 revealed that the program improperly included a number of clients in its monthly census reports.\textsuperscript{151} Moreover, even the inaccurate census reports understate LNRI’s under-utilization, since in preparing the reports the program relied on DSAS rules which permit counting as active any client who appears at the program just once during the 30 days prior to the report.\textsuperscript{152} According to Armstrong and Debye-

\textsuperscript{145} Griffin Tr. at 475.
\textsuperscript{146} Armstrong Tr. at 351-52.
\textsuperscript{147} Id. at 440.
\textsuperscript{148} Id. at 439-40; Rendon Tr. at 27-29.
\textsuperscript{149} Memorandum to Jose Rendon from Ivan Garcia, dated May 11, 1989, p. 1.
\textsuperscript{150} Id.; Martinez Tr. at 516-17; Deming Tr. at 52, 54; DSAS Policy and Procedure Manual for Service Providers, Item 3300.2(B), dated April 1986.
\textsuperscript{151} Memorandum to Jose Rendon from Ivan Garcia, dated May 11, 1989. For example, some clients reported by the program had no history of substance abuse. Id. See also Memorandum to William J. Griffin from Jose Rendon, dated June 2, 1987.
\textsuperscript{152} Armstrong Tr. at 295. DSAS Policy and Procedure Manual for Service Providers, Item 3300.2(B), dated April 1986.
Saxinger, an effective treatment regimen mandates client attendance three to four times per week.\footnote{Armstrong Tr. at 296; Debye-Saxinger Tr. at 472-73.}

Staff problems also persisted at LNRI. In early 1984, LNRI staff again made written allegations reciting numerous irregularities at the program.\footnote{Similar to the earlier allegations, staff charged Cantellops with, among other things, "intimidation," "humiliation and embarrassment" of staff, threatening non-payment of wages, and misuse of program funds. Statement of Grievances and Concerns submitted by Julio Gerena, Carlos Martinez and Luis LaBoy, pp. 2-3. \textit{See also} Memorandum to Gerry Armstrong from Neil C. Grogin, dated March 22, 1984.} At Armstrong’s request, DSAS’ Bureau of Field Audit and Program Review ("FAPR") investigated the allegations and issued a written report.\footnote{Armstrong Tr. at 444.} FAPR’s investigation, for the most part, was limited only to a review of documentary evidence which did not verify most of the allegations.\footnote{Memorandum to Gerry Armstrong from Neil C. Grogin, dated March 22, 1984.} FAPR did find evidence that Cantellops’ took a trip to Puerto Rico at program expense which was unauthorized and unrelated to program business.\footnote{Id., p. 4.}

Armstrong was concerned about the allegations; he believed they were another "smoke signal" that something was amiss at LNRI.\footnote{Armstrong Tr. at 31, 452. Initially, Martinez testified that he knew nothing about these allegations, notwithstanding that he was listed as a recipient of FAPR’s report. Martinez Tr. at 519-21. Upon further examination, however, he admitted that he had heard about the trip to Puerto Rico. \textit{Id.} at 521, 523. He testified that he would have closed the program down if Cantellops had misused state funds. \textit{Id.} at 521.} He told Martinez about Cantellops’ "inability to run a good program;" the ineffectiveness of Cantellops’ "confrontational approach" to drug rehabilitation; and Cantellops’ preference for Hispanic staff and clients, which contributed to the program’s low client census.\footnote{Armstrong Tr. at 297-305, 341-43.} Martinez’s usual response was that DSAS needs the services and has to do more to help Cantellops.\footnote{\textit{Id.} at 341-42, 345-46; Debye-Saxinger Tr. at 478.}

However, Cantellops has continually resisted Contract Management staff’s efforts, preferring to work directly with Martinez.\footnote{Armstrong Tr. at 42-43, 344.} Four of the five Contract Management staff who testified about LNRI or YATC recalled incidents where Cantellops went over their heads to
Martinez, or at least threatened to do so. Contract Management staff has had difficulty holding Cantellops accountable, because he can deal directly with Martinez rather than his contract manager. By allowing Cantellops to do so, Martinez himself undermines Contract Management's authority.

G. Martinez Commits Additional DSAS Funds To LNRI's Young Adults In Transition Center ("YATC")

In 1985, notwithstanding LNRI's fluctuating census, staff complaints, and two recent negative FAPR reports, Martinez committed additional DSAS funds to LNRI, so that it could run a residential drug treatment program.

1. Cantellops Applies For HHAP Funds From The Department Of Social Services

In the first half of 1985, Cantellops approached Martinez directly -- as he had in 1980 -- to request additional funding to start a residential program. Martinez told Cantellops that DSAS didn't have capital funds available and suggested that he apply to DSS, which had issued an RFP under its Homeless Housing and Assistance Program ("HHAP"). Through HHAP, DSS grants capital monies to service providers for site acquisition and renovation, on the condition that the grantee has secured a funding commitment for operating expenses from a sister agency such as DSAS. By June 1985, Cantellops submitted his application to DSS, proposing that LNRI be granted additional funds to set up YATC, a residential treatment program targeting

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162 See, e.g., Rendon Tr. at 88-89; Armstrong Tr. at 343-44, 459, 464; Griffin Tr. at 56-59; Deming Tr. at 592-97. Houser, the fifth Contract Management staff member to testify about LNRI, was not asked to address this issue at his private hearing.

163 See, e.g., Armstrong Tr. at 344.

164 See, e.g., Debye-Saxinger Tr. at 542.

165 In May 1985, FAPR conducted a comprehensive review of LNRI. A final report issued by FAPR in September 1985 contains numerous references to LNRI's failure to comply with DSAS regulations regarding client treatment and fiscal systems. A prior FAPR report issued in February 1985 also documented failures by LNRI to adhere to DSAS regulations in the treatment of clients and the administration of the program.

166 Martinez Tr. at 529-30; LNRI Board of Directors Meeting Minutes, dated June 5, 1985.

167 Martinez Tr. at 530, 543.

168 Id. at 550-51.
homeless Hispanic youth.169

2. **Martinez Supports Funding For YATC**

Martinez committed DSAS funds for YATC's operating costs without consulting Contract Management staff.170 In the Summer of 1985, while Armstrong was on vacation, Martinez approached Carl Deming, Downstate Chief of Contract Management and instructed him to send a letter to DSS indicating that DSAS would provide operational funds to LNRI for YATC.171

Deming's July 1, 1985 letter gave YATC preferential treatment over other service providers competing for the same DSS funds in two respects: it was sent earlier than DSAS letters in support of other programs and, unlike the other letters, it contained an explicit DSAS funding commitment.172 Based on DSAS' support and DSS' evaluation of the program's proposal, DSS originally committed $700,000, and later an additional $100,000, to YATC.173

Armstrong testified that it was unusual for Martinez to bypass him on a funding question, and that neither he nor Deming thought that DSAS should fund YATC, given LNRI's poor track record.174 Deming testified that if Martinez had solicited his opinion on YATC, he would have told him to replace Cantellops with another program director and inform DSS of DSAS' problems with LNRI.175 However, Deming did not voice any opposition to Martinez at this

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170 Martinez Tr. at 548.

171 Deming Tr. at 545, 612-13. Minutes from the LNRI Board of Directors meeting on June 5, 1985, indicate that Martinez had made a commitment to Cantellops to provide funds for YATC even before he spoke to Deming.


173 Homeless Housing And Assistance Program 1985 Evaluation Form: Young Adults in Transition Center, pp. 1-2; Memorandum to Gerard Armstrong from Carl Deming, dated November 23, 1987.

174 Armstrong Tr. at 315, 480-82. Armstrong speculated that Martinez might have by-passed him because Martinez anticipated his opposition. Id. at 463, 482.

175 Deming Tr. at 618-19.
H. YATC’s Persistent Problems

Because of numerous problems, YATC never began operations and DSAS terminated funding for the project in June 1989.177

1. Cantellops’ Inability To Raise Necessary Funds

YATC failed to attract other sources of revenue necessary to fund the project. In May 1986, the cost of purchasing and renovating the first program site identified by Cantellops was estimated at $2.4 million.178 Since at that time DSS had committed only $700,000 in capital funds, and DSAS anticipated providing funds only for the program’s operating costs, additional funding sources had to be found to enable YATC to secure and renovate a program site.179

DSAS hoped that other agencies would provide the needed funds, but Armstrong believed they would not if they were as familiar with Cantellops as DSAS was.180 Ultimately, Cantellops failed to attract any significant funding from other agencies.181 Since a complete funding package was a prerequisite to the release of DSS funds, and because of other difficulties, DSS refused to disburse any funds for YATC.182

176 Id. at 619-20. Armstrong’s testimony is equivocal as to whether and when he may have expressed reservations about funding YATC. Armstrong Tr. at 475, 480-81.

177 Letter to Andrew Schulz from Gerard Armstrong, dated August 2, 1989; Letter to Rafael Cantellops from Gerard Armstrong, dated July 14, 1989; Memorandum to Gerard Armstrong from Jose Rendon, dated June 29, 1982; Memorandum to Julio Martinez from Gerard Armstrong, dated June 22, 1989; Memorandum to Gerard Armstrong from Carl Deming, dated June 20, 1989.

178 Letter to Nancy Travers from Rafael Cantellops, dated May 12, 1986, p. 2.

179 Armstrong Tr. at 492; Memorandum to Gerard Armstrong from Carl Deming, dated April 28, 1987.

180 Armstrong Tr. at 491-92.

181 Id. at 547. Letter to Rafael Cantellops from Gerard Armstrong, dated July 14, 1989; Memorandum to Gerard Armstrong from Jose Rendon, dated June 29, 1989.

2. Cantellops Alienates His Board Of Directors

Since 1986, LNRI has not had an effective Board of Directors to oversee Cantellops. As early as 1985, Giordani and others on the board became largely inactive. Giordani testified that he had become increasingly frustrated with Cantellops' operating without board authority. For example, he testified that Cantellops failed to notify the board when he applied for HHAP funds for YATC in 1985. The last straw for Giordani, prompting his alienation from LNRI, came in 1986 when Cantellops signed an agreement without board authority to buy a building for YATC.

Giordani then sought Cantellops' removal. In December 1986, the board split over the issue, with the result that several members, including Giordani, left the board. After that, according to Armstrong, LNRI's board was only "a paper" one.

3. Delays In Finding And Renovating A Site

After several unsuccessful efforts, LNRI finally secured a site for YATC in August 1987, entering into a long-term lease for a building which it had previously sought to purchase.

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183 Armstrong Tr. at 291. Armstrong views a strong Board of Directors or a strong administrator as critical to any possible success of this program. Id. at 291, 329.

184 Id. at 519-20.

185 Giordani Tr. at 99.

186 Id. at 72.

187 Id. at 33-34, 90-91.

188 Id. at 91-92, 98.

189 Id. at 34, 98; Rendon Tr. at 48, 50-51.

190 Armstrong Tr. at 531. Memorandum to Carl Deming from Jose Rendon, dated May 18, 1989. In 1987, DSAS discovered that Cantellops had been a member of his own Board of Directors since 1981, in violation of DSAS regulations. He was required to step down. Rendon Tr. at 40-42, 47-49. Cantellops testified that there are only two Board members at LNRI, notwithstanding a DSAS stipulation that there be at least five. Cantellops Tr. at 193; Rendon Tr. at 48. Contract Management staff was unaware of this situation until Commission staff brought it to their attention during their private hearings. See, e.g., Griffin Tr. at 12-13.

Renovation of the site was then delayed by the shortage of funds and numerous failures by the program architect to submit required plans and information.\textsuperscript{192}

Then, in the Spring of 1989, DSAS discovered that the architect, hired by Cantellops in 1986 without competitive bidding or an RFP, was unacceptable, because he was in fact an interior designer.\textsuperscript{193} As a result, a new architect had to be found and new estimates obtained. The new architect indicated that the cost of renovations would be substantially higher, rendering an earlier estimate of the program's funding shortfall "dated and grossly inaccurate."\textsuperscript{194}


Contract Management staff concluded that Cantellops needed extensive supervision in administering YATC if it was to become a viable program, and the staff "spent an inordinate amount of time" working to help the program.\textsuperscript{195} However, as with the ambulatory program, in administering YATC, Cantellops resisted both the advice and the authority of Contract Management.\textsuperscript{196} There were numerous conflicts between Cantellops and DSAS staff over such issues as the architect, retention of consultants, and the financing of YATC.\textsuperscript{197}

For example, in December 1987, Cantellops refused to follow a cash management plan devised by Contract Management staff to help him cope with his shortage of funds.\textsuperscript{198} At the time, YATC owed four months rent on the program site, the landlord was threatening to dissolve the lease agreement, and the program had numerous other debts about to become due.\textsuperscript{199}

\textsuperscript{192} Griffin Tr. at 74. See, e.g., Letter to Rafael Cantellops from Jose R. Rendon, dated December 9, 1988; Letter to Rafael Cantellops from Jose R. Rendon, dated September 21, 1988; Letter to John Grover from Stanley Buczek, dated September 23, 1988; Memorandum to Gerard Armstrong from Jose R. Rendon, dated September 22, 1988; Memorandum to William Griffin from Nick Cristo, dated April 6, 1988.

\textsuperscript{193} Rendon Tr. at 102-05.

\textsuperscript{194} Memorandum to Gerard Armstrong from Jose Rendon, dated June 29, 1989.

\textsuperscript{195} See, e.g., Armstrong Tr. at 291, 329; Memorandum to Gerard Armstrong from Carl Deming, dated November 23, 1987, p. 3; Griffin Tr. at 97-98; Rendon Tr. at 18-20.

\textsuperscript{196} Rendon Tr. at 17-20; Giordani Tr. at 37-38.

\textsuperscript{197} See, e.g., Armstrong Tr. at 478-79, 516-18; Rendon Tr. at 19-20, 101-04; Griffin Tr. 39-41.

\textsuperscript{198} Letter to Rafael Cantellops from Gerard Armstrong, dated December 9, 1987; Memorandum to Julio A. Martinez from Nick Cristo and Carl Deming, dated December 2, 1987.

\textsuperscript{199} Memorandum to Julio A. Martinez from Nick Cristo and Carl Deming, dated December 2, 1987.
Armstrong admonished Cantellops for wasting his, Martinez’s and Contract Management staff’s time, and warned that YATC would fail for lack of funds if he did not follow instructions.200

I. Martinez’s Continuing Support For YATC Over Contract Management’s Objections

Contract Management staff’s lack of confidence in Cantellops’ ability grew. Numerous documents describe the staff’s increasing dissatisfaction and frustration with YATC’s lack of progress.201 Yet, despite his staff’s recommendations to the contrary, Martinez continued to support funding for the project.

For example, in the Spring of 1987, Cantellops requested $235,000 from DSAS to cover various YATC expenses.202 Deming wrote to Armstrong strongly urging that DSAS deny the funds.203 Jose Rendon, then contract manager of LNRI and YATC, concurred in this judgment, as did Bill Griffin, then Regional Supervisor.204 Nevertheless, soon thereafter the funds were authorized.205

In November 1987, DSAS estimated that the cost of developing the program would exceed existing DSAS and DSS funding commitments by $350,000.206 Contract Management staff, including Armstrong, was unanimous that DSAS should not provide the money, even though that would preclude the release of DSS funds and ensure the demise of the


201 See, e.g., Memorandum to Carl Deming from Jose Rendon, dated May 16, 1989; Memorandum to Gerard Armstrong from Jose R. Rendon, dated September 22, 1988; Letter to Rafael Cantellops from Jose R. Rendon, dated September 21, 1988; Memorandum to William Griffin from Nick Cristo, dated April 6, 1988; Letter to Rafael Cantellops from Gerard Armstrong, dated December 9, 1987; Memorandum to Gerard Armstrong from Carl Deming, dated November 23, 1987; Memorandum to Gerard Armstrong from Carl Deming, dated April 28, 1987.

202 Letter to Carl Deming from Rafael Cantellops, dated May 12, 1987; Deming Tr. at 628-31.


204 Rendon Tr. at 72-76; Griffin Tr. at 44-45.

205 Armstrong Tr. at 542-47. Armstrong has no clear recollection of the discussions leading to DSAS’ decision to commit these funds to YATC, but testified that he would not have authorized the funds without first discussing the decision with Martinez or Debye-Saxinger. Id.

After YATC was refused additional funding by Contract Management, Cantellops and Martinez met, at Cantellops' request, in Albany at the end of November 1987. At that meeting, Martinez gave Cantellops his oral commitment that DSAS would provide the $350,000 and called DSS Commissioner Cesar Perales to so advise him in the hope of triggering the release of that agency's funds.

Martinez did not advise Contract Management staff that he had committed additional DSAS funds for YATC. Rendon first learned of the commitment from Cantellops. Although Armstrong knew of the November meeting, he was not aware that Martinez had made a funding commitment at that time until he was shown documentary evidence of it by Commission staff.

In fact, as late as January 1988, Armstrong was led to believe that a commitment to provide the $350,000 had not yet been made. At that time, Armstrong participated in a telephone conference with Martinez and Debye-Saxinger during which the merits of the funding commitment were discussed as though the issue was still unresolved. Armstrong adamantly opposed providing the funds. Debye-Saxinger and Martinez proposed that DSAS not provide the funds but, in order to trigger the release of DSS funds, tell DSS that DSAS would do so. Armstrong objected, stating that the funds would have to be provided if the commitment was to be made.

Nevertheless, Debye-Saxinger directed Armstrong to send a commitment letter to Cantellops. Armstrong directed Deming to write the letter, hoping that he might be able to

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207 Griffin Tr. at 32-38; Armstrong Tr. at 548; Rendon Tr. at 80-85. Martinez has no recollection of Armstrong's opposition to DSAS committing additional monies to close YATC's funding gap. Martinez Tr. at 560. To the contrary, Martinez testified that Armstrong advised him to provide the $350,000. Id. at 559-60.

208 Martinez Tr. at 555-56.

209 Id. at 555-59.

210 Rendon Tr. at 89, 95.

211 Armstrong Tr. at 571-78.

212 Id. at 555-59; Martinez Tr. at 560-62.

213 Martinez Tr. at 558-59.

214 Id. at 555.
"overrule" Deming if he could later convince Martinez and Debye-Saxinger that it was wrong to make a sham commitment.215

The ploy to persuade DSS to release its funds did not succeed, although following receipt of DSAS' commitment letter DSS finalized its contract with LNRI for YATC and obtained approval from the State Division of Budget.216 By the time that approval was obtained in September 1988, the chronic problems with YATC's architect, as well as other concerns about the program, caused DSS again to withhold its funds.217

J. DSAS Terminates YATC's Funding

Because of the program's increased costs identified by the new architect, the latest reports of client under-utilization, the lack of strong involvement in the project by the Board of Directors, and perhaps also the scrutiny of this investigation,218 in July 1989, DSAS decided to discontinue its support for YATC.219 Having spent $973,525 on the project with no results, and anticipating additional expenditures in excess of $687,123 before YATC would be operational, DSAS determined that it would not provide a fourth year of funding.220

215 Armstrong Tr. at 556-57; Letter to Rafael Cantellops from Carleton Deming, dated January 14, 1988. When the decision was not reversed, Armstrong made certain that the monies were included in the agency's allocation plan for the following year. Armstrong Tr. at 555-57, 559.

216 Letter to Jose Rendon from Jose Nicot, dated February 17, 1988; Memorandum to Jose Rendon from Bill Griffin, dated June 20, 1988; Memorandum to Gerard Armstrong from Jose R. Rendon, dated September 22, 1988.


218 Martinez testified in June 1989 that he would take another look at YATC in light of issues raised by the Commission's investigation. Martinez Tr. at 540-41.

219 See Memorandum to Gerard Armstrong from Jose Rendon, dated June 29, 1989; Memorandum to Gerry Armstrong from Julio A. Martinez, dated June 23, 1989; Memorandum to Julio Martinez from Gerry Armstrong, dated June 22, 1989; Memorandum to Gerry Armstrong from Carl Deming, dated June 20, 1989; Memorandum to Carl Deming from Jose Rendon, dated May 16, 1989.

220 Letter to Rafael Cantellops from Gerard Armstrong, dated July 14, 1989; Memorandum to Gerard Armstrong from Jose Rendon, dated June 29, 1989.
III. PROSPECT, INC.

A. Introduction And Summary

During the periods July 1985 to September 1985 and January 1986 to March 1987, DSAS budgeted $174,253 for Arnold Freeman, the Executive Director of Prospect, Inc., ("Prospect") to establish a residential substance abuse program.221 For the initial three-month period, Prospect was allocated $45,000 to cover Freeman’s expenses while he sought to acquire a site, obtain DSAS licensing and begin operations.222 The site of the program was to be Prospect Hospital ("Hospital"), located in the South Bronx, where Freeman had been the administrator until the Hospital closed and went into bankruptcy in March 1985.223 However, because Freeman was unable to acquire the Hospital, the program was never established there.

For the second 14-month funding period, DSAS provided Freeman $129,253 to find an alternate site and begin operations.224 Although a site was located in Brooklyn, the program was never established. Rather, DSAS terminated funding as of March 1987, because of Prospect’s "lack of demonstrable progress, poor documentation, and lack of response to calls and communications."225

An internal DSAS audit conducted between November 1987 and January 1988, and issued in March 1989, uncovered overwhelming evidence of both financial and bookkeeping irregularities, as well as questionable payments for leases and services to individuals associated with Freeman.226 In addition, the Commission’s investigation revealed that Prospect’s subcontracts were plagued with conflicts of interest and higher costs resulting from those conflicts. Such problems, however, were either undetected or ignored by DSAS.


223 Freeman Tr. at 13, 29-30.


226 DSAS Bureau of Field Audit and Program Review Audit Report on Prospect, Inc., filed March 29, 1989. In particular, of $83,000 in total audit disallowances, $37,000 was disallowed as salary payments made by Prospect to Freeman during periods when Prospect had no contract with DSAS. Id. A consultant’s fee of $2,000 was also disallowed, because it was paid to one of Prospect’s own stockholders. Id. Finally, DSAS disallowed $29,085 in payments for office space leased to Prospect, which proved to be an upper East Side one-bedroom cooperative apartment. Id.
Benito Fernandez, a close friend of DSAS Director Martinez and Deputy Director LaPorte, was the person who first approached DSAS about funding for Prospect and was Freeman's primary financial sponsor and strategist. Fernandez (1) had the primary leasehold interest in the cooperative apartment that Prospect rented as an office, (2) owned the Brooklyn site located for Prospect's program, and (3) is related to the owner of the construction company that submitted the low bid for renovation work that was to have been done at the Brooklyn site. In each instance, Fernandez set up and arranged the subcontracts, each time benefiting either himself or a relative.

B. The Relationships Between Director Martinez, Deputy Director LaPorte, Benito Fernandez And Arnold Freeman

Fernandez, a wealthy and influential businessman, has known Martinez about nine or ten years, and they and their wives socialize together in New York City, Albany and Puerto Rico. LaPorte who has known Fernandez for many years has an even closer relationship with Fernandez than does Martinez.

Fernandez's relationship with Freeman, on the other hand, was purely financial. Fernandez committed $450,000 to Prospect and arranged for a financial services agency to lend the project another $240,000; Freeman obtained the latter loan without ever making an application or talking to a representative of the agency. According to Freeman, if the project had gone forward, Fernandez would have received a "finder's fee" for his assistance.

227 Fernandez Tr. at 16-18; Martinez Tr. at 354-58, 367. Martinez described various incidents indicative of a close relationship, such as his visiting Fernandez in the hospital, and his daughter staying with the Fernandez family at their Long Island home. Martinez at 354, 357.

228 LaPorte Tr. at 86-88.

229 Martinez Tr. at 366-67. Armstrong has seen photographs of LaPorte at parties at Fernandez's home in Puerto Rico. Armstrong Tr. at 1083-84.

230 Freeman Tr. at 37-38; Undated Letter to Nicholas J. Mongiardo from B. R. Fernandez. Fernandez testified that the $450,000 was not his own money and would not actually have been loaned to Freeman. Fernandez Tr. at 30-35. The commitment letter was written to satisfy Health Department concerns about the fiscal viability of Freeman's proposal. Id. The amount of the commitment represented the mortgage value of certain brownstones that Freeman would have purchased as a part of his acquisition of the Hospital, but which the Health Department had refused to recognize in assessing the proposal. Id.

231 Freeman Tr. at 38.
C. Prospect's Initial Contact With DSAS And The Involvement Of Charles LaPorte

The idea of using DSAS funding to turn the bankrupt Hospital into a drug treatment center was first broached to Martinez by Fernandez sometime in the first half of 1985. Martinez recalls that Fernandez was the principal person interested in buying the facility, and that he told Fernandez to complete a DSAS funding application and follow the agency's normal procedures.

However, Prospect did not follow the normal procedures, which would have entailed a review of the program's funding proposal by Contract Management staff. Rather, Freeman approached and worked with LaPorte. Armstrong did not learn of the project until he was called into a meeting with Martinez and LaPorte in the Summer of 1985. They told Armstrong that DSAS would fund Prospect as part of a multi-agency effort, spearheaded by the Governor's office, to save the Hospital. Thus, contrary to DSAS guidelines, Contract Management had no input into the decision.

LaPorte continued his active involvement thereafter. For example, at LaPorte's suggestion, Freeman sent him Prospect's first proposed budget, and the two of them discussed ways that it should be modified before it was sent on to Contract Management. Armstrong testified about LaPorte's persistent involvement:

232 Martinez Tr. at 347-53.
233 Id.
234 Id. at 365-66.
235 Freeman Tr. at 63. Freeman's first correspondence with DSAS, as well as his original funding proposal, were sent to and discussed with LaPorte. See Letter to Charles LaPorte from Arnold Freeman, dated April 22, 1985; Letter to Charles LaPorte from Arnold Freeman, dated May 29, 1985.
236 Armstrong Tr. at 1007.
237 Id. at 1007, 1418-19. In his testimony, Martinez denied that funding the project was a priority of the Governor. Martinez Tr. at 358-60. The Governor's office was more interested in a church-related organization's acquiring the site and using it to help homeless persons. Id.
238 Armstrong Tr. at 1013, 1016.
239 Freeman Tr. at 312-13. The first budget authorized a $26,000/year salary for Thomas Puzo, one of Freeman's partners, to be employed as an "Assistant Site Selector." See Contract No. COO1502 between DSAS and Prospect, Inc., effective July 1, 1985 to September 30, 1985. Since in DSAS parlance "site" refers to the location of the program and at the time of the contract the Hospital had already been identified as the site, the need for a "site selector" or an "assistant" is not apparent.
There was always pressure put on myself and my staff [by LaPorte] to hurry things along in terms of processing, to continue funding, to help them in terms of technical assistance, find additional sites, to generally keep the project moving forward and fully funded.240

* * *

In this particular case, the pressure ... was constant, was overt and was relentless.241

Even after funding had terminated and DSAS auditors had found numerous irregularities, LaPorte continued to urge additional funding for the project.242 Indeed, Armstrong overheard LaPorte helping Freeman draft responses to DSAS’ audit report.243

LaPorte’s involvement with Prospect was inappropriate, because he has no official responsibilities in that area. As head of Chemotherapy Services, LaPorte would have had an interest in Prospect’s initial proposal, which sought to establish a detoxification unit at the Hospital.244 However, he should not have had any role with respect to the program’s budget, since that was Contract Management’s responsibility.245 Moreover, after the Hospital became unavailable, the project changed to a drug-free treatment program, and LaPorte had no reason to continue his involvement.246 Any assistance to Freeman in responding to the agency’s audit should have come from the Bureau of Field Audit and Program Review, not LaPorte.247

240 Armstrong Tr. at 1021.

241 Id. at 1175. See also id. at 1427-32, 1434-35.

242 Id. at 1144, 1164.

243 Id. at 1130-31, 1432-33. Freeman denied receiving any such assistance, Freeman Tr. at 247-48, and LaPorte testified that he told Freeman only that he had a right to respond. LaPorte Tr. at 145.

244 Griffin Tr. at 294; Armstrong Tr. at 1009.

245 Griffin Tr. at 421-22. LaPorte denies any involvement in the funding process. He claims that he only wrote a letter attesting to the need for detoxification services in the South Bronx and that he did not even know that Prospect had applied for DSAS funding until after the contract had been signed. LaPorte Tr. at 86, 91-92, 97.

246 Griffin Tr. at 421-22.

247 Debye-Saxinger Tr. at 418.
D. Attempts To Secure Prospect Hospital And The Rental Of An "Office" On East 80th Street

Freeman testified that throughout the Fall of 1985 and into the Spring of 1986 he was working with lawyers to acquire the Hospital through bankruptcy proceedings.\textsuperscript{248} Prospect sought and received DSAS funding for the rental of an office in Manhattan to satisfy Freeman's purported need to attend frequent meetings and bankruptcy court proceedings.\textsuperscript{249}

However, the rental of the "office" was not an arms-length transaction. The "office" was a one-bedroom cooperative apartment on East 80th Street which Fernandez had leased for more than ten years under the name "Real Estate Associates" for about $600/month.\textsuperscript{250} Fernandez testified that at times he has used the apartment as a residence but that, when he sub-leased it to Prospect, he was using it as an office.\textsuperscript{251}

The so-called office was located for Prospect by Fernandez,\textsuperscript{252} and the lease, which ran from June 1, 1985 through June 30, 1988, was signed by Fernandez, as lessor, on behalf of Real Estate Associates.\textsuperscript{253} Although dated July 1, 1985, the lease was prepared by Fernandez in 1987 after funding had ceased and DSAS had notified Freeman that it would audit Prospect's contract.\textsuperscript{254} The lease called for monthly rent payments of $1,360, and later $1,667, but, according to Freeman, Fernandez did not always require payment since he understood that Prospect could only pay rent when it had the money.\textsuperscript{255}

Moreover, Freeman rarely used the "office." By his own account, he used it only two to four times a month but since he had no keys to the apartment, Fernandez always met him

\textsuperscript{248} Freeman Tr. at 32-34.
\textsuperscript{249} Letter to Nick Colamaria from Arnold Freeman, dated April 12, 1988.
\textsuperscript{250} Fernandez Tr. at 5-6, 11-12.
\textsuperscript{251} Id. at 5-6.
\textsuperscript{252} Freeman Tr. at 97.
\textsuperscript{254} Freeman Tr. at 292-95. Bill Griffin, the contract manager for Prospect, testified that he never saw the lease prior to his deposition in this investigation. Griffin Tr. at 459-60.
there to let him in. With at most four exceptions throughout Freeman’s "tenancy," he never had exclusive use of the apartment. DSAS always telephoned Freeman at his home in Westchester County, and all but two DSAS letters were addressed to his home. Indeed, Freeman incorrectly described the apartment as being on the building’s first floor, when it actually is on the fifth floor.

Finally, even though by June 1986, Freeman’s alleged need to attend frequent bankruptcy proceedings had ended and Prospect had found a new site in Brooklyn, he kept the "office" and drew DSAS funds for it until November 1987. He terminated the lease after DSAS notified him that it would be auditing Prospect, and told the auditors that the "office" would not be available for their inspection since he no longer rented it.

DSAS never learned the full extent of Fernandez’s interest in the apartment. Martinez, however, knew that the "office" was one of Fernandez’s residences, since the two had dined there together. Martinez testified that when he saw the DSAS audit raising questions about the "office" and the identity of its owner, he "chose not to" tell the auditors about Fernandez’s interest in the apartment.

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256 Freeman Tr. at 286-88.
257 Id.
258 DSAS Bureau of Field Audit and Program Review Audit Report on Prospect, Inc., filed March 29, 1989, p. 9. One of the two letters sent to East 80th Street was returned to DSAS marked "addressee unknown." Id.
259 Freeman Tr. at 99.
260 Id. at 118, 260.
261 Id. at 268-69; DSAS Bureau of Field Audit and Program Review Audit Report on Prospect, Inc., filed March 29, 1989. Freeman testified that he gave up the "office" to move to the new facility in Brooklyn. Freeman Tr. at 261.
262 When questioned by DSAS auditors, Freeman denied knowing the identity of the landlord. Freeman Tr. at 257-59. Later, Freeman discussed the auditors’ questions with Fernandez, who told Freeman that the apartment was owned by Sheldon Gold, and Freeman so informed DSAS. Id. DSAS auditors did learn that Freeman sent rent for the apartment to a Brooklyn post office box that Fernandez had rented. See DSAS Bureau of Field Audit and Program Review Audit Report on Prospect, Inc., filed March 29, 1989.
263 Martinez Tr. at 357, 394.
264 Id. at 393, 395. When asked why he didn’t tell the auditors, Martinez stated that he "[p]robably didn’t think of it." Id. at 395.
E. The Loss Of Prospect Hospital And The Move To Brooklyn

By the middle of 1986, it became clear that Prospect would not secure the Hospital through the bankruptcy proceeding. Nevertheless, DSAS remained committed to funding Prospect. According to Armstrong, DSAS' (particularly LaPorte's) desire to do business with Prospect was unshakable.

Almost as soon as the Hospital purchase fell through, Freeman located a new site on Van Siclen Avenue in Brooklyn. As with the East 80th Street apartment, however, the Van Siclen site was not discovered by chance: Fernandez suggested the site, and offered to buy it and then lease it to Freeman. By mid-June 1986, Freeman had submitted to DSAS a proposed lease for the site.

However, Fernandez's involvement with the Van Siclen site was never made clear to DSAS. Upon learning that the proposed lease listed Fernandez as an officer of the building's corporate owner, Armstrong asked Griffin, Deming and LaPorte to determine the full extent of Fernandez's involvement. Armstrong cannot remember what Griffin and Deming learned, but LaPorte told him that Fernandez was not involved.

Subsequently, Freeman gave DSAS a revised lease for the Van Siclen site which showed a new landlord. On the surface, since the landlord had changed, it looked as if

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265 Memorandum to Joe Robert from William Griffin, dated June 17, 1986; Memorandum to Gerard Armstrong from Charles LaPorte, dated June 30, 1986.

266 Armstrong Tr. at 1063. Martinez's interest and participation in the project faded over time, particularly by the Fall of 1985, when the involvement of other agencies looked doubtful. Id. at 1058, 1102-03.

267 Freeman Tr. at 144-47.

268 Id. at 147-55.

269 Memorandum to Deborah Damm from William J. Griffin, dated June 17, 1986, and attached Lease between Horizons Investors Corp. and Prospect, Inc.

270 Ultimately, DSAS auditors learned that the landlord at Van Siclen used the same post office box that Fernandez had rented in connection with the East 80th Street "office." See DSAS Bureau of Field Audit and Program Review Audit Report on Prospect, Inc., filed March 29, 1989.

271 Armstrong Tr. at 1100-01.

272 Id. at 1101. Griffin does not remember ever discussing Fernandez's involvement in the Van Siclen site: he claims not to have known about this connection until, at the earliest, DSAS' audit. Griffin Tr. at 347, 351-53.

Fernandez was no longer involved.\textsuperscript{274} In fact, the new lease was signed by one of Fernandez’s associates and Fernandez continued to have an ownership interest in the property.\textsuperscript{275}

Fernandez also had a hidden interest in the extensive renovation work that the Van Siclen site required. Although DSAS rules required Prospect to solicit three bids for the work, Freeman obtained only two bids and showed them to Fernandez, who then recommended a third (and ultimately the lowest) bidder, Confiansa Builders Corp.\textsuperscript{276} Confiansa is owned by Fernandez’s cousin\textsuperscript{277} and in its bid documents used the address and a telephone number of a Brooklyn psychiatric facility owned by Fernandez.\textsuperscript{278}

\textbf{F. Freeman’s Other Paid Activities During The Contract Term}

Although Freeman drew a full-time annual salary of $65,000 while working to establish Prospect, he also engaged in other paid business activities during the term of his contracts.\textsuperscript{279} During the last half of 1986, he earned $17,000 as a consultant to Physician’s Hospital in Queens,\textsuperscript{280} and "on and off through ’87" he was actively working with Fernandez in his ultimately unsuccessful effort to acquire a midtown Manhattan nursing home.\textsuperscript{281}


\textsuperscript{275} Fernandez testified that the switch in landlords was done to shield the owner, a real estate holding company, from liability on the property. Fernandez Tr. at 73.

\textsuperscript{276} Freeman Tr. at 174, 176, 319. Freeman maintains that he showed the two bids to Fernandez because their costs were significantly different and he wanted an opinion as to the disparity in amounts. \textit{Id.} at 319.

\textsuperscript{277} Fernandez Tr. at 78-81.

\textsuperscript{278} \textit{Id.} at 80; Statement of Construction Expense Dated March 31, 1987, Submitted By Confiansa Builders Corp., 2830 Pitkin Avenue, Brooklyn, New York, to Mr. Arnold Freeman, 222 East 80th Street, Suite 5A, New York, New York. When the telephone number is called, a person answers by stating the name of the psychiatric facility. Confiansa is not listed in any 1986-1987 New York City or Long Island telephone directory.

\textsuperscript{279} These other activities were not discovered during DSAS’ audit.

\textsuperscript{280} Freeman Tr. at 8.

\textsuperscript{281} \textit{Id.} at 207-10.
G. Contract Management’s Dissatisfaction With Freeman And The Termination Of Prospect’s Funding

By the Fall of 1986, Contract Management staff had grown disillusioned with Freeman and Prospect. Freeman missed deadlines and often ignored Contract Management’s requests, as if Freeman had been assured that LaPorte would take care of everything. Indeed, Freeman testified that he always viewed LaPorte as the one in charge.

By late 1986, Armstrong became concerned about Prospect’s expenditures and did not want to extend its contract. Although such a decision would normally be his to make, perhaps in consultation with Martinez and/or Debye-Saxinger, in this instance he felt that his hands were tied since LaPorte wanted to continue funding Prospect.

Eventually, Armstrong approached Martinez about closing the program. However, because Martinez relied on LaPorte’s continual reassurances that Freeman would "deliver" a program, Martinez did not support Armstrong. Moreover, because of LaPorte’s adamant commitment to Prospect, Armstrong did not press his own staff’s position as strongly as he would have on a program that lacked such an influential advocate. As a result, LaPorte’s interests prevailed and a new contract was signed continuing funding through March 1987. This contract would, however, prove to be Prospect’s last.

282 Armstrong Tr. at 1121-22.
283 Id. at 1130.
284 Freeman at 221. LaPorte, however, denies any significant involvement, saying that he occasionally got a call from Freeman asking about the status of his contracts or payments, and that he would then casually inquire of Griffin. LaPorte Tr. at 94-95.
285 Armstrong Tr. at 1128, 1143-44, 1159-64.
286 Id. at 1162.
287 Id. at 1163, 1462.
288 Id. at 1475-76.
289 Id. at 1163.
In the Fall of 1987, at Armstrong's request, DSAS audited Prospect.\textsuperscript{290} In addition to disclosing the questionable office rental, the payment of Freeman's salary in unfunded periods, and the consultant payment to a Prospect shareholder, the audit's initial findings, released in December, revealed that Prospect's financial records were in total disarray. Neither time and attendance, nor daily activity reports had been maintained, and payroll taxes had not been withheld.\textsuperscript{291} Presented with the overwhelming evidence that no progress was being made, Martinez was convinced, over LaPorte's continuing objection, to terminate Prospect's contract.\textsuperscript{292}

IV. NATIONAL EXPERT CARE CONSULTANTS

A. Introduction And Summary

Don Russakoff founded National Expert Care Consultants, Inc. ("NECC") in 1985 as a for-profit business with Russakoff its sole owner and shareholder.\textsuperscript{293} He is also the owner of National Management Analysts, Inc. ("NMA"), which provided consulting services to NECC and other DSAS-funded substance abuse programs, and A.K. Holdings, Inc. ("AKH"), a real estate holding company that leased space to NECC for its operations.\textsuperscript{294}

DSAS entered into a series of contracts with NECC between July 1986 and March 1988. During that time, NECC received funds for the start-up and operation of a drug-free residential treatment program with a capacity of 40 clients at 455 West 50th Street; residential and outpatient programs with capacities of 36 and 70 clients, respectively, at 458 West 50th Street;

\textsuperscript{290} Id. at 1134-35. At approximately the same time, the State Comptroller was auditing DSAS and showed some interest in Prospect. See Letter to Norwig Debye-Saxinger from Christine A. Storonslcy, dated January 11, 1988, and accompanying Preliminary Draft Audit Findings of the Office of State Comptroller, p. 12.

\textsuperscript{291} DSAS Bureau of Field Audit and Program Review Audit Report on Prospect, Inc., dated March 29, 1989. See also Memorandum to Gerard Armstrong from William Griffin, dated December 4, 1987; Memorandum to Gerard Armstrong from William Griffin, dated December 7, 1987.

The DSAS auditors did not discover Fernandez's relationship with Confiansa Builders Corp., or that the lowest bid did not come in until after the first two had been reviewed by Fernandez. They also did not realize Fernandez's interests in the Van Siclen site and the East 80th Street "office." Although the auditors were suspicious about Freeman's use of the "office," they did not uncover how seldom he used it or that the lease was prepared after the fact. The auditors also did not uncover Freeman's other paid activities while he was receiving DSAS funding.

\textsuperscript{292} Armstrong Tr. at 1164.

\textsuperscript{293} Russakoff Tr. at 3-5. NECC now operates under the name "National Recovery Institutes." Id. at 17.

\textsuperscript{294} Id. at 3-4.
and, briefly, administrative offices at 309 West 91st Street in Manhattan.\textsuperscript{295} In all, NECC received contracts totaling more than $4.2 million.\textsuperscript{296}

NECC was a unique DSAS contractor in three respects. First, with one small exception, NECC was the first and only for-profit treatment provider with which DSAS contracted.\textsuperscript{297} Second, NECC proposed to operate an intensive rehabilitation program which, instead of the usual long-term program (18 months on average), would release clients in three to four months.\textsuperscript{298} Third, DSAS funded NECC with the understanding that Russakoff intended to phase out treating indigent clients within two to five years and instead treat fee-paying clients without DSAS financial support.\textsuperscript{299} Thus, DSAS funds helped Russakoff start a private profit-making enterprise.\textsuperscript{300}

\section*{B. The Relationship Between Don Russakoff And Director Martinez}

Both Martinez and Russakoff deny that they are personal friends.\textsuperscript{301} However, they admit that they have a social relationship,\textsuperscript{302} and the two are perceived as friends by others at DSAS.\textsuperscript{303} Martinez attributes the perception to their long professional relationship and Russakoff's habit of "dropping" Martinez's name in conversations with others.\textsuperscript{304}

\begin{footnotesize}
\begin{enumerate}
\item Id.
\item Deming Tr. at 378.
\item Id. at 385; Armstrong Tr. at 678-79.
\item Armstrong Tr. at 725; Deming Tr. at 398-99, 427-29.
\item Deming Tr. at 399.
\item Martinez Tr. at 80; Russakoff Tr. at 167.
\item They have visited each other's home on several occasions, and Russakoff has spent the night at Martinez's home in Albany and has joined Martinez's private card games. Martinez Tr. at 87-89; Russakoff Tr. at 170-71.
\item Armstrong Tr. at 362, 659, 821-22, 1349, 1401-02.
\item Martinez acknowledged that DSAS employees believe that he and Russakoff are "very close friends and ... very, very tight." Martinez Tr. at 97. Russakoff contributes to that impression by telling others, "Julio and I discussed this," when discussing a matter that interests Russakoff. Id. at 99.
\end{enumerate}
\end{footnotesize}
Martinez and Russakoff have known each other since the late 1960's, when both worked for the Addiction Services Agency and then operated treatment programs in New York City.\(^{305}\) In the 1970's, they were both active in organizing the "City of the Forgotten" in Albany -- a protest against the Legislature's cutbacks in funding for drug treatment.\(^{306}\) Russakoff, both as an official of a treatment program and later as a registered lobbyist, also lobbied for bills that would increase DSAS funding for his clients.\(^{307}\) Martinez and Russakoff often consulted during the legislative session and had long telephone conversations on programmatic issues of mutual concern.\(^{308}\)

C. The Decision To Fund NECC

Although Armstrong and other high-level DSAS staff had reservations about funding NECC, "Martinez felt Don had the credentials to run a decent program, he felt he could trust Don, and Don would deliver, and he'd rather do business with someone that he knew, and knew had clinical experience and academic credentials, than somebody he did not know."\(^{309}\) Martinez therefore rejected or ignored concerns expressed by Armstrong and failed to consult Debye-Saxinger. He thus committed DSAS to supporting NECC and circumvented the agency's evaluation process.

1. The Meeting Between Director
Martinez, Don Russakoff And Ed Menken

NECC's first funding application proposed to establish a residential program at 455 West 50th Street, where Veritas (another treatment provider and client of NMA) had operated a

\(^{304}\)(...continued)

Other DSAS-funded service providers also view Martinez and Russakoff as having a close relationship, since they sometimes called Martinez to complain about NMA's failure to perform services under consultant contracts. Armstrong Tr. at 663-64, 822; Martinez Tr. at 118-19. Debye-Saxinger and Martinez believe that NMA succeeded in obtaining consultant contracts because service providers perceived him as being close to Martinez. Debye-Saxinger Tr. at 48-51; Martinez Tr. at 125.

\(^{305}\) Deming Tr. at 223; Armstrong Tr. at 362, 818-19.

\(^{306}\) Armstrong Tr. at 657-58, 819, 1353-54.

\(^{307}\) Id. at 655-57, 1351-53; Deming Tr. at 212, 220.

\(^{308}\) Armstrong Tr. at 1351-53; Debye-Saxinger Tr. 148. On at least one occasion, Martinez also sought Russakoff's advice on a personal matter. Martinez needed an accountant and Russakoff recommended his own in a conversation that Martinez says occurred before he became Director of DSAS. Russakoff Tr. at 174; Martinez Tr. at 93-95.

\(^{309}\) Armstrong Tr. at 1387. See also Deming Tr. at 219.
program. The proposal was submitted to DSAS in early February 1986 at a meeting in Martinez's New York City office. Attending the meeting were Martinez, Russakoff, and Ed Menken, who was NECC's Executive Director and a long-time associate of Martinez. Immediately after the meeting, Martinez gave the proposal to Armstrong. Sometime later, Armstrong received another copy of the proposal in the mail with a cover letter dated February 3, 1986.

Martinez does not recall the initial meeting with Menken and Russakoff, but remembers Russakoff mentioning that he had a treatment site. He testified that he told Russakoff to submit a proposal and "go through the normal process." However, the normal process was not followed, in part because Martinez in fact had met with Russakoff and Menken. Armstrong explained that "[t]he fact of the matter is, if [a funding proposal] has already been discussed at Julio's level, then there is what is perceived as a commitment and it can't be handled as objectively as other programs."

Indeed, subsequent conversations with Martinez convinced Armstrong that Martinez had already decided to fund NECC and that any concerns or objections by DSAS staff would not alter the outcome.

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310 Russakoff Tr. at 114; Deming Tr. at 207, 227.
311 Armstrong Tr. at 635-37, 1361.
312 Id. at 363, 635-37, 1361. Menken is a former addict who used to be Martinez's boss at the New York City Addiction Services Agency in the late 1960's. Sometime later, when Martinez was director of Project Return, Menken began using drugs again and called him for help. Martinez got him into the Odyssey House treatment program and then hired him to work at Project Return. Martinez Tr. at 134-35.
313 Armstrong Tr. at 635-37.
314 Id. at 680.
315 Martinez Tr. at 112-15.
316 Id. at 199. Russakoff also has no recollection of meeting with Martinez and Menken; he testified that his proposal was initially discussed only by Menken and Armstrong. Russakoff Tr. at 163, 165.
317 Armstrong Tr. at 840-41. Armstrong testified that he raised this problem to Martinez in the context of the NECC proposal, id. at 839-41, but Martinez recalls no such conversation. Martinez Tr. at 131.
2. **Armstrong's Objection To Ed Menken As NECC's Executive Director**

In particular, Armstrong was concerned about funding a program that had Ed Menken as its Executive Director. Menken had briefly served as director of Project Return after Martinez had left that program to head DSAS.\(^\text{318}\) According to Armstrong, during Menken's short tenure at Project Return Menken, he led the program to the brink of bankruptcy.\(^\text{319}\)

As soon as Armstrong saw that Russakoff's proposal included Menken as NECC's director, he strongly argued to Martinez that DSAS should not fund NECC.\(^\text{320}\) Martinez reacted by harshly castigating Armstrong.\(^\text{321}\) Soon afterward, LaPorte warned Armstrong that Martinez was extremely upset about his objection to Menken; LaPorte gave Armstrong the clear impression that his job was at risk if he did not become more supportive of DSAS funding for NECC.\(^\text{322}\)

Based on Martinez's angry reaction and LaPorte's pressure, Armstrong concluded that Martinez had effectively decided to fund NECC.\(^\text{323}\) Armstrong realized that Martinez had a strong personal commitment to the program and viewed Armstrong as "attacking his friends."\(^\text{324}\) Armstrong therefore concluded that there would be no way "to manage NECC in a neutral way" and gradually withdrew from active involvement in the project: "I withdrew deliberately ... with the sense that -- I didn't want this from the beginning."

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\(^{318}\) Deming Tr. at 237; Armstrong Tr. at 645.

\(^{319}\) Armstrong Tr. at 363, 645. See also Deming Tr. at 237-38.

\(^{320}\) Armstrong Tr. at 363, 365, 688, 840, 1362.

\(^{321}\) Id. at 363-64, 647-48, 839-40, 1362. Armstrong concluded that Martinez must have had a vested interest in Menken being NECC's Director and that Martinez may have urged Russakoff to hire Menken. Id. at 654-55, 684-85, 1362-63, 1384. His conclusion was bolstered in the Spring of 1986, when Menken "disappeared" without notice or forwarding address. Russakoff Tr. at 161; Deming Tr. at 268-69. Then, Russakoff expressed relief and stated that he had not wanted to hire Menken anyway. Armstrong Tr. at 364, 647, 685.

\(^{322}\) Armstrong Tr. at 647-48, 841-44. Martinez denies that Armstrong raised any objections to Menken, that he had any conversation about Menken with Armstrong, or that he discussed the issue with LaPorte. Martinez Tr. at 146-48, 150. LaPorte does not recall having had any conversation with Armstrong about the latter's exchange with Martinez, or even knowing that the two had disagreed about Menken. LaPorte Tr. at 74-75.

\(^{323}\) Armstrong Tr. at 841-44, 1362.

\(^{324}\) Id. at 847-49.

\(^{325}\) Id. at 847-50.
3. Concerns About NECC's Contract With The Division Of Parole

Although Armstrong felt more comfortable about funding NECC once Menken left the program in the Spring of 1986, by then he also had concerns because of information he had received from the New York State Division of Parole ("Parole"). NECC had previously contracted with Parole in late 1985 for the operation of a "Parole Resource Center" at 455 West 50th Street, to provide counseling and other services for recent parolees. Parole cancelled the contract in February 1986, even before the program had begun, when Parole officials concluded that NECC had deceived them.

According to Ramon Rodriguez, Parole's Chairman, NECC had sub-leased the program site from AKH without disclosing that AKH was also owned by Russakoff. Rodriguez testified that during negotiations Russakoff pressured Parole to consummate the contract by asserting that NECC was under pressure from AKH to sign a lease. In late January 1986, Parole discovered that Russakoff owned AKH and that the sub-lease between AKH and NECC called for more rent than AKH had to pay the building's owner under the prime lease. Thus, Russakoff was secretly earning a profit on the lease arrangement, at Parole's expense.

On February 3, 1986, Rodriguez decided to cancel the NECC contract and his staff so advised Russakoff. Angry about NECC's deception, Rodriguez also immediately called Martinez and told him the details surrounding Parole's decision.

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326 Id. at 848, 1383. See above, fn. 321.
327 Armstrong Tr. at 649-50.
330 Rodriguez Tr. at 10-11.
331 Id. at 7-8, 10-11.
332 Id.
333 Id. at 12-13.
334 Rodriguez Tr. at 11-15. Rodriguez testified that he called Martinez because he knew that Russakoff worked with DSAS-funded programs. Id. Martinez testified that Rodriguez called him and said that the program was too expensive and that he had reservations about Russakoff. Martinez Tr. at 164.
Sometime after Armstrong received the NECC proposal that had been mailed to him on February 3, 1986, Armstrong learned (possibly from Russakoff himself) that NECC had had a contract with Parole. Armstrong told Martinez, who instructed him to contact Martin Kelly at Parole and find out about Parole's dealings with NECC. Martinez did not tell Armstrong what he had already learned from Rodriguez, or even that he had spoken to Rodriguez.

Armstrong called Kelly who told him that Parole had terminated its contract with NECC because Parole did not like Russakoff's method of doing business. Kelly explained that Parole also was concerned about NECC's status as a for-profit entity and Russakoff's proposed profit level. Kelly advised Armstrong that Parole had already paid NECC for certain expenses at 455 West 50th Street, and that if DSAS contracted with NECC it should be wary not to pay for them again. Kelly recommended that DSAS not get involved with Russakoff.

Armstrong conveyed the substance of this conversation to Martinez, saying that Parole "feels pretty strongly against this and is recommending that we don't get involved in this." Martinez responded that Parole did not have experience with local service providers and indicated that he would call Rodriguez. Armstrong testified that Martinez later mentioned that he had spoken to Rodriguez and that Parole's concerns should not affect DSAS' doing business with Russakoff.

335 Armstrong Tr. at 649-51.
336 Id. at 650.
337 Id. at 650-51, 666, 693.
338 Id. at 651-53, 666.
339 Id. at 652, 666-67.
340 Id.
341 Id. at 652, 666-72.
342 Id. at 652.
343 Id. at 665.
344 Id. at 665, 669-70. Martinez does not recall any discussion with Armstrong or anyone else within DSAS about Parole's problems with NECC, or that anyone at DSAS told him that Parole did not think DSAS should enter into a contract with Russakoff. Martinez Tr. at 168-72.
4. **Other Concerns About Funding NECC**

Armstrong, Debye-Saxinger and Deming had additional reservations about contracting with NECC based upon their own experiences with Russakoff. They all considered Russakoff an "operator," and Armstrong remembered him as "very difficult to do business with" and as having failed to perform work he had promised to NMA clients.

Although Armstrong believed that Russakoff had good credentials and the ability to run a decent program, he felt that Russakoff was not committed to delivering treatment services. Debye-Saxinger similarly felt that Russakoff was "too much after the money and too little after the services," and also believed that Russakoff sold himself by whom he knew rather than what he could do.

Debye-Saxinger also opposed funding NECC because DSAS had just gotten its financial affairs in order after having exceeded its budgets, and the agency could not afford a major new funding commitment. In his view, even if the agency had extra money, the money should have been given to existing programs to alleviate staff shortages and budget deficits or to expand treatment capabilities, rather than to an expensive profit-making business. Debye-Saxinger also noted that there were other new programs seeking funding but, unlike NECC, they went through the normal application process.

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345 Armstrong Tr. at 652-53; Debye-Saxinger Tr. at 139-42; Deming Tr. at 208.

346 Armstrong Tr. at 659-60.

347 Id. at 653-54. See also Deming Tr. at 208-09.

348 Armstrong Tr. at 645, 653. See also Deming Tr. at 230-31.

349 Armstrong Tr. at 639.

350 Debye-Saxinger Tr. at 50-51, 126. Martinez acknowledged that Russakoff was perceived as "not committed or dedicated" to the field, and recalls that Armstrong once advised him that Russakoff had over-committed himself and could not deliver on the work he had promised to NMA clients. Martinez Tr. at 118-20. Nevertheless, Martinez believed that Russakoff would deliver on NECC’s treatment program. Id. at 151.

351 Debye-Saxinger Tr. at 122-24.

352 Id. at 125, 127. In 1986, DSAS did add 400 beds by asking existing programs to convert common space into residential space. Armstrong Tr. at 718.

353 Debye-Saxinger Tr. at 121-22.
However, Debye-Saxinger testified that Martinez did not solicit his views on funding NECC because Martinez knew that he would object to it.\textsuperscript{354} According to Armstrong, when he advised Debye-Saxinger of his own objections to funding NECC and about his conversations with Martinez and LaPorte, he sensed that Debye-Saxinger, like himself, felt powerless to change the course of events: "I got the feeling ... that he, like I, felt it's a fact, and we are going to have to live with it."\textsuperscript{355}

5. **Contract Management's Role In The Funding Decision**

Thus, apart from Armstrong's futile objections and concerns, Contract Management played no role in the decision to fund NECC. Although Deming testified that he had recommended that DSAS fund NECC,\textsuperscript{356} Armstrong made no mention of Deming's role in the decision and no documents reflect any such recommendation. To the contrary, two of Deming's memoranda at the time suggest that Deming believed that the decision had been or would be made by others.\textsuperscript{357}

Martinez testified that he asked Armstrong, LaPorte and Debye-Saxinger for their judgment on NECC's proposal and none of them opposed funding the program.\textsuperscript{358} He also said that the decision to contract with NECC was made by Armstrong, Chief Counsel Deborah Damm and Debye-Saxinger.\textsuperscript{359}

\textsuperscript{354} Id. at 139, 143, 144.

\textsuperscript{355} Armstrong Tr. at 843.

\textsuperscript{356} Deming Tr. at 235.

\textsuperscript{357} In one, Deming obliquely stated, "[d]eterminations have been made within DSAS to provide support to [NECC]." Memorandum to Martin Ringer from Carl Deming, dated February 26, 1986. In another, Deming wrote: "I have requested Dennis Whalen [then an Executive Assistant to Martinez] to ascertain the direction we shall go in regarding the contractor and the site... ." Memorandum to John Cavallaro from Carl Deming, dated March 25, 1986.

In response to the memoranda, Whalen wrote: "there appears to be some confusion regarding the role of Contract Management in the licensing process, particularly regarding the [NECC] program." Memorandum to Carl Deming from Dennis P. Whalen, dated March 31, 1986. Whalen described Contract Management's role at length, insisted that "every program applying for licensure is subject to the identical process," and concluded: "Simply stated, we still need your office's preliminary funding determination and general recommendation before anything can be done with the licensing application." Id.

\textsuperscript{358} Martinez Tr. at 146, 155.

\textsuperscript{359} Id. at 159-60.
D. **NECC's Lease Arrangement At 455 West 50th Street**

As a part of its contracts with NECC, DSAS agreed to reimburse NECC for its rent at 455 West 50th Street beginning July 1, 1986. As with the Parole contract, NECC sub-leased the site from AKH at a higher rent than AKH paid to the landlord.\(^{360}\) Over a four and one-half year term, the total difference between the two leases was $167,700.\(^{361}\)

The rent surcharge is contrary to DSAS policy, which specifies that when a program leases space from a close affiliate, the rent should be the lesser of fair market value or net cost.\(^{362}\) Although this violation was repeatedly noted by DSAS staff and officials for more than a year, the rent was not corrected until sometime in 1988 after it had been identified by the State Comptroller in the course of an audit of DSAS' oversight of community-based programs.\(^{363}\)

In response to the State Comptroller's audit report, DSAS took the position that its policy regarding lease arrangements between affiliated companies pertains only to not-for-profit entities.\(^{364}\) However, the written policy is not so limited and neither Armstrong nor Debye-Saxinger could justify such a distinction.\(^{365}\) Deming simply said, "we blew it... We didn't do it properly. We didn't follow our own guidelines."\(^{366}\)

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361 Id.

362 Id.; Deming Tr. at 247, 278. See DSAS Policy and Procedure Manual for Service Providers, Item 3100.6.

363 Deming Tr. at 255, 282, 307-08. At the beginning, Russakoff argued that the higher rent did reflect both the market value and the actual cost of the building. Letter to Gerard Armstrong from Don Russakoff, dated May 9, 1986. Although Contract Management was unsatisfied with Russakoff's explanations, Armstrong Tr. at 697-98, 702-03, nothing was done to change the lease arrangement at that time.

The rent issue surfaced again in February 1987 when DSAS' Bureau of Field Audit and Program Review ("FAPR") issued a report stating that the lease arrangement violates DSAS policy. See Memorandum to Julio Martinez, et al., from Neil Grogin, dated February 2, 1987, and accompanying "Report on the Examination of National Expert Care Consultants," by New York State Division of Substance Abuse Services, Bureau of Field Audit and Program Review. A month later, after NECC had provided essentially the same explanation that it had given the previous May, FAPR concluded that, of the $167,700 that AKH would earn from the surcharge, only $5,145 qualified as legitimate expenses eligible for DSAS funding. Memorandum to Julio Martinez from Neil Grogin, dated March 2, 1987. Nevertheless, DSAS continued to pay the surcharge.

364 Letter to Robert H. Atmore from Julio Martinez, dated November 16, 1988, p. 3.

365 Armstrong Tr. at 776-80, 1379-80; Debye-Saxinger Tr. at 180.

366 Deming Tr. at 244.
E. **NECC's "Indirect Cost Factor"**

In addition to the profit from the lease arrangement, DSAS agreed to include in each contract a guaranteed profit margin calculated at 17.5%, and later 17.9%, of the program's personnel costs. Based upon NECC's approved budgets, DSAS authorized NECC to receive over $300,000 in profit in less than two years of operation.

This profit is not disclosed anywhere on the face of the contracts or the approved budgets; instead, it is built into each budget's "salary," "fringe benefit," and "consultant" categories by increasing the dollar amounts therein by the amount of the profit factor. The profit is revealed only in the "line-item back-up" documents that state in greater detail how the amounts in the general budget categories will be spent -- but there it is only identified as an "indirect cost factor," a term that is usually used to refer to non-itemized overhead costs. No documentation indicates how the term was selected.

Nor did DSAS document how the amount of profit was determined. Deming and Armstrong testified that Russakoff told them he needed that level of profit to get a bank loan. In response to the Comptroller's Preliminary Draft Audit Findings, DSAS stated that it understood during negotiations that the profit level was necessary for the program to obtain a mortgage. Yet, no written confirmation of any such requirement was found in DSAS' files and,

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367 Deming Tr. at 376; Ringer Tr. at 26-28.

368 Deming Tr. at 519-21; Ringer Tr. at 52-53. Although also not indicated anywhere on the face of the contracts, or in any other document, consultant contracts with NMA were excluded when determining the guaranteed profit on personnel costs. Deming Tr. at 386-87. See below, pp. 70-71.

369 Deming Tr. at 431; Ringer Tr. at 52-53.

370 Deming testified that the term had been suggested by Russakoff. Deming Tr. at 430.

371 In his February 2, 1987 memorandum (see above, fn. 363) Neil Grogin suggested that instead of an "arbitrary 17.5% of personal services costs, ... from the perspective of service provider incentive and the Division's desire to get quality services, it would seem that a profit factor linked to service provider performance (utilization) would be more effective and justifiable." No documentation indicates whether Grogin's suggestion was followed or even discussed.

372 Deming Tr. at 377; Armstrong Tr. at 903-05.


374 Letter to Robert H. Attmore from Julio Martinez, dated November 16, 1988, p. 3.
as the Comptroller’s audit report points out, the program had no mortgage until Spring 1987, when AKH purchased the site at 458 West 50th Street.375

The Comptroller’s audit report likewise found no evidence that the profit level was ever evaluated by DSAS "to ensure it was reasonable when compared to similar proprietary operations funded by the State."376 Debye-Saxinger and Armstrong testified that DSAS did examine the practices of other state agencies in 1987, but found no analogy to NECC.377

F. NECC’s Subcontract With NMA For Consulting Services

DSAS permitted Russakoff to earn additional profit by allowing NECC to hire Russakoff’s consulting company, NMA, under subcontracts worth over $100,000.378 As with all of NECC’s consultants, none of the NMA subcontracts was competitively bid, even though DSAS rules require it.379 Deming approved the NMA subcontracts without competitive bidding because, in his view, time was of the essence.380

Under the subcontracts, NMA was to perform at least two functions. First, NMA provided consultants until NECC could hire permanent staff.381 Second, NMA helped prepare personnel manuals and other start-up documents.382 Armstrong testified that the first function was temporary and, in his view, appropriate, but the second function was one that should have been provided by NECC itself.383

375 Office of the State Comptroller Report No. 88-S-57, “Division of Substance Abuse Services, Oversight of Community-Based Programs,” p. 3.

376 Id., p. 4.

377 Debye-Saxinger testified that Contract Management was told to allow a profit within the guidelines of other agencies that contract with proprietary providers, and in Spring 1987 Henry Bartlett, head of DSAS’ Third Party Reimbursement Unit, was asked to look into this matter. Debye-Saxinger Tr. at 194. In a memorandum to Deming dated December 24, 1987, Bartlett reported that he found no situation analogous to NECC. He described DSAS’ relationship with NECC as "akin to the relationship between a venture capitalist and an entrepreneur."

378 Office of the State Comptroller Report No. 88-S-57, “Division of Substance Abuse Services, Oversight of Community-Based Programs,” p. 5. However, the Comptroller’s office has disallowed reimbursement for certain payments by NECC to NMA. Letter to Julio A. Martinez from Robert H. Atmore, dated April 11, 1989.

379 Deming Tr. at 375; DSAS Policy and Procedure Manual for Service Providers, Item 3100.22.

380 Deming Tr. at 375, 382-83.

381 Armstrong Tr. at 726-35.

382 Id.

383 Id.
NECC proposed in its licensing application that NMA provide "quality assurance" by monitoring NECC's compliance with DSAS procedures and to detect programmatic problems. Although DSAS documents do not make clear whether DSAS actually paid for that service, the Comptroller's audit report indicates that DSAS did.\textsuperscript{384} The audit report also states, "from the deficiencies noted in the Division's comprehensive review, it does not appear that the consulting firm provided the services for which it was contracted."\textsuperscript{385}

G. The Agreements Surrounding 458 West 50th Street

In 1987, DSAS agreed to fund NECC's expansion of its program to an additional site at 458 West 50th Street. The contracts included $264,000 for "facility improvement," which in fact was a grant to AKH to purchase the building in AKH's name.\textsuperscript{386} Under a Memorandum Of Understanding accompanying the grant, NECC and AKH agreed to use the site for substance abuse treatment for 20 years, but DSAS retained no other rights or interest in the building\textsuperscript{387} and imposed no requirement concerning the clients the program must treat.\textsuperscript{388}

In addition to granting $264,000 to AKH to purchase the building, DSAS also agreed to reimburse NECC for rent paid to AKH at that site. DSAS agreed that AKH could lease the site to NECC at the building's "fair market value" as determined by appraisals obtained by NECC (which turned out to be about $20,700/month).\textsuperscript{389} That agreement again violated DSAS rules limiting reimbursement to the lower of fair market value or net cost (about

\textsuperscript{384} Office of the State Comptroller Report No. 88-S-57, "Division of Substance Abuse Services, Oversight of Community-Based Programs," p. 5.

\textsuperscript{385} Id.

\textsuperscript{386} Deming Tr. at 479.

\textsuperscript{387} Memorandum of Understanding between DSAS, National Expert Care Consultants, Inc. and A. K. Holdings, Inc, signed April 30, 1987 and May 12, 1987. Apparently, DSAS does not like to own real estate, and it is not unusual for the agency to provide partial funding for the acquisition of a site by a not-for-profit service provider. Armstrong Tr. at 894.

\textsuperscript{388} Deming explained that DSAS has a responsibility to all substance abusers, including those belonging to the middle class, and therefore it is appropriate to finance a program that treats non-indigent clients. Deming Tr. at 398.

$12,000/month). However, the lack of documentation makes it impossible to establish why DSAS agreed to pay the greater amount.

The agreement under which DSAS reimbursed NECC for rent greater than AKH's mortgage cost also circumvented Mental Hygiene Law § 25.03(a). That provision prohibits DSAS from paying more than half of the mortgage obligation incurred by a program in purchasing real estate. According to Deming, the formation of a separate entity to purchase property and lease it back to the service provider, so that DSAS is technically paying for "rent" rather than "debt service," is a common method of avoiding the Mental Hygiene Law's restriction.

In addition to the Memorandum of Understanding, AKH and NECC entered into a side letter agreement, which DSAS considers a part of its contract with NECC and AKH. The letter agreement conditions AKH's promise to operate the property as a treatment facility for 20 years upon continued DSAS funding for the cost of operations. Therefore, once DSAS terminates funding for NECC -- as it now has -- AKH can disregard its 20-year commitment.

The letter agreement also provides that NECC's lease from AKH at 458 West 50th Street automatically terminates upon termination of DSAS funding for NECC. DSAS has the right to select a new service provider to lease the facility, but subject to the approval of AKH and the building's mortgage holder. Even if DSAS is unable to find a new provider that is satisfactory to AKH, DSAS is still required to pay funds to AKH for operating expenses. If a new

390 DSAS Policy and Procedure Manual Service Providers, Item 3100.6. AKH's mortgage and taxes on the property, which arguably constitute the net cost, were about $12,000/month. Russakoff Tr. at 277-80; see also Letter to Norwig Debye-Saxinger from Christine A. Storonsky, dated January 11, 1988, and accompanying Preliminary Draft Audit Findings of the Office of State Comptroller, p. 4.

391 How much DSAS actually reimbursed NECC for rent at 458 West 50th Street is also difficult to determine. A DSAS budget approved in July 1987 authorized $27,500/month for the start-up period February-March, 1987, while an August 1987 request for reimbursement indicates that the program was authorized to receive and was paid $28,150/month for April-August 1987. An internal DSAS memorandum in December 1987 indicates that NECC was receiving $30,910/month. See Memorandum to Carl Deming from Henry Bartlett, dated December 24, 1987. A budget amendment in June 1988 reduced NECC's monthly rental for the April-August 1987 period to $22,550/month. Russakoff testified that NECC was reimbursed at $18,500/month. Russakoff Tr. at 239.

392 Deming Tr. at 507-08.


395 Id.

396 Id.

397 Id.
provider has not been selected after a year, AKH can cease using the property as a treatment facility upon repayment to the State of $264,000, without interest. 398

H. NECC's Cost And Performance

The annual cost to DSAS of NECC's residential program was about $33,000/bed, 399 as compared to only about $6,000/bed in other residential programs operated by not-for-profit providers. 400 DSAS justifies the higher cost on the ground that NECC was able to begin operations quickly, had a more professional staff, offered more intensive treatment, and rehabilitated clients more rapidly than other programs. 401 However, contemporaneous DSAS documents raise doubts about DSAS' evaluation of the quality of the treatment program.

By late 1986, Deming found that NECC had "active and ... serious problems," including substance abuse by program clients and staff; termination of program staff for "indiscretions" with clients; and poor management by the program's "highly degreed professionals." 402 Deming noted that "the place would have fallen apart" but for the work of one consultant. 403 A year later, in December 1987, Deming observed that NECC's cost per bed was too high and that "much work" was needed for NECC's service delivery to reach the level expected under the contract. 404

Contract Management conducted a "Comprehensive Review" of the program and issued a report in February 1988. Among other things, the report noted that despite the rich staffing levels there was no documentation of any significant amount of individual counseling or

398 Id.
399 Memorandum to Carl Deming from Henry Bartlett, dated December 24, 1987. The Comptroller's office calculated the cost per client at $27,700, excluding NECC's profit. Office of the State Comptroller Report No. 88-S-57, "Division of Substance Abuse Services, Oversight of Community-Based Programs," p. 3.
400 Deming testified that, while there are variations among programs depending on factors such as the intensity of the services provided, a drug-free residential program such as Phoenix House today costs DSAS between $5,200 and $6,500 per bed. Deming Tr. at 342-43. The Comptroller's audit report noted two not-for-profit residential treatment programs that cost $8,670 and $22,390 per client. Office of the State Comptroller Report No. 88-S-57, "Division of Substance Abuse Services, Oversight of Community-Based Programs," p. 3.
401 See, e.g., Armstrong Tr. at 750-54 ("we got our money's worth and ... yes, it was more expensive, but you can't compare apples and oranges"); Deming Tr. at 263 ("within a matter of three months, [NECC] actually got clients in, got the program running").
402 Memorandum to Gerard Armstrong from Carl Deming, dated January 8, 1987; Deming Tr. at 467.
403 Memorandum to Gerard Armstrong from Carl Deming, dated January 8, 1987.
404 Memorandum to Gerard Armstrong from Carl Deming, dated December 30, 1987.
individual participation in group sessions; client records "were generally prepared with a distinct lack of substantive staff/client interaction;" and services provided were generally not consistent with prescribed treatment plans.405

At the same time, NECC was extremely uncooperative with Contract Management. From the beginning, NECC began hiring staff without approval, paying salaries above approved budget levels, sub-contracting and taking other actions without authorization.406 Thus, in December 1986, Deming asked DSAS' Bureau of Field Audit and Program Review ("FAPR") to examine NECC, even though FAPR does not usually conduct such a review until after a full year of operations.407

In February 1987, FAPR reported its findings, which included a number of problems in NECC's operations relating to the program's accounting policies and procedures, accounting records and practices, program expenditures and documentation thereof, and personnel record-keeping.408 However, NECC's compliance with DSAS requirements did not improve.409 For example, NECC never timely submitted its "Workscope," the principal document describing the services that the program would deliver under each contract.410 When the "Workscopes" were eventually submitted, Contract Management found them "overly primitive, simplistic, unsophisticated and lacking in detail... ."411

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406 See, e.g., Deming Tr. at 251-52; Ringer Tr. at 63-64; Memorandum to John Cavallaro from Martin Ringer, dated January 28, 1987.

407 Deming Tr. at 250-52; Armstrong Tr. at 754-56.


409 Indeed, many of the problems noted in FAPR's report were noted again in Contract Management's Comprehensive Review report in February 1988. See "Division of Substance Abuse Services Comprehensive Review of National Expert Care Consultants, Conducted by Contract Management and Fund Allocation."

410 Deming Tr. at 474-76.

411 Id.
NECC's paperwork had so many errors that Contract Management staff spent inordinate time checking for accuracy and asking for explanations and corrections.412 Deming testified that some of the errors, which if undetected would have resulted in more money for the program, were implausible.413 One contract manager wrote that NECC "continues to demonstrate either a remarkable incompetence or a willful failure to understand DSAS requirements,“414 and many DSAS letters and memoranda expressed growing frustration with the program.415 NECC frequently failed to provide adequate responses to DSAS’s many questions and requests for information.416

Martin Ringer, the head of the regional office assigned to handle the NECC contracts, testified that he finally decided that every communication with Russakoff had to be in writing, and he told Russakoff that unless he could show written permission for an expenditure it would not be approved.417 Nevertheless, NECC continued to act without DSAS approval.418 When questioned, Russakoff would explain that someone else had orally approved it.419 Upon checking, Contract Management staff frequently discovered that the action had not been approved.420

412 Ringer Tr. at 42. See, e.g., Deming Tr. at 490-91; Letter to Roger Cohn from Lillian Milne, dated March 11, 1988; Letter to Don Russakoff from Cynthia Bell and Martin Ringer, dated April 23, 1987; Memorandum to Carl Deming from John Cavallaro, dated January 26, 1987 ("an enormous amount of staff time ... has been given to this project with very little real results. No other project ... has had so much attention"); Memorandum to Gerard Armstrong from Carleton Deming dated January 8, 1987, p. 2 (Contract Management staff is "somewhat overwhelmed" by NECC, having "literally spent hours and hours" on the program; the time devoted to NECC "is severely out of line with the size of the project" and has been at the expense of other New York City treatment programs).

413 Deming Tr. at 490-91.


416 See, e.g., Armstrong Tr. at 691-92; Ringer Tr. at 37, 39, 41, 63, 69-70; Bell Tr. at 13, 28; Letter to Roger Cohn from Lillian Milne, dated March 3, 1988 ("[i]t has been a consistent and habitual practice at National Expert Care Consultants to fail to respond to specific requests from the contract manager").

417 Ringer Tr. at 59, 60, 64-65.

418 Id. at 65. See, e.g., Memorandum to Carl Deming from Martin Ringer and Lillian Milne, dated February 16, 1988 ("[i]t is becoming increasingly clear that NECC continues to hire staff without DSAS approval").

419 Ringer Tr. at 60, 64, 131.

420 Id. at 64, 131.
Finally, in early 1988, Contract Management conducted a review of the contracts and "disallowed" approximately $350,000 of NECC's expenditures.421 DSAS recouped all but about $50,000 of that sum by withholding payments on a $1.7 million contract for the period September 1987 to March 1988.422

The State Comptroller also audited the NECC contracts, except for the September 1987 - March 1988 contract, and uncovered nearly $547,000 in additional improper expenditures (on $2.6 million worth of contracts) that DSAS must recoup.423

I. The Decision To Terminate NECC's Funding

The combination of programmatic and financial problems and increasing adverse publicity surrounding the NECC contracts prompted Deming, Armstrong and Debye-Saxinger to decide in early 1988 to cease funding NECC.424 For his part, Russakoff claims to have become frustrated with DSAS, principally due to the agency's delays in approving purchases and hiring.425

In Spring 1988, DSAS began negotiating a three-month (April through June) "close-out" contract to end the agency's financial support for NECC.426 The purpose of the contract was to assist NECC in making an orderly transition from serving DSAS clients (i.e., indigent) to serving private, fee-paying clients.427

DSAS knew at the time that the Comptroller had preliminarily found approximately $500,000 in disallowances. Thus, the close-out contract was negotiated with the awareness that it would probably offset the disallowances and that, as a result, DSAS might pay

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421 Deming Tr. at 287-99.
422 Id. at 285-305.
423 Letter to Julio A. Martinez from Robert H. Attmore, dated April 11, 1989. The disallowed costs were associated with NECC employees and consultants who were hired without the required DSAS approval, and costs not related to the purpose of the programs, not properly supported, or in excess of approved budgets. DSAS took "no issue with the scope, content and findings" of the Comptroller's report. However, based on its own review, DSAS concluded that the total amount due DSAS was only $415,691. Letter to Robert H. Attmore from Julio A. Martinez, dated May 11, 1989, p. 2.
424 Armstrong Tr. at 982-84; Debye-Saxinger Tr. at 224; Deming Tr. at 334, 425-27.
425 Russakoff Tr. at 344-45.
426 Deming Tr. at 301, 324.
427 Id. at 301, 327, 334-35.
little or nothing on the close-out contract.\textsuperscript{428} These circumstances create the impression that DSAS negotiated the contract so as to help Russakoff offset the disallowances, but Deming denied any such purpose.\textsuperscript{429}

DSAS and NECC staff members negotiated the close-out contract until December 1988 at which time it was forwarded to Russakoff.\textsuperscript{430} However, Russakoff never signed or returned the proposed contract and, after the Comptroller's Report was issued in April 1989, Debye-Saxinger decided to withdraw it.\textsuperscript{431} DSAS is now left to recoup from Russakoff its remaining disallowances and those identified by the Comptroller. As DSAS noted in its response to the Comptroller's audit of NECC's contracts, "[s]ince NECC is no longer under contract to DSAS, the recovery cannot be accomplished in the normal fashion, i.e., through disallowances of future payments. Nevertheless, we plan to enter into negotiation with NECC officials to develop a repayment schedule for recovering the refund due the State."\textsuperscript{432}

J. Explanations Offered For The NECC Debacle

None of the DSAS witnesses disputed that the NECC contracts were handled poorly. Each of them offered a different combination of the following reasons: (1) DSAS employees felt reluctant or powerless to take steps necessary to manage the contracts properly because they knew that Russakoff had direct access to Martinez; (2) Russakoff was difficult to deal with; (3) the Legislature, the Governor, Martinez and the agency wanted to make more treatment beds available as quickly as possible to respond to the crack epidemic; (4) NECC was the first for-profit provider DSAS had funded, and DSAS had no policy and procedures for such businesses; (5) Contract Management was overworked and overwhelmed by NECC and therefore mismanaged the contracts; and/or (6) Martinez was unaware of the problems with respect to NECC and was misled by his staff. A discussion of each follows.

\textsuperscript{428} Id. at 305-06, 321, 323-24.

\textsuperscript{429} Id. at 320. See also Armstrong Tr. at 990-91.

\textsuperscript{430} Armstrong Tr. at 995-96. The impression that DSAS sought to create an off-set for Russakoff's disallowances is enhanced by DSAS' failure, in calculating the amount of the close-out contract, to determine NECC's actual costs in carrying the remaining indigent clients. Instead, DSAS arbitrarily agreed to pay half the amount of NECC's monthly expenses, calculated on the assumption that NECC would have the same client and staffing levels as under previous contracts. However, by the time that the contract was forwarded to NECC in December 1988, DSAS knew that NECC actually had treated only half the number of clients as it had previously. Deming Tr. at 310-20.

\textsuperscript{431} Debye-Saxinger Tr. at 231; Deming Tr. at 313; Armstrong Tr. at 991-92.

1. **Staff Reluctance To Intervene Because Of The Russakoff-Martinez Relationship**

Although Martinez played no role in negotiating the NECC contracts, his relationships with Russakoff and with Menken made it difficult for Contract Management staff to act objectively in dealing with NECC.\(^{433}\) Armstrong himself withdrew from active involvement because of the relationships, and he testified that his absence partially accounts for the agency's failure to resolve some of the issues that arose during the course of the contracts.\(^{434}\)

In addition, Russakoff often talked directly with Martinez and would tell contract managers that he had "already talked to Julio" about a matter.\(^{435}\) In fact, there was frequent contact (i.e., twice a week) between the two men until the end of 1986, when, according to Armstrong, Martinez began to see Russakoff "as being very pesty, as wanting more and more of a piece of the action, in terms of lobbying, in terms of funding."\(^{436}\)

Because of the frequent contact and name-dropping, some contract managers concluded that "ordinary day-to-day administration of the program" was meaningless because the program was "being handled up above."\(^{437}\) Assuming that matters had been "pre-approved," they adopted an attitude of "I'll just process paper."\(^{438}\)

According to Armstrong, Ringer felt tremendous pressure to keep NECC funded and LaPorte added to the pressure by urging Ringer to accommodate Russakoff.\(^{439}\) Ringer saw NECC as "greater than him, that it was at an upper level of the agency, and that he saw himself as a functionary of higher-ups."\(^{440}\) Chief Counsel Damm similarly recalls that Ringer felt that if he

\(^{433}\) Armstrong Tr. at 818-24, 1348, 1373-74, 1398.

\(^{434}\) Id. at 847-50.

\(^{435}\) Id. at 819-20, 825-26, 1388-89. See also Debye-Saxinger Tr. at 103-04. Martinez surmised that given Russakoff's name-dropping tendencies, Russakoff probably did tell DSAS employees he had discussed something with Martinez even when he had not. Martinez Tr. at 97-100.

\(^{436}\) Armstrong Tr. at 1357-60. Martinez also got "feedback" that Russakoff was alienating people in Albany and not performing satisfactorily as a lobbyist. Id.

\(^{437}\) Id. at 821, 822-25, 836, 1370-71.

\(^{438}\) Id. See also Debye-Saxinger Tr. at 208-09.

\(^{439}\) Armstrong Tr. at 824-30, 1045-47, 1365-66, 1389-90.

\(^{440}\) Id. at 824-25, 1368-69.
"raised too many questions" or "gave Don a hard time," then Russakoff would talk to Martinez and Ringer would get "yelled at."441

Ringer testified that he was not aware of the extent or nature of the contact between Martinez and Russakoff and that the only pressure he felt stemmed from Martinez’s "urgency to get residential beds up."442 He also testified that while occasionally Russakoff told him that he had spoken to or would be seeing Martinez, this name-dropping created no added pressure.443

2. Russakoff Was A Difficult Contractor

Armstrong testified that Russakoff was such an uncooperative contractor that Contract Management’s oversight capability was simply overtaxed.444 As already noted above, at pp. 74-75, he frequently hired staff and purchased equipment without DSAS’ approval; he claimed to have received oral approval when in fact he had not; and paperwork was often submitted late and had to be returned because it was improperly or inadequately completed.445 Although Armstrong told Martinez that Contract Management staff were overextended, Martinez responded that "we have to do more to help Don.446

3. Pressure To Increase Treatment Capacity

The crack crisis in 1986 placed tremendous pressure on DSAS to establish more treatment beds.447 According to Armstrong, Martinez was so "consumed and driven" by the need to expand residential treatment that he would have responded favorably to anyone offering to open a facility quickly, and he simply failed to recognize the significance of NECC’s problems.448

441 Damm Tr. at 59-60. See also Armstrong Tr. at 1371.

442 Ringer Tr. at 110, 114, 118, 122, 123. Ringer also denied having discussed NECC with LaPorte. Id. at 147-48.

443 Id. at 133-37.

444 Armstrong Tr. at 802-04, 1366-67, 1373.

445 See id. at 1370, 1372.

446 Id. at 803.

447 Ringer Tr. at 81-82, 118; Armstrong Tr. at 715-16, 717, 829, 1368-69, 1373.

448 Armstrong Tr. at 716-17, 719, 811.
When Armstrong complained to Martinez about Russakoff or about Contract Management being overwhelmed by the program, Martinez's reply was "Russakoff has a building, we need space and we ought to give it a shot."449 Similarly, Armstrong told Martinez that rather than moving ahead with the second site at 458 West 50th Street, NECC should have been contained until the issues were resolved.450 However, Martinez responded that "we need beds."451

4. **NECC Was The First For-Profit Provider**

Every DSAS witness identified the absence of a policy relating to contracting with a for-profit business as a primary source of the agency's problems with NECC.452 Although the need for a policy was recognized, none was ever developed.453 As early as March 1987, it was decided that Contract Management should develop a policy for profit-making contractors, but "we didn't know how to begin and really what to do."454 As a result, it was the general consensus that the agency would develop the guidelines as the NECC contracts progressed.455

That approach was unrealistic and placed Contract Management staff in an impossible situation. Since Ringer's superiors gave him no specific instructions on how to deal with a for-profit entity or determine a reasonable profit factor, he would have liked to have moved more slowly with the program; yet, he was expected to keep the cash flow to NECC moving so that services could be provided.456

5. **Contract Management Mismanaged The Contracts**

The combination of inadequate staff, pressure to expand treatment, and the sense that NECC was being handled by high level DSAS officials resulted in poor management of the

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449 Id. at 723.
450 Id. at 809, 811.
451 Id. at 809, 1377.
452 See, e.g., id. at 1374.
453 Id.
454 Damm Tr. at 40-44.
455 Armstrong Tr. at 709-10, 747.
456 Ringer Tr. at 118-22, 130, 151-53.
contracts. According to Debye-Saxinger, "awfully shoddy, hurried work was being done by people who feel the director and his executive assistant want to move something quickly." 457

Contract Management staff agreed that the New York City regional office was inundated with work, and that NECC in particular created a tremendous drain on staff. 458 Neither Armstrong nor Deming were able to give NECC the attention it demanded. 459 Both Ringer and contract manager Cynthia Bell devoted a substantial, but ultimately insufficient, amount of time to NECC's contracts because of their complexity, the fact that NECC was a new provider, and the problems identified above. 460

6. Martinez: Unaware And Misled By His Staff

Martinez testified that if he had known there had been problems with NECC, he would have told his staff, "if you people don't feel comfortable with it, phase the ... thing out, end it." 461 He added that he would have expected Debye-Saxinger to resolve the issues raised by the FAPR review in late 1986 and early 1987, and that if there was disagreement among department heads Debye-Saxinger should have brought the issue to him for resolution. 462 Martinez testified that he was "sandbagged" since Debye-Saxinger knew about the problems with NECC "from day one" but did not tell him. 463

Although Martinez testified that DSAS would not fund another for-profit contractor since the agency does not know how to handle them, 464 he maintains that in 1986 funding NECC was appropriate because there was a crack epidemic and Russakoff was "the only

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457 Debye-Saxinger Tr. at 184-85.
458 Armstrong Tr. at 824, 1366-67; Ringer Tr. at 42.
459 Armstrong Tr. at 733-34; Deming Tr. at 254, 258.
460 Ringer Tr. at 42; Bell Tr. at 15-16, 27-28.
461 Martinez Tr. at 178. Armstrong testified that he kept Martinez apprised of problems with NECC and that during the Spring and Summer of 1986, he would discuss them with Martinez about once every two weeks. Armstrong Tr. at 713. Martinez does not recall these discussions. Martinez Tr. at 172-74.
462 Martinez Tr. at 190-91, 193-94.
463 Id. at 157-58, 213-18, 225.
464 Id. at 153-54.
game in town. He had a site...."465 Thus, said Martinez, "I was able to take 40, 50 people off the streets, rather than leaving them out there."466

V. EL REGRESO

A. Introduction And Summary

El Regreso has been under contract with DSAS since July 1986 to provide drug-free residential treatment to 40 clients in Brooklyn, New York.467 Since its inception, DSAS has budgeted approximately $2,015,000 for the program.468 As of March 1989, approximately $1,079,000 had been disbursed.469

However, El Regreso has yet to open a treatment facility, although it has operated a store-front counseling and referral service since June 1988. The delay appears mainly attributable to a series of problems in obtaining and renovating a building for the program.

The decision to contract with El Regreso was made by Director Martinez and certain of his close associates who have long-standing close personal friendships with Carlos Pagan, El Regreso's Executive Director. El Regreso thus bypassed Contract Management and DSAS' usual contracting procedures. Moreover, the two principal contractors employed to help El Regreso in locating and renovating a site were selected in violation of DSAS requirements.

B. Carlos Pagan's Friendship With Director Martinez And Franklin Soto

Pagan and Martinez have known each other for at least 20 years. They went through drug rehabilitation together in the 1960's.470 Together, they founded and worked at two drug treatment programs, Phoenix House and Project Return.471 When Martinez left Project

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465 Id. at 113-14.
466 Id. at 154.
468 DSAS - Commission on Government Integrity Data Request, DSAS Contract and Payment Information - El Regreso.
469 Id.
470 Pagan Tr. at 49-50.
471 Id.
Return to become Director of DSAS, he picked Pagan to succeed him as president of the treatment program. As Pagan testified, "people in China know that we're friends."

Pagan is also good friends with Franklin Soto, a close friend and assistant of Martinez. When Martinez is in New York City, the three of them socialize together.

C. DSAS' Decision To Fund El Regreso

Pagan relied on these friendships in the Spring of 1986, when he approached DSAS about opening his own treatment program. He began discussions with members of Martinez's executive staff, Soto in particular, who at that time worked in DSAS' community relations office. Soto then ordered an inspection of Pagan's proposed site without Armstrong's knowledge. Indeed, no one in Contract Management was informed of the project until much later.

As early as April 1986, Armstrong overheard Soto and LaPorte discussing a program to be run by Pagan, yet neither Soto nor LaPorte mentioned it to Armstrong until he approached them in late May or early June. At that time, LaPorte and Soto told Armstrong that a commitment already had been made to Pagan. Contract Management was completely cut out of the process.

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472 Armstrong Tr. at 1195-96.
473 Pagan Tr. at 49.
474 Id. at 26, 66-67; Soto Tr. at 16, 20-22.
475 Soto Tr. at 21.
476 See Armstrong Tr. at 1193; Debye-Saxinger Tr. at 247.
477 Pagan Tr. at 11, 66-67.
478 Armstrong Tr. at 1216-18. Armstrong first learned of Soto's action while giving private hearing testimony during this investigation; he was disturbed but not wholly surprised since Soto often carries out Martinez's directives personally. Id. at 1218.
479 Id. at 1192-93.
480 Id. Soto maintains that he only assisted Pagan in completing the application and, once he received it, forwarded it to Armstrong. Soto Tr. at 28. Pagan denies that he received any commitment from Soto or LaPorte, or that he received any assistance in completing the application. Pagan Tr. at 15, 18. Any such assistance normally should be provided by Contract Management staff. Armstrong Tr. at 1234-35.
481 Armstrong Tr. at 1193-95.
When Armstrong learned of the commitment, he approached Martinez, who confirmed that he and Pagan had discussed the possibility of funding a program; Martinez explained his involvement by citing the need to develop residential beds.\footnote{482} Faced with no choice but to proceed, Armstrong held a meeting with Pagan on June 9, 1986, in which he formally confirmed the agency’s commitment to fund El Regreso.\footnote{483}

D. Delays In The Opening Of El Regreso

Apart from a storefront counseling and referral service begun in June 1988,\footnote{484} El Regreso has not yet begun operations. One reason appears to be a series of delays in obtaining a site for its proposed residential treatment program. Between May 1986 and the end of that year, two possible sites fell through when landlords were unable to provide vacant buildings.\footnote{485} During the first weeks of 1987, a third and apparently final program site was located on South Second Street, Brooklyn.\footnote{486} Since then, problems in completing renovations at the site have caused additional delay.

1. Site Selection And The Subcontract With NMA

After El Regreso’s first proposed site fell through in the Summer of 1986, the program signed a $20,000 subcontract with Don Russakoff’s consulting firm, National Management Analysts ("NMA"), which was to assist El Regreso in finding a new site.\footnote{487} Although DSAS regulations require that consultant contracts be bid competitively and pre-approved in writing by the agency,\footnote{488} this contract was entered into without any competitive process and was not approved by DSAS until more than a month after it was signed.\footnote{489} DSAS records contain no justification or explanation for this.

\footnote{482} Id. at 1192-93. Martinez testified that he had no involvement in the decision to fund El Regreso; he simply told Pagan to complete the application and follow the normal routine. Martinez Tr. at 254-56.

\footnote{483} Armstrong Tr. at 1187.

\footnote{484} Letter to Doug Nelson from Jon Lushing, dated July 18, 1988.

\footnote{485} Memorandum to Dennis Whalen from John Cavallaro, dated December 11, 1986.

\footnote{486} Letter to William Griffin from Carlos Pagan, dated March 9, 1986.


\footnote{488} DSAS Policy and Procedure Manual for Service Providers, Item 3100.22.

\footnote{489} Letter to Carlos Pagan from William Griffin, dated October 9, 1986.
A second subcontract for more than $12,000 was signed by El Regreso and NMA on January 1, 1987.\footnote{Contract Between El Regreso and National Management Analysis, Inc., dated January 1, 1987.} Once again, there was no competitive bidding, no approval by DSAS until many months after the fact,\footnote{Letter to Carlos Pagan from Doug Nelson, dated August 3, 1987.} and no documentation explaining why DSAS rules were not followed.\footnote{Bill Griffin, the contract manager assigned to El Regreso, has no recollection of the events surrounding these contracts. Griffin Tr. at 211-14. However, when questioned on this subject, Griffin recalled that in mid-1987 Carl Deming told him that a decision had been made to disapprove future contracts with NMA. Id. at 202-06. Although Deming confirmed such a decision (Deming Tr. at 433), it is not documented and neither Armstrong nor Debye-Saxinger could recall it. Armstrong Tr. at 1296; Debye-Saxinger Tr. at 297-98.}

Armstrong testified that either Soto or LaPorte must have suggested that Pagan hire Russakoff and essentially gave verbal approval to the subcontracts.\footnote{Armstrong Tr. at 1256-57.} Pagan testified that it was his own idea to hire NMA and that he would never have done so without DSAS approval, but the documents do not support that sequence of events.\footnote{Pagan Tr. at 29-31; see above, fn. 489 and fn. 491.}

2. Renovations And The Contract With CMTC

The current program site on South Second Street is now being renovated at an estimated cost of $559,000.\footnote{Memorandum to Carl Deming from William Griffin, dated April 13, 1987.} El Regreso is not expected to be operational until Spring 1990, more than three years after the site was identified.\footnote{Griffin Tr. at 261.} Armstrong attributes part of the delay to inefficiency by the construction manager hired by DSAS to oversee this and other projects.\footnote{Armstrong Tr. at 1283.}

The construction manager, Construction Management Training Company ("CMTC") was hired by DSAS without any competitive bidding. Armstrong testified that Debye-Saxinger and Martinez wanted to preserve good relations with CMTC’s parent organization, the
Urban Coalition, and that therefore they contracted with CMTC to offset the termination of another DSAS contract with the Urban Coalition for organizing conferences.\(^{498}\)

The use of CMTC on the El Regreso project also served another purpose. DSAS had received inquiries from a reporter and a lawyer about the close relationship between Martinez and Pagan and, in a memorandum summarizing a meeting with Pagan, the contract manager handling El Regreso wrote: "Carlos [Pagan] was assured that, although there are no known improprieties involved, the fact the Urban Coalition CMTC (an uninvolved third party) is handling contracts further distances Carlos and DSAS from any erroneous appearances of sweetheart deals."\(^{499}\)

Armstrong and Griffin testified that using CMTC may have helped avoid the appearance of propriety because Pagan, if left to his own devices, would have hired NMA to be the construction manager.\(^{500}\) If he had done so, DSAS might have been vulnerable to claims that Pagan was being given unfettered discretion to spend money and hire friends of Director Martinez.\(^{501}\)

E. El Regreso's Staff

Since DSAS funding began, Pagan has been paid $40,000 annually.\(^{502}\) However, Pagan may have been paid full-time wages for only part-time work; similar salaries have been paid to directors of fully operational programs.\(^{503}\)

\(^{498}\) Id. at 1274-81. Debye-Saxinger testified it was merely coincidence that CMTC was hired at the same time DSAS stopped using the Urban Coalition to organize its conferences, but did not deny that the CMTC contract was not competitively bid. Debye-Saxinger Tr. at 282-89. Martinez testified he did not know about the CMTC contract until after its execution. Martinez Tr. at 336.

\(^{499}\) Memorandum to File from Doug Nelson, dated October 16, 1987.

\(^{500}\) Armstrong Tr. at 1281-82, 1292-93; Griffin Tr. at 189-190, 223-24, 228. Pagan testified he had intended to oversee the renovations himself, and denied wanting to hire NMA. Pagan Tr. at 39-41.

\(^{501}\) Armstrong Tr. at 1292-93; Griffin Tr. at 223-24, 228.

\(^{502}\) Griffin Tr. at 237; DSAS Report to N.Y.S. Inspector General Joseph A. Spinelli, dated October 7, 1988 (Part B, "El Regreso Foundation, Inc.").

\(^{503}\) See Armstrong Tr. at 1305; Deming Tr. at 569-73. See also Memorandum to Carleton Deming from William J. Griffin, dated January 5, 1988 (the salary for Rafael Cantellops as the director of a combined day service program (serving 40 clients) and residential program (serving 72 clients) "should not exceed $50,000").
At the outset, Pagan’s duties included activities such as locating a site and meeting with community officials, legislators and architects. However, the contract manager responsible for El Regreso had doubts that those activities kept Pagan fully engaged. Once Pagan found and secured the current program site in early 1987, his duties diminished.

Still more questionable is the program’s need for three employees (in addition to Pagan) since January 1987, and a fourth one after El Regreso opened its storefront counseling and referral center in June 1988. The program received DSAS’ written approval for each new position, but no DSAS records contain an evaluation or explanation of the need for the additional staff.

Although Martinez and the program’s contract manager deny it, El Regreso’s storefront center appears overstaffed. The program’s records indicate that, on average, Pagan and his four employees make one referral each day. Two employees, a "Fiscal Officer" and a "Special Assistant," are paid full-time salaries to write checks for such matters as utility and insurance bills.

F. El Regreso’s Future

The prognosis for El Regreso is unclear and Armstrong and Debye-Saxinger disagree on the subject. Armstrong believes that Pagan is an honest man with a sincere desire and the ability to open and operate a treatment facility. He believes the successive site problems were merely misfortune and that El Regreso will ultimately open.

504 Memorandum to Gerard Armstrong from Bill Griffin, dated October 6, 1988; Armstrong Tr. at 1300.

505 Griffin Tr. at 254-58.


507 Martinez Tr. at 340-42; Griffin Tr. at 262-64.


509 Pagan Tr. at 54-56.

510 Armstrong Tr. at 1199.
On the other hand, Debye-Saxinger, in addition to objecting to the original decision to fund El Regreso, questions Pagan's ability to start and run a new program successfully.

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The facts set forth above concerning DSAS' procedures and the contracts with the four programs investigated in depth by the Commission provide ample support for the conclusions and recommendations set forth in Part One of this report.

Dated: New York, New York
December, 1989

STATE OF NEW YORK
COMMISSION ON GOVERNMENT INTEGRITY

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511 Debye-Saxinger Tr. at 266-67, 280.
Glossary
Of Individuals
GLOSSARY OF INDIVIDUALS


Cynthia Bell: DSAS Contract Manager.

Raphael Cantellops: Founder and Executive Director of La Nueva Raza Institute.

Deborah Damm: DSAS Chief Counsel.

Norwig Debye-Saxinger: DSAS First Deputy Director.

Carleton Deming: DSAS Downstate Chief of Contract Management. Deming is responsible for programs in New York City and Nassau and Suffolk Counties.

Benito Fernandez: Businessman, entrepreneur and Prospect., Inc.'s chief financial strategist and sponsor.

Arnold Freeman: Executive Director of Prospect, Inc. and former Administrator of Prospect Hospital.

Angelo Giordani: Former Chairman of the Board of La Nueva Raza Institute.

Bill Griffin: DSAS Contract Manager.

Neil Grogin: DSAS Deputy Director for Field Audit and Program Review.

Gerard Houser: DSAS Contract Manager.

Charles LaPorte: DSAS Deputy Director for Chemotherapy Services.

Julio Martinez: Director of DSAS.