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May 16, 2001

**THE HONORABLE DONALD R. "DON" CRAVINS,
CHAIRMAN, SENATE JUDICIARY B, AND
MEMBERS OF THE COMMITTEE**
Baton Rouge, Louisiana

Dear Senator Cravins:

The Senate Judiciary B Committee expressed concerns regarding the operation of the Tallulah Correctional Center for Youth. In order to address those concerns, the Legislative Auditor sought answers to two questions:

1. What was the actual construction cost and the amount of debt service of the Tallulah Correctional Center for Youth?
2. What amount did the owners of the Tallulah Correctional Center for Youth receive from inception of the agreements with DOC?

This report is intended to respond to these questions and report additional matters for consideration resulting from our examination.

TALLULAH CORRECTIONAL CENTER FOR YOUTH

DOC - CITY OF TALLULAH - TRANS-AMERICAN

The Louisiana Department of Public Safety and Corrections, Corrections Services (DOC) entered into a Cooperative Endeavor Agreement with the City of Tallulah (City) during February 1994 to construct a juvenile correctional facility. At the same time, the City entered into a Management Services Agreement with Trans-American Development Associates (Trans-American) to operate the facility. Subsequently, during March 1995, the City assigned its rights and obligations to Trans-American.

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TRANS-AMERICAN - FORMATION AND OWNERSHIP

Trans-American Development Associates was created solely to build and subsequently operate the Tallulah Correctional Center for Youth (TCCY). The owners of Trans-American are Mr. George A. Fischer of Metairie, Louisiana; Mr. James R. Brown of Tallulah, Louisiana; and Mr. Verdi Adam of Baton Rouge, Louisiana. Trans-American was responsible for the operations of the facility. The same principals later created FBA, a limited liability corporation, to hold ownership of the facility, and Frostline, Inc., to provide phone services to the juvenile offenders.

Mr. Adam explained that Trans-American was advised by its attorneys to create FBA as a "bankruptcy remote company" which would hold ownership of the facility's buildings and land while Trans-American continued operating TCCY. This separation of ownership from operations was intended to protect the facility's assets in the event of bankruptcy.

WHAT WAS THE ACTUAL CONSTRUCTION COST OF TCCY?

TCCY was constructed in two phases. The facility's minimum security structures were erected as phase I in 1994, while the phase II structures erected from 1995 through 1997 relating mostly to high security lockdown facilities. Trans-American records indicate construction costs of \$6,286,254 and \$16,151,864 for phase I and phase II, respectively, for a total construction cost of the facility of \$22,438,118.

**WHAT AMOUNT OF DEBT WAS INCURRED
BY THE OWNERS OF TCCY?**

Trans-American financed the cost of original construction through bank loans, capital leases, and internal financing. On January 27, 1997, Trans-American refinanced \$16,893,318 of its outstanding loans, capital leases, and internal financing with the issuance of \$29,475,000 in bonds. Included in the proceeds of the bond issue was \$4,687,270 for future construction. The remaining \$7,894,412 of bond proceeds were used to fund a reserve of \$2,947,500 and pay fees associated with the bond issue of \$4,946,912. During May 1998, Trans-American again refinanced its outstanding debt through a second bond issue for \$32,995,000.

WHAT AMOUNT WAS PAID TO THE OWNERS OF TCCY?

The financial records of Trans-American and its TCCY related companies are maintained in the offices of Gulf Engineers and Consultants (GEC), a Baton Rouge firm owned by Mr. Fischer and Mr. Adam. During our examination of these records, we noted dividend distributions made by Trans-American and its related companies from August 1996 through April 2001. Those

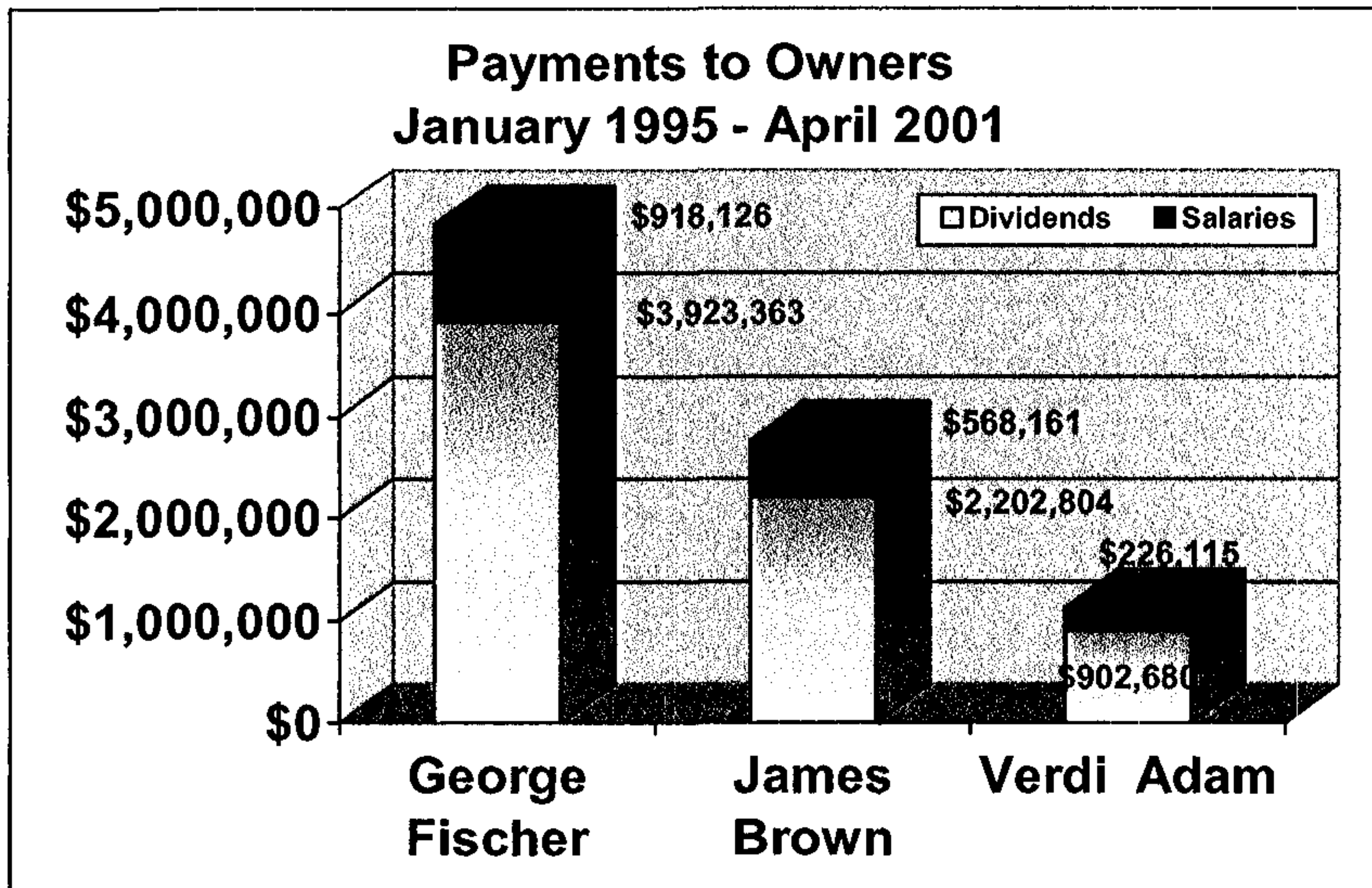
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payments to Mr. Fischer, Mr. Brown, and Mr. Adam totaled \$3,923,363; \$2,202,804; and \$902,680, respectively.

We further noted that Trans-American paid salaries to the owners from January 1995 through December 1998. Those payments to Mr. Fischer, Mr. Brown, and Mr. Adam were \$918,126; \$568,161; and \$226,115, respectively. No salaries were paid after December 1998.



Therefore, the combined dividends and salaries paid to the owners from January 1995 through April 2001 was \$8,741,249.

During our discussions with DOC Secretary Richard Stalder, we pointed out the amount of money distributed to the owners. Secretary Stalder's immediate response was that these types of payments bring to mind the question, "What is unjust enrichment?" Secretary Stalder explained that in his opinion, the facility probably failed because the owners pulled out too much money. He added that this is a risk inherent with private operators of correctional facilities.

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MATTERS FOR FURTHER CONSIDERATION

Our examination of TCCY revealed the following concerns regarding the construction of the facility, the agreements between DOC and the City and its operations:

1. Trans-American was selected even though the company had no prior experience constructing or operating correctional facilities. According to both Secretary Stalder and Mr. Adam, Trans-American's original intent was to subcontract the facility's operations to an experienced contractor.
2. We could find no current or former public official who would take responsibility for selecting Trans-American.
3. The original agreement provided for DOC to pay the City a specified rate per day, per offender housed in the facility. Thereafter, numerous amendments were made to the agreements between the parties, which were primarily in favor of Trans-American. The amendment approved on January 27, 1997, guarantees Trans-American payment for more offenders than are actually housed in the facility. On the same day, Trans-American refinanced its debt obtaining over \$7.6 million in additional funds. On the subsequent day, Trans-American paid its three owners \$2 million in dividends.
4. The amendment dated January 8, 1997, specifies that DOC may not cancel the agreement so long as the indebtedness related to TCCY remains outstanding. Therefore, at the end of the term of the agreement, even though DOC will have paid for all of the costs of financing, construction, and operation of TCCY, the facility will remain the property of FBA.
5. The DOC agreement may not meet all of the requirements of a cooperative endeavor as defined by Louisiana law and the Attorney General.

SELECTION OF TRANS-AMERICAN

The facility began through an agreement between the City and DOC. Simultaneously, the City entered into an agreement with Trans-American to fulfill its obligations to DOC. Trans-American did not have previous experience constructing or operating a juvenile detention facility. Furthermore, we could find no public official, current or former, who would take responsibility for selecting Trans-American.

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Former Governor Edwards explained that he was not involved in the selection of Trans-American. However, he explained that he had Secretary Stalder meet with Mr. Fischer and Mr. Brown. He further stated that he left any decision to approve the arrangement up to Secretary Stalder's discretion and that he (Edwards) did not instruct Secretary Stalder on this matter. Mr. Edwards also said that he considered Mr. Fischer and Mr. Brown to be his friends and conceded that Mr. Fischer probably spoke with him about the arrangement.

Secretary Stalder told us that he did not select Trans-American because this was a decision made by the former Mayor of Tallulah, Donald Walker.

Mr. Walker told us that it was Mr. Brown who approached him. According to Mr. Walker, he and Mr. Brown then met with Secretary Stalder about the idea, and Mr. Brown negotiated directly with Secretary Stalder. Mr. Walker added that, in his opinion, there was never any doubt that Mr. Brown's group would get the contract.

Mr. Brown explained that when Mayor Walker asked him for a way to help Tallulah, he (Brown) came up with the idea of building a juvenile facility. According to Mr. Brown, he and Mayor Walker then took the proposition to Secretary Stalder.

Mr. Fischer stated that he worked at getting the contract for the facility for Trans-American. To accomplish this, he explained that he had telephone conversations and meetings with DOC officials. He added that he did not have discussions or meetings with officials of the City, because the City was not originally involved in the matter. Mr. Fischer, who served as Governor Edwards' campaign manager in 1991, further stated that he discussed the arrangement with Governor Edwards because if the governor had objected, the prison would not have been built.

NUMEROUS AMENDMENTS MADE TO DOC AGREEMENT

During February 1994, TCCY began through an agreement between DOC and the City. The City then, through a separate agreement, assigned its rights and obligations to Trans-American. Thereafter, numerous amendments have been made to the agreements between the parties, which were primarily in favor of Trans-American. The amendment entered into on January 27, 1997, guarantees Trans-American payment for more offenders than are actually housed in the facility. On the same day, Trans-American refinanced its debt obtaining over \$7.6 million in additional funds. On the subsequent day, Trans-American paid its three owners \$2 million in dividends.

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DOC and the City entered into a Cooperative Endeavor Agreement dated February 24, 1994. The term of the agreement was the sooner of 25 years or at the time of repayment of the debt associated with construction. DOC agreed to pay the City \$48 per day per offender housed in phase I, and \$58 per day per offender when phase II is completed and operational. Payments were subject to legislative appropriation. In the event the City failed to fulfill its obligations, DOC had the option of taking control of the facility's operations. In the event of such a takeover, DOC could terminate the agreement, so long as DOC paid the City enough to pay the principal, interest, and other requirements of the initial debt incurred.

The City was responsible for constructing or causing to construct the facility. Phase I was established to have a minimum capacity of 365 beds, while phase II minimum capacity was to be 155. The City agreed to operate and maintain the facility while DOC agreed to house a minimum of 350 juveniles in phase I and 150 juveniles in phase II.

The City and Trans-American entered into a Management Services Agreement dated February 10, 1994. Under the terms of this agreement, the City retained the services of Trans-American to operate the facility in the manner set forth in the Cooperative Endeavor Agreement.

Amendment I of the DOC-City Agreement was dated August 30, 1994. This amendment increased the minimum capacity of phase II from 155 to 305 beds. In addition, commencement of phase II was changed from 36 months after completion of phase I to immediately upon completion of phase I. Furthermore, DOC agreed to maintain a population of not less than 300 juveniles in phase II, which is an increase from the original obligation of 150.

Amendment II of the DOC-City Agreement was dated November 30, 1994, and signed by Secretary Stalder for DOC. This amendment increased the per diem from \$48 to \$50 per juvenile during phase I, and from \$58 to \$60 upon the completion of phase II subject to legislative appropriation.

Amendment III of the DOC-City Agreement was dated February 10, 1995, and signed by Secretary Stalder for DOC. This amendment increased the minimum capacity of phase I from 365 to 409 beds. The minimum number of juveniles to be housed by DOC increased from 350 to 386 offenders.

The City assigned its rights and obligations under the DOC-City Agreement to Trans-American on March 30, 1995. Trans-American agreed to pay the City \$150,000 annually as consideration for the assignment.

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Amendment IV of the DOC-City Agreement was dated April 21, 1995, and was signed by Secretary Stalder for DOC. This amendment incorporated the previous three amendments into a revised agreement. DOC's obligation to provide the minimum number of juvenile offenders in phase II was changed from 180 days after commencement of phase II to when phase II is fully completed and operational. Commencement of phase I changed from when the facility is completed and becomes operational to when any portion of phase I is completed and occupied.

Amendment V of the DOC-City Agreement was dated July 12, 1995, and was signed by Secretary Stalder for DOC. The per diem is increased from \$50.00 to \$52.88 per juvenile offender during phase I, and from \$60.00 to \$62.88 per offender upon the completion of any portion of phase II. According to records obtained from DOC, this adjustment was made to fund educational programs at the facility.

Amendment VI of the DOC-City Agreement was dated December 20, 1996, and was signed by Secretary Stalder for DOC. "Initial Debt" is redefined to include any debt incurred to refinance the aforementioned debt.

Amendment VII of the DOC-City Agreement was dated January 8, 1997, and was signed by Secretary Stalder for DOC. This amendment deletes the provision allowing DOC to terminate the Agreement and abandon use of the facility under certain conditions, by notifying the City in writing.

Amendment VIII of the DOC-City Agreement was dated January 22, 1997, and contained a Division of Administration approval stamp dated January 27, 1997, and was signed by Mr. Trey Boudreaux, an Undersecretary to Secretary Stalder. This amendment changed DOC's financial obligation in the event it took over operation of the facility. The previous obligation was a rate based on the principal and interest owed for constructing the facility, plus property taxes and insurance. The new provision provided that as of January 1997, DOC would pay a \$16.62 per diem on a minimum of 686 juvenile offenders, regardless of the number actually housed in the facility. This amendment amounted to a guarantee to the owners assuring them of at least \$11,196 per day. Furthermore, Trans-American's profit margin increased whenever less than 686 offenders were housed. Records indicate that 686 offenders were not housed on any day at TCCY. This per diem was to be adjusted every 12 months based on increases in the Consumer Price Index. DOC took over operations of TCCY on September 25, 1999.

Amendment IX was dated October 30, 1997, and signed by Mr. Boudreaux. A 12-man litter crew was established, and DOC agreed to pay the contractor \$3,912 per month to cover the cost of security officers to supervise the work.

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On August 4, 2000, an agreement signed by Secretary Stalder converted the appropriated amount of \$4,283,295 into 12 monthly payments of \$356,941.25 each.

**AGREEMENT GUARANTEES PAYMENT FOR 686
OFFENDERS THOUGH COURT RESTRICTED
ACTUAL POPULATION TO MUCH LESS**

As stated previously, during January 1997, DOC agreed in Amendment VIII that, in the event DOC took over operation of the facility, DOC would pay Trans-American \$16.62 per day on a minimum of 686 offenders. According to correspondence received from DOC, at the time this agreement was entered, TCCY was authorized by the United States Court to house only 540 offenders. Between January 1997 and October 1998, the court increased this amount to 620 only to later reduce the operational capacity to 536. This operational capacity was later further reduced by the court and currently stands at 440 offenders.

DOC took over the operations of TCCY on September 25, 1999, and began paying Trans-American in accordance with its agreement. Therefore, DOC currently pays Trans-American \$17.10 (the \$16.62 adjusted for the increase in the Consumer Price Index and agreement dated August 4, 2000) for 686 offenders when it is authorized to house only 440 offenders. This results in DOC paying Trans-American \$1,535,409¹ per year for offenders not actually housed at TCCY. This \$1,535,409 represents 36% of the total \$4,283,295 appropriated for such payments.

DIVIDENDS TO OWNERS COINCIDE WITH REFINANCING

The largest individual dividend payments were made on January 28, 1997, one day after approval of Amendment VIII noted previously, and the corresponding refinancing. These payments to the owners of Trans-American were as follows:

George Fischer	\$1,180,000
James Brown	620,000
Verdi Adam	<u>200,000</u>
Total Distribution	<u><u>\$2,000,000</u></u>

¹ Total 2001 appropriation of \$4,283,295 divided by 686 offenders divided by 365 days per year equals \$17.10 per offender, per day. \$17.10 multiplied by 246 (the number of offenders not actually housed) multiplied by 365 days equals \$1,535,409.

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TCCY REMAINS PROPERTY OF FBA

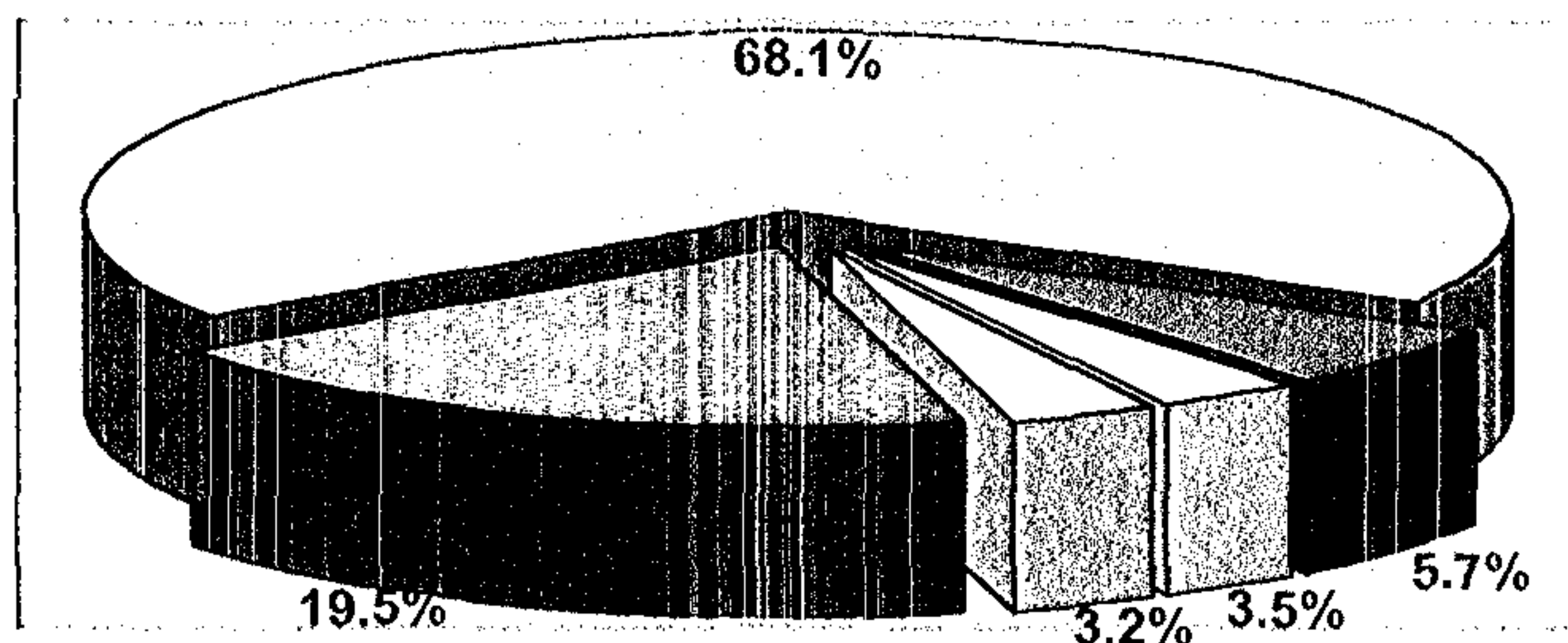
It is noteworthy that at the expiration of this arrangement, the sooner of 25 years or at the time of repayment of the debt, ownership of TCCY will remain with FBA even though DOC will have paid for all of the costs of financing, construction, and operation of TCCY. Furthermore, DOC's consent to Amendment VII provides that DOC may not cancel the agreement so long as the indebtedness related to TCCY remains outstanding.

CURRENT DISTRIBUTION OF DOC PAYMENTS

The appropriated amount of DOC's payments during the current (2000-2001) fiscal year is \$4,283,295. DOC currently makes monthly payments of \$356,941.25 to the trustee, Chase Manhattan, who then distributes the money. Based upon the payments made from July 2000 through March 2001, the current year appropriation will be distributed as follows: Certificate Fund, 68.1%; Maintenance Reserve, 5.7%; Property Tax, 3.5%; Insurance Fund, 3.2%; and Distribution to FBA, 19.5%.

As noted above, the distribution to FBA during fiscal year 2000-2001 will be approximately \$834,000. Based on the monthly dividends paid by FBA during this time period, the total amount distributed to FBA's owners will be \$600,000 during this time.

2000-2001 Trust Distribution



☐ Certificate Fund

☒ Maintenance Reserve

☐ Property Tax

☐ Insurance Fund

☐ FBA Distribution

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**DOC AGREEMENT MAY NOT MEET REQUIREMENTS
OF COOPERATIVE ENDEAVOR**

The agreement entered into between DOC and the City is considered a cooperative endeavor agreement under Louisiana law. The Attorney General has recognized a threefold test to determine the validity of cooperative endeavor agreements:

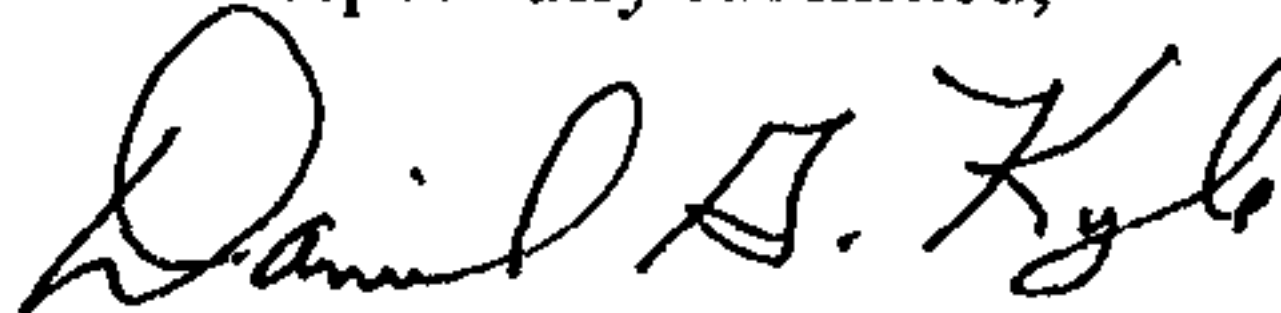
1. The expenditure or transfer of public funds or property must be based on a legal obligation or duty.
2. The expenditure must be for a public purpose.
3. The expenditure must create a public benefit proportionate to its cost.

Considering that the agreement requires DOC to pay for at least 246 offenders not actually housed in the facility and that 19.5% of the DOC payments are being distributed to FBA, the public benefit may not be proportionate to the cost incurred by DOC.

RECOMMENDATION

We recommend that DOC establish and maintain active participation in the selection of contractors receiving public funds. Such participation should not be neglected where DOC chooses to enter into cooperative endeavor agreements with other public agencies. We further recommend that DOC negotiate such agreements so as to maximize the value received for the expenditure of public funds.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Daniel G. Kyle".

Daniel G. Kyle, CPA, CFE
Legislative Auditor

MJL:EKL:DGP:dl

[ccv]



DEPARTMENT OF PUBLIC SAFETY AND CORRECTIONS

RICHARD L. STALDER, SECRETARY

May 15, 2001

Mr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
P. O. Box 94397
Baton Rouge, LA 70804

Dear Dr. Kyle:

The following information represents the Department's response to the letter recently submitted by your agency to the Senate Judiciary B Committee.

1. History

In 1992 and 1993, the backlog of juvenile offenders pending transfer to state secure facilities approached 400 and was projected to increase to 750 within three years. This was a critical public safety issue. As a result, by early 1994, Orleans Parish was involved in significant litigation in the United States District Court/Eastern District; Ascension Parish was preparing to sue the state to force us to accept their backlog of "pending secure care" juveniles; action had been taken in the Florida Parishes to hold the state in contempt; Jefferson Parish threatened weekly to turn dangerous and violent offenders out of their detention centers; and I was subject to contempt action in over 150 individual cases around the state. Our efforts to secure state funding to capitalize critically needed secure juvenile beds to resolve this problem had not been successful.

In this environment, the cooperative endeavor agreements with the LaSalle Hospital District in Jena, Louisiana and the Town of Tallulah were initiated. They shifted the burden of capitalization from the public sector to the private sector. They offered a total cost to the state inclusive of capitalization that was less than the state's cost to operate its secure facilities exclusive of capitalization. While both projects failed in the long-run to provide safe, stable, and productive operations, and while such ventures will not be repeated in the future, it is important to note the external conditions in which they evolved.

2. Comments Regarding Section Entitled "Matters for Further Consideration"

You note that the amendment approved on January 27, 1997, guaranteed TADA payment for more offenders than were actually housed at the facility. We are not paying for offenders who are not housed at the facility. We are paying for buildings that were originally designed to house offenders that are now utilized to provide space for administrative segregation, programming, the Boys Club and medical and mental health

services. The reduction in capacity and transformation of the use of certain parts of the physical plant were in everyone's best interest. The change in utilization of portions of the physical plant does not imply underutilization. On September 20, 1999, we began to pay \$16.62 per day per bed built, an amount that was, as represented by bond counsel, equivalent to the cost of principal, interest and premium or other requirements of the initial indebtedness. The amount of debt service was converted to a "per diem" per bed built. The state's obligation to pay debt service on a physical plant that is completely occupied is independent of the number of offenders housed there. (September 20, 1999, is the date we assumed permanent operational responsibility and discontinued paying a third party for operational costs.)

You correctly conclude that, at the end of the term of the agreement, the facility will remain the property of FBA even though the state will have paid the costs. To have done otherwise would have made the agreement a capital lease and placed it in the constitutional and general obligation debt limits.

Your concern that the agreement may not meet all of the requirements established by the Attorney General and Louisiana law for a cooperative endeavor agreement is based, as I understand it, on the requirement that the expenditure must create a public benefit proportionate to its cost. I suggest, as mentioned earlier, that the public benefit exceeded the cost from the inception of the agreement at least through September of 1999 as evidenced by the fact that the per diem, which is inclusive of capitalization, is less than the average daily operating cost of a state facility, which is exclusive of capitalization. As I mentioned to your staff during the exit interview, should the Legislature determine that the current payment, (originally designed to cover debt service), provides excessive remuneration to the owners because of reductions in any component of debt service costs resulting from the state's assumption of operations, then the Legislature has the prerogative, through partial non-appropriation, to reduce such payments to cure any perceived disproportionality. That is not an option for the DPS&C because of the "due diligence" clause in the cooperative endeavor agreement. In addition, for reasons outlined above, the agreement does not require the Department to pay for 246 offenders not housed in the facility, (See "DOC Agreement May Not Meet Requirements of Cooperative Endeavor.")

3. Analysis of Amendments

Please note that, neither in the original agreement or in any amendment, does the DPS&C have any responsibility to pay debt service if the agreement is terminated. The only responsibility the DPS&C has for debt service is if the agreement remains in force and the DPS&C utilizes the physical plant and operates the facility.

Amendment I-In July of 1994, there were approximately 400 juveniles in local communities backlogged to come into state secure custody. This backlog was projected to increase significantly. That is what precipitated the acceleration and expansion of this project.

Amendment II-The initial scope of Phase I provided short-term boot camp beds only. The state critically needed long-term beds and 50% of Phase I was converted to long-term housing. The additional requirements based upon the change in the mission of the facility prompted the execution of Amendment II.

Amendments III and IV-No additional comment.

Amendment V-The Department was advised by then State Superintendent of Education, Ray Arveson on June 7, 1995, that the Minimum Foundation Program (MFP) would only provide funds to the Madison Parish School Board for 175 instructional days per year. The DPS&C wanted to provide a twelve month school calendar. This amendment provided funds for the continuation of school for 75 additional instructional days at the MFP rate which converted to a per diem of \$2.88 per offender on an annualized basis.

Amendments VI, VII, and VIII-In late 1996, the owners, (through Friedman, Luzzato and Co.), had submitted documentation to Standard and Poors for a rating review prior to re-financing. These amendments were the result of negotiations among counsel for all parties and were intended to enable an investment grade financial transaction. The compromises struck in these amendments were designed to support the goal of shifting the full capitalization of additional secure juvenile beds from the public sector to the private sector.


Amendment IX-This amendment was executed at the request of the state to enable litter abatement in northeast Louisiana.

4. Comments Regarding Section Entitled "Agreement Guarantees Payment for 686 Offenders Though Court Restricted Actual Population to Much Less"

Relative to the auditor's comments regarding the current \$17.10 per diem for 686 beds, please refer again to Item No. 2 above. As explained to the auditors, in the cooperative endeavor agreement under the section that outlined the state's responsibilities in the event that the state assumed operational control and continued to utilize the physical plant, a dollar amount sufficient on an annual basis to pay debt service, (as represented by FBA bond counsel), was converted to a per diem per bed built, (not per bed occupied.) We use every square foot of the facility. We are not paying for offenders not actually housed at the facility. We are paying for "beds built," not "beds occupied." We programmatically altered how we use certain buildings that used to be part of offender capacity, but are not any longer.

Please advise if you have any questions.

Sincerely,


Richard L. Stalder
Secretary