# Office of the Inspector General

*Patrick J. Maley*

# Review of a $1.2 Million Rural Infrastructure Fund Grant in 2013 to Marion County

**ADMINISTRATIVE NOTE CASE UPDATE:** On 1/13/2017, subject Navin Xavier plead guilty to two federal felony criminal charges of wire fraud in the United States District, Southern District of Florida (Case No. 16-20685-CR-Gayles/Turnoff). One count pertained Xavier's criminal conduct in the $1.2 million grant fraud contained in this report & the second count pertained to subject's criminal conduct in an unrelated $30 million Ponzi scheme in Florida. On 5/16/2017, Xavier was sentenced to 15 years on each count to run concurrent. Additionally, the Marion County, SC industrial property obtained by Xavier was forfeited to the U.S. government and will be returned to Marion County.

Case # 2014-805-I

March 2015

# I. Executive Summary

The State Inspector General (SIG) initiated its review based on a credible complaint of suspected grant mismanagement or fraud. The allegation pertained to a $1.2 million Rural Infrastructure Fund (RIF) grant to Marion County awarded in December 2012 to re-develop an abandoned textile plant, known as the Blumenthal Mill Plant (Blumenthal). The $1.2 million was to be used solely for improvements to Blumenthal, which would house Essex Holdings, Inc.'s (Essex) business operations to re-package bulk rice for retail sales and manufacture diapers. The complainant alleged only several hundred thousand dollars of the $1.2 million grant was expended on re-development of Blumenthal. Shortly after the grant funds were exhausted in July 2013, re-development work ceased at the Blumenthal site and there has been no substantial site improvement since that time.

On 10/31/2012, Marion County officials, on behalf of Essex, submitted an Economic Development Grant Application to the South Carolina Coordinating Council for Economic Development (Council). The grant ultimately totaled $1.2 million from the RIF. Marion County agreed to deed Blumenthal to Essex at no cost, which would be improved by Essex to include up to $1.2 million in reimbursements from the RIF. Essex offered to commit $3,000,000 to improve Blumenthal, $50,430,000 in manufacturing equipment, and create 215 jobs by year end 2017. The South Carolina Department of Commerce (SCDC), which administers the RIF, materially relied upon Essex's independently audited financial statements to recommend the grant for approval. The SIG's review determined the signature of the Certified Public Accountant on the unqualified opinion letter accompanying Essex's financial statements was forged.

On 12/6/2012, the RIF grant was approved, which was followed with a conditional authority to proceed on the project, effective 3/22/2013. Essex submitted five reimbursement invoices between 3/25/2013 – 7/10/2013, which were approved and reimbursed $1.2 million. For documentation to support its reimbursement, Essex submitted five invoices from its site contractor, Persal Property Improvements (PPI), to Essex, and five Essex wire transfers to PPI as proof of incurring expenses claimed for reimbursement. The SIG's review determined all the PPI invoices and Essex wire transfers were fictitious documents. Interviews of PPI officials and review of PPI records determined PPI invoiced and was paid $212,217 from Essex in 2013, which was a discrepancy of $987,783 from PPI invoices Essex submitted to Marion County to justify $1.2 million in grant reimbursements.

Based on the review to date, there is ample evidence to suspect the State, SCDC, Council, and Marion County were victims of a potential fraud using fictitious documentation. Hindsight is always 20/20, so it is important to be mindful the state and county employees involved were not trained fraud investigators in carrying out their grant related duties. Nevertheless, lessons learned can be used to strengthen their future contract formulation and monitoring processes, as well as benefit other State agencies.

A review of SCDC's grant monitoring determined there were adequate structure and tools to identify the grant's risks and mitigate through monitoring. The problem was in the execution phase of not rigorously using the tools available. The SCDC administered the grant, but delegated much authority to Marion County, which did not conduct an adequate grant monitoring effort. Going forward, SCDC can delegate authority for contract monitoring tasks, but it can never delegate responsibility which rests with SCDC. As a result, SCDC should examine its grant monitoring procedures for opportunities to improve.

The fundamental grant monitoring lessons learned were two-fold. First, the more safeguards or protections that can be negotiated into the contract, such as the company contributing funds first to a project, the lower the overall project risk and the less time and effort required for grant monitoring. Second, economic development grant monitoring plans can't be cookie cutter checklists; each must be tailored to the grant risk of non-performance. A written grant monitoring plan needs to be established for each grant primarily to fix responsibility and accountability for specific monitoring tasks to specific individuals, and then ensure each has sufficient training and experience to make the judgments required to evaluate monitoring data and take appropriate corrective action if required.

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# II. Background

## A. Predicate of Review

The State Inspector General (SIG) initiated its review based on a credible complaint of suspected grant mismanagement or fraud. The allegation pertained to a $1.2 million Rural Infrastructure Fund (RIF) grant to Marion County in December 2013 to re-develop an abandoned textile plant, known as the Blumenthal Mill Plant (Blumenthal). The $1.2 million was to be used solely for improvements to Blumenthal, which would house Essex Holdings, Inc.'s (Essex) business operations to re-package bulk rice for retail sales and manufacture diapers. Based on the complainant's expert opinion, only several hundred thousand dollars of the $1.2 million grant was expended on re-development of Blumenthal. Shortly after the grant funds were exhausted in July 2013, re-development work ceased at the Blumenthal site and there has been no substantial site improvement since that time.

## B. Objectives

The review's objectives were:

- Review the $1.2 million RIF grant to Marion county (#C-13-2175) to determine if funds expended were in compliance with contract requirements;
- Review the $1.2 million RIF grant for "red flags" of fraud and conduct logical follow-up; and
- Examine the South Carolina Department of Commerce's (SCDC) grant application, award, execution, and monitoring processes for opportunities to improve.

## C. Overview - South Carolina Coordinating Council for Economic Development

The South Carolina Coordinating Council for Economic Development (Council) promotes economic opportunity for individuals and businesses by assisting with location of new sites and buildings with grants for community development and infrastructure improvements. The Council was established in 1986 by the General Assembly (SC Code § 13-1-1710) in response to a general need for improved coordination of efforts in the area of economic development by those state agencies involved in the recruitment of new business and the expansion of current enterprises throughout the State. The Council approves the State's discretionary incentives, which is approximately $50 million in grant dollars annually.

The Council is chaired by the Secretary of Commerce. Ten additional members are drawn from other state agencies involved in economic development, who are agency heads, board chairmen, or cabinet officials. The Council's administrative staff is housed in the Grants Administration Division, SCDC, which manages the Council's state grant funds.

SCDC's Community and Rural Development Division assists with projects eligible for the RIF program. The South Carolina Rural Development Act was enacted by the legislature in 1996 (SC Code § 12-10-80). The act established the RIF with the purpose of providing financial assistance to local governments, primarily in rural counties, for economic development. The RIF assists qualified counties in the state's rural areas by providing financial assistance for infrastructure and other activities that enhance economic growth and development. It can be used for job creation and/or product development.

When the Council approves a RIF grant award, the SCDC's Grants Administration Division administers the funds and the Community and Rural Development Division works with the county to ensure successful implementation of the project. In the 2012 report titled, "*Annual Report of Economic Development Set-Aside Fund, Governor's Closing Fund and Rural Infrastructure Fund Activity,*" the Council reported 21 different counties had qualified, been approved, and received approximately $10 million dollars under the RIF program. Marion County received $1.2 million.

## III. Review of Rural Infrastructure Fund Grant #C-13-2175 to Marion County

A chronological review of the grant's four phases was conducted: grant application; award; execution; and closeout. The review established the basic record framework for the grant along with relevant facts impacting the allegations of mismanagement and fraud. To facilitate the report's review, the appendix location of referenced documents in the narrative will be set forth in parenthesis at the end of a sentence where appropriate.

### A. Grant Application

In mid-2012, Marion County officials learned through county business associates that Essex, a Florida based international resource and manufacturing company, desired to expand their base of operations into South Carolina. Marion County officials met with Essex's Chief Operating Officer (CEO) Navin Xavier, and learned Essex was in search of a South Carolina facility to establish operations for manufacturing diapers and re-packaging bulk rice for retail distribution. Essex was prepared to invest tens of millions of dollars of its own capital and create over 200 new jobs. Inasmuch as Marion County posted the highest 2012 unemployment rate in South Carolina, county officials vigorously recruited Essex to locate in Marion County.

On 10/31/2012, Marion County officials, on behalf of Essex, submitted an Economic Development Grant Application to the Council (A-1). Marion County applied for an initial $1,000,000 in economic development funding through the RIF program for building improvements to Blumenthal, an abandoned textile mill, in Marion County, to be used for Essex's operations. Marion County agreed to deed Blumenthal to Essex at no cost, which would be improved by Essex to include up to $1.2 million in reimbursements from the RIF. Essex offered to commit $3,000,000 to improve Blumenthal, $50,430,000 in manufacturing equipment, and create 215 jobs by year end 2017. Commercial Director Anthony Baker, Essex, provided Marion County officials with a "letter of verification," dated 10/31/2012, confirming that all information and data submitted in the grant application regarding the operation and financial status of Essex was accurate, which included Essex's independently audited financial statements for calendar year 2011 (A-2).

A review of the RIF award file to re-develop Blumenthal (#C-13-2175) identified one document pertaining to SCDC's review of the grant application titled, "Financial Assessment for Enterprise Zone Eligibility," dated 10/23/2012 (A-3). The document was "analyzed by" Cyndy Turnipseed, which reflected Essex's self-reported financial data and a comment section stating: "I reviewed the audited financial statements of the holding company. The holding company has very little liabilities and should be able to provide financial support for this project." During interview, Turnipseed advised she relied on Marion County officials' vetting of Essex. Interview of Marion County officials revealed their due diligence vetting pertained to reviewing Essex's 2011 audited financial statements and Internet google searches. Marion County officials reciprocally advised they were relying on SCDC's expertise to conduct a due diligence vetting of Essex.

The SIG's review determined CPA Karen Burgess's name was forged on a 9/21/2012 letter to Essex which provided an unqualified opinion on Essex's annual financial statement with year-end 12/31/2011 (A-4). Interview of Burgess determined the signature of Karen Burgess on the 9/21/2012 letter was a forgery, but the Florida CPA certificate #37298 under her name on the letter belonged to her. She has never worked nor was even aware of the existence of the accounting firm of Holmes & Associates, PLLC, which was on the letterhead. She has never heard or worked for Essex nor Navin Xavier. She left Florida in 2008 and has since resided and worked in Jamaica. She has not performed financial audits since 2008. Additionally, an open record Internet search failed to identify the existence of the accounting firm of Holmes & Associates, PLLC.

### B. Grant Award

On 12/6/2012, the Council approved a $1 million dollar grant to Marion County for building improvements to Blumenthal under RIF award #C-13-2175 (A-5). On 6/6/2013, the Council approved an additional $200,000 dollars bringing the fund total to $1.2 million (A-6). The change was due to "changes in financing structure for the project" without further documented detail rationale.

On 12/11/2012, the Council provided Marion County two contracts for signatures to finalize the grant (A-7). The Grant Award Agreement (GAA) was signed by Timothy Harper, Marion County Administrator, as the "grantee" with a date of 12/18/2012 (A-8). The following are relevant sections of the GAA pertaining to issues of appropriate grant management or the allegation of fraud:

- Section 2 - Project Description: These funds will be used to assist Marion County with building improvements.

- Section 8 - Contractor Selection: Selection of a contractor by the Grantee must follow applicable procurement laws, regulations, and guidelines.

- Section 22 - Reporting: The Grantee agrees to submit quarterly progress reports that provide a status update and identification of any material issues affecting the Project.

- Section 25 - Payment: Grantee must submit to the Council a certified request for payments for work that is documented by the Grantee…The Grantee will certify, to the best of its knowledge, information and belief, that work on the Project for which reimbursement is requested has been completed in accordance with the terms and conditions of this Agreement…All requests for payment must be certified as valid expenditures by an official representative of the Grantee. Invoices and canceled checks supporting the Grantee's request for reimbursement from Grant funds must be kept on file and be available for inspection at any time.

The second contract required was a Performance Agreement signed, with an effective date of 12/6/2012, by Buddy Collins, Marion County Council Chairman; Alan D. Young, Executive Director of the Council; and the CEO Navin Xavier, Essex (A-9). The following are relevant sections of the Performance Agreement pertaining to issues of appropriate grant management or the allegation of fraud:

- 2.0 - Use of Proceeds: The Grantee will use the RIF grant award to assist the Company with building improvements.

- 2.1 - Disbursement of Funds: No funds will be disbursed until the approval of expenditures, through submission of invoices and proof of payment to the Grantee.

- 5.0 - Contractor Selection: Company must follow applicable procurement laws, regulations, and guidelines.

- 10.0 - Maintenance of Records: The Company shall maintain records relating to procurement matters for the period of time prescribe by applicable procurement laws, regulations, and guidelines, but no less than three years.

- 20.0 (a) - Events of Defaults: Any representation or warranty made by the Company herein that is false or misleading in any material respect at the time made.

On 3/22/2013, the Council, via letter, provided conditional authority to Marion County to proceed with the building improvement project (A-10). Formal approval occurred on 4/15/2013 upon the Council receiving Performance Agreement signed by all parties.

### C. Grant Execution

On 3/25/2013, Essex and its contractor, Persal Property Improvements (PPI), signed a Construction Contractor Agreement for a total of $4,800,000 to improve Blumenthal (A-11). The contract had three phases; each pertained to approximately 1/3 of the Blumenthal plant square feet. Each phase had a number of requirements as follows: phase 1 – 34 requirements; phase 2 – 25 requirements; and phase 3 – 26 requirements. All three phases had 25 of the same requirements, which were best described as generic tasks lacking specificity to hold the contractor accountable, particularly in the area of design standards, quality, and specifications of materials. Generic requirements such as installing a new security system, new air conditioning system, and a new roof without specification as to standards, quality and material specifications creates an ambiguous contract, undermines enforceability, and provides insufficient guidance to the contractor in completing the project.

The unusually generic nature of the contract requirements, as well as the absence of a typical mechanical engineer design standards plan, raises the question and "red flag" of how both parties worked up a negotiated, arms-length contract of $4,800,000? A 2/9/2015 interview of PPI officials revealed this was not a negotiated contract. Xavier prepared the contract for PPI's signature with the unwritten terms of paying PPI $10,000 plus expenses for supervising the Blumenthal construction site.

The RIF grant disbursed $1,200,000 in five payments to Essex as reimbursement for expenses incurred to improve Blumenthal. Each payment was based on five documents:

- PPI would submit an invoice to Essex for work performed, which was only a one page document with a list of general activity followed by a single amount due. This one page summary did not contain any itemization of labor or material costs to provide reasonable assurance the reimbursed costs were directly related to improving Blumenthal.

- Essex provided a copy of a Bank of America wire transfer in the identical amount of the invoice to PPI's bank account as proof of payment of invoice for work performed on Blumenthal.

- These two documents were provided by Baker and/or Xavier, Essex, to Rodney Berry, Marion County Economic Development Director, who made the determination the reimbursement request met the terms of the grant contract, which was then documented in Request for Payment by Marion County to SCDC signed by Tim Harper, Marion County Administrator. The Marion County reviewing official acknowledged the PPI invoices were generic and failed to provide detailed documentation or itemized cost receipts typically required by finance departments for payment of invoices. The Marion County reviewer accepted the Essex invoices as "work completed" and processed the reimbursement requests without on-site inspections or requiring additional itemized receipts to verify completed the work.

- SCDC official Judi Burman approved the Request for Payment resulting in a SCDC memo to the Comptroller General's Office to pay Marion County with a check.

- Marion County paid Essex with a check.

The table below summarizes the five disbursements in a three and a half month period totaling $1,200,000 to Essex and the corresponding documentation workflow:

| Disbursement # | Amount | PPI Invoice Date | Essex Wire Date | Marion Request for Payment Date | SCDC Memo to Pay Essex Date | Marion Check to Essex Date |
|---|---|---|---|---|---|---|
| #1 (A-12) | $175,000 | 3/25/2013 | 3/26/2013 | 4/16/2013 | 4/25/2013 | 5/6/2013 |
| #2 (A-13) | $212,000 | 4/19/2013 | 4/24/2013 | 5/3/2013 | 5/9/2013 | 5/20/2013 |
| #3 (A-14) | $190,800 | 5/1/2013 | 5/6/2013* | 5/21/2013 | 6/13/2013 | 6/10/2013 |
| #4 (A- 15) | $296,508.67 | 6/5/2013 | 6/7/2013 | 6/19/2013 | 6/30/2013 | 7/3/2013 |
| #5 (A-16) | $325,691.33** | 7/10/2013 | 7/5/2013 | 7/19/2013 | 7/16/2013 | 7/26/2013 |
| Total | $1,200,000 | | | | | |

*Essex wire was $193,000, which exceeded invoice by $2200.

**PPI invoice and Essex wire were $367,461.59, which exceeded available grant balance of $325,691.33.

In addition to Essex's $175,000 invoice, dated 3/25/2013, Essex submitted a $300,000 invoice with the same date and the description of "advance payment as per Article 4 of the Construction Contractor Agreement (A-17)." Marion County approved both invoices at the same time and forwarded to SCDC for review and payment. However, SCDC did not pay the $300,000 "advance" inasmuch as the grant only disbursed on a reimbursement basis, and the construction contractor agreement between PPI and Essex did not supersede the RIF contract terms.

On 2/9/2015, the SIG interviewed the owners and operators of PPI. PPI officials have known Essex CEO Navin Xavier for over ten years. PPI has performed construction/remodeling work at his business and his residence in South Florida. In 2012, Xavier approached PPI officials regarding travelling to South Carolina to assist in a construction project. PPI owners reviewed the Construction Contractor Agreement between PPI and Essex, dated 3/25/2013, and confirmed it was a contract signed by PPI. Xavier requested PPI to sign the contract prior to traveling to Marion County to perform work. PPI would be paid $10,000 per month for the time spent in Marion County working on the re-development project. When PPI left the Marion County project to return to Florida in June or July 2013, Xavier still owed them money for work performed.

Based on PPI's description of the Essex and PPI contract, dated 3/25/2013, the SIG suspects this $4,800,000 contract amount is less than an arm's length contract, potentially even arbitrary, and may have been the basis for the additional $200,000 grant increase approved on 6/6/2013. While the RIF file lacked sufficient documentation to provide a detailed rationale for this increase, the SIG's suspicion is based on funding by RIF of 25% ($1,000,000) of the initial site improvement project's estimated cost ($4,000,000). Applying this same 25% RIF funding percentage to the $800,000 increase ($4.8 – $4.0 million) in the Essex contract with PPI over the original estimate cost is $200,000.

PPI officials reviewed the five PPI invoices that Essex submitted to Marion County as justification for its $1,200,000 grant reimbursements. PPI denied submitting these five invoices to Essex, because it never issued invoices in those incredibly large amounts ($175,000 lowest; $367,461 largest) to Essex nor received payment in a like amount. PPI advised it did invoice Essex approximately $220,000 for work performed (PPI services; PPI employees; and materials) on the Marion plant, which Essex paid through wire transfers to PPI's Bank of America account used for the Marion project.

A review of PPI business records revealed PPI invoiced and received from Essex $212,117.74 during calendar years 2013-2014 (A-18). The $212,117.74 can be categorized as follows: $21,117.74 in three invoices during the period 2/15/2013 – 3/14/2013 not discernable on Essex or PPI Bank of America banks records; $190,000 in

11 wire transfers during the period 3/22/2013 – 6/18/2013 to PPI's Bank of America bank account; and $1000 in one invoice on 8/22/2013 not discernable on Essex or PPI Bank of America bank records.

PPI officials reviewed the five Essex wire transfers to PPI underpinning the $1,200,000 grant expenditures provided to Marion County. PPI denied receiving these wires for the same reasons as invoices. As denoted above, PPI received eleven wire transfers from Essex during the project totaling $190,000.

A review of PPI invoices and Essex corresponding wire transfers provided to Marion County determined the following irregularities indicating a potential fictitious nature with every document (analysis of A-12 to A-17; A-18; and Bank of America Subpoena Records for Essex and PPI):

<u>PPI Invoices to Essex</u>

- PPI business records identified invoice #412, dated 4/3/2013, to Essex for $0 for "supervision of warehouse cleaning and remodeling Marion, North Carolina." Essex provided Marion County the same PPI invoice #412, dated 3/25/2013, to Essex for $300,000 with description, "Advance payment as per Article 4 of the Construction Contractor Agreement."

- PPI business records identified invoice #447, dated 3/22/2013, to Essex for $30,000 for "supervision of warehouse cleaning and remodeling Marion, North Carolina." Essex provided Marion County the same PPI invoice #447, dated 5/1/2013, to Essex for $190,800 with a description list of tasks.

- PPI business records identified invoice #413, dated 3/29/2013, to Alan & Ann Frank for $1160. Essex provided Marion County the same PPI invoice #413, dated 3/25/2013, to Essex for $175,000.

- PPI business records identified invoice #436, dated 11/20/2013, to Marlene Leatherbee for $9569.18. Essex provided Marion County the same PPI invoice #436, dated 4/19/2013, to Essex for $212,000.

- PPI business records identified invoice #461, dated 2/4/2014, to Marlene Leatherbee for $2500. Essex provided Marion County the same PPI invoice #461, dated 6/5/2013, to Essex for $296,508.67.

- PPI business records identified invoice #485, dated 8/28/2014, to Ken Drukerman for $2539.56. Essex provided Marion County the same PPI invoice #485, dated 7/10/2013, to Essex for $367,461.59.

<u>Essex Wire Transfers to PPI</u>

- Essex provided Marion County a Bank of America wire transfer, dated 3/26/2013, transferring $300,000 into PPI's Bank of America A/C# 229013093089 with a related reference #97210070. A review of Bank of America subpoena records showed A/C# 229013093089 belonged to PPI, but there was no wire of $300,000 into that account. The subpoena records also showed a $30,000 wire, dated 3/22/2013, into PPI's A/C# 229013093089 with the same related reference #97210070.

- Essex provided Marion County a Bank of America wire transfer, dated 3/26/2013, transferring $175,000 into PPI's Bank of America A/C# 277201612683. A review of Bank of America subpoena records showed A/C# 277201612683 does not belong to PPI. PPI also denied having that account number at any bank.

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- Essex provided Marion County a Bank of America wire transfer, dated 4/24/2013, transferring $212,000 into PPI's Bank of America A/C# 229013093089 with a related reference #98640050. A review of Bank of America subpoena records showed A/C# 229013093089 belonged to PPI, but there was no wire of $212,000 into that account. The subpoena records also showed a $15,000 wire, dated 4/17/2013, into PPI's A/C# 229013093089 with the same related reference #9860050.

- Essex provided Marion County a Bank of America wire transfer, dated 5/6/2013, transferring $193,000 into PPI's Bank of America A/C# 291606781736. A review of Bank of America subpoena records showed A/C# 291606781736 does not belong to PPI. PPI also denied having that account number at any bank.

- Essex provided Marion County a Bank of America wire transfer, dated 6/7/2013, transferring $296,508.67 into PPI's Bank of America A/C# 067014822. A review of Bank of America subpoena records showed A/C# 067014822 does not belong to PPI. PPI also denied having that account number at any bank.

- Essex provided Marion County a Bank of America wire transfer, dated 7/5/2013, transferring $367,461.59 into PPI's Bank of America A/C# 4261421500. A review of Bank of America subpoena records showed A/C# 4261421500 does not belong to PPI. PPI also denied having that account number at any bank.

### D. Grant Closeout

Marion County, in a letter dated August 26, 2013, returned two forms to SCDC to close out the grant (A-19): Grantee Assertions Regarding Compliance, dated 8/1/2013 and signed by Marion County Administrator Tim Harper (A-20); and Grant Closeout Certification, dated 8/21/2013 and signed by Essex Commercial Director A. Baker (A-21). Analysis of the Grant Closeout Certification identified a number of concerns:

- The document was designed for the Grantee, Marion County, to provide certification of grant information and performance by Essex, yet the form was signed by an Essex executive certifying Essex's performance.

- The document asserted Essex had made a $2,200,000 capital investment to date in the "building" beyond the grant expenditures, which, by all available data, was false. Construction halted on the building when the building permits were pulled in August 2013. PPI's total expenditures on the building were, as denoted above, $212,117.74.

- The document asserted Essex had made a $24,800,000 capital investment to date for "machinery," which appears false by physical inspection of Blumenthal. It currently contains one used assembly line for diapers which has never been used because additional machinery is required to supplement the complete assembly line process, as well as the fact there has never been electricity connected to the building.

In a subsequent letter dated 8/30/2013 (A-22), the Council informed the County that the financial closeout of the grant was complete, but that the grant's Performance Agreement was still "pending." It was pending because the County was required to confirm that no fewer than 215 new full-time jobs had been created with a capital investment of not less than $54,430,000 by 12/31/2017.

### E. Other Relevant Data

A local general contractor, Patrick Brady, was hired by Essex to obtain building permits and allow PPI to work under his license on Blumenthal. According to Brady, he was hired to verify PPI work performed and approve

Essex requests for reimbursement to Marion County. In June 2013, Brady learned Essex had bypassed him and sent reimbursement requests direct to Marion County. Brady also became concerned PPI construction work was undermining the structural integrity of Blumenthal, so in August 2013, he pulled the permits operating under his license. As a result, all work ceased. Since that time, Essex has not obtained any new building permits and no visible improvement has been made on Blumenthal.

Brady was aware Essex had a small crew working to gut the plant of tons of structural steel and sold as scrap to a local Marion scrap yard, which raised further concerns by Brady as to Essex's ultimate intentions. The SIG reviewed records from Jordan Scrap Metal Company, Marion County, and determined from 4/5/2013 to 11/14/2014 Essex sold approximately 800,000 pounds of metal to Jordan for approximately $96,000. Scrap metal sold after Brady pulled his building permits in August 2013 causing building improvements to cease totaled approximately $55,375. Additional concerns regarding Essex's ultimate intentions for the plant surfaced when an employee of Essex informed the SIG that he was told by the CEO and Commercial Director that there was enough scrap metal in the plant that could be sold to cover operational start-up costs.

PPI was aware a roofing company from Florida, Emanuel General Services (EGS), also performed work on the Marion County project. PPI was not responsible for paying EGS for the work completed. Essex supposedly paid EGS direct. PPI believes Essex still owes EGS, as much as $100,000, for roof work completed.

Essex purchased five diaper lines in excellent condition from a company in Arkansas, which were transported to Blumenthal in 2013. Only one diaper line has been set up, but it has never been in production. Essex has not elected to run electricity to the facility to date, which was estimated to cost $70,000. It was estimated over a half a million dollars would be needed to operationalize this one diaper line. A witness with reliable access advised there was no sense of urgency to get this first diaper line into production.

The SIG initiated contact with the Essex CEO Xavier on 11/18/2014. Xavier agreed to be interviewed by the SIG inasmuch as he travels to South Carolina monthly, as well as provide copies of the itemized expenses to support PPI's five invoices to Essex. To date, efforts to coordinate an interview and records have proved unsuccessful despite the Performance Agreement requiring Essex to maintain records available for three years after the project. Investigation to date revealed that Essex has not yet paid any property tax, unemployment insurance, or workers compensation insurance in South Carolina.

## IV. Grant Monitoring of Rural Infrastructure Fund Grant #C-13-2175 to Marion County

Based on the review to date, there is ample evidence to suspect the State, SCDC, Council, and Marion County were victims of a potential fraud using fictitious documentation. Hindsight is always 20/20, so it is important to be mindful the employees involved were not trained fraud investigators in carrying out their grant related duties. Nevertheless, lessons learned can be used to strengthen their future contract formulation and monitoring processes, as well as benefit other State agencies.

The level of effort to monitor a grant is a function of the risk of grant non-performance. For example, how would the risk of non-performance be assessed if an established national retailer offered to place a store in South Carolina; had a detailed business plan; agreed to invest $54 million in capital; promised to create 215 new jobs; only used a South Carolina economic development grant of $1.2 million for site development <u>after</u> the retailer invested $3 million dollars in site development? Most would agree there is very little risk to the state. However, in the case of Essex, the grant beneficiary was an unknown entity without a detailed business plan where the State would provide its $1,200,000 first; essentially, a no money down deal with an immediate $1,200,000 of State funds to start the project. The Grant Application, Grant Award Agreement, and the

Performance Agreement provided an adequate structure and tools to identify the grant's risks and mitigate through monitoring. The problem was in the execution phase of not rigorously using the tools available.

When assessing Essex's grant application, both SCDC and Marion County relied on Essex's self-reported audited financial statements and a review of Essex's Internet web page. Each assumed the other would be primarily responsible for the vetting of financial and operational capability to meet the grant's requirements, when in fact they both did the same review of paper documents from a company unknown to both. The focus of the grant was to improve Blumenthal, which was estimated to cost $4,000,000 of which the state would pay $1,000,000 (25%). There was no documentation provided to underpin the estimate of $4,000,000 facility improvement other than a one paragraph rough estimate with a note of details forthcoming which are currently not reflected in the file. This was a red flag for a company committing $3,000,000 in building improvements in an abandoned plant followed by $50,000,000 in machinery investments. Ultimately, it is a judgment call when assessing Essex's financial and operational capabilities, but there was a lack of clarity on vetting responsibilities between Marion County and SCDC, as well as a formal process to integrate Marion County's vetting information into SCDC's analysis, inasmuch as SCDC has the ultimate responsibility for the grant recommendation decision.

The primary tool to ensure RIF funds were not misused was the simple requirement of having Essex provide documentation through invoices of expenditures on property improvements along with proof of payment prior to the state approving reimbursement from the grant. The summary nature of PPI's invoices of generic tasks was insufficient to provide assurance of how the funds were being expended on property improvement. Again, it is a judgment call when assessing the quality of documentation to support expenditures being used on property improvements. Even the Marion County reviewing official had his concerns about the lack of detail which he ultimately approved without asking for further assurance. This lax scrutiny on reviewing and approving Essex reimbursement requests by Marion County is further illustrated in Essex's attempt to receive a $300,000 advance on 3/25/2013. This transaction was clearly precluded by the RIF's contract yet initially approved by Marion County prior to being denied by SCDC. This also raises the question of the appropriateness of the County Economic Development Office objectively monitoring a grant when it has likely potential conflict of interest as being the unit initially championing the grant project.

The grant had a number of other controls which were completely overlooked indicating lax grant monitoring, which were:

- Performance Agreement, Section 5.0, required the Company (Essex) must follow applicable procurement laws, regulations, and guidelines. Essex selected PPI without a competitive process and did not provide justification for a sole source contract as required by South Carolina Procurement Code.

- Grant Award Agreement, Section 22, required the Grantee to submit quarterly progress reports that provide a status update and identification of any material issues affecting the Project. Marion County has never submitted a report and there is no record of SCDC following up on delinquent reports.

- The Grant Closeout Certification was designed for the Grantee, Marion County, to provide certification of grant information and performance by Essex, yet the form was signed by an Essex executive certifying Essex's performance. It was unchallenged by Marion County and SCDC despite containing clearly erroneous information to any casual observer of the project, such as $2,200,000 capital investment to date in the "building" and a $24,800,000 capital investment to date for "machinery."

Economic development grants have an inherent risk as with any new business endeavor. The fundamental lessons learned are two-fold. First, the more safeguards or protections that can be negotiated in the contract, such as the company contributing funds first to a project, the lower the overall project risk and the less time and effort required for grant monitoring. Second, economic development grant monitoring plans can't be cookie cutter checklists; each must be tailored to the grant risk of non-performance. A written grant monitoring plan needs to be established for each grant primarily to fix responsibility and accountability for specific monitoring tasks to specific individuals, and then ensure each has sufficient training and experience to make the judgments required to evaluate monitoring data.

## V. Findings and Recommendations

**Finding #1:** Evidence suggests Essex provided fictitious and fraudulent documents to the Council, SCDC, and Marion County in the application and execution phases of the Rural Infrastructure Fund Grant #3-13-2175.

> **Recommendation #1:** The SIG will refer this matter to the State Law Enforcement Division and other law enforcement authorities with appropriate jurisdiction.

**Finding #2:** The SCDC grant monitoring controls have opportunities to improve.

> **Recommendation #2a:** The SCDC should clarify its grant application assessment procedures to reinforce it has the sole due diligence responsibility to assess potential companies seeking grants and any vetting data relied upon from the county should be formally documented as part of South Carolina Department of Commerce's due diligence recommendation.
>
> **Recommendation #2b:** The SCDC should consider requiring the county grant monitor to be outside of the county's economic development unit to add greater independence and objectivity, as well as avoid potential conflicts of interest of the monitor also being the person or unit initially championing the grant project.
>
> **Recommendation #2c:** The SCDC should require a written grant monitoring plan be established for each grant primarily to fix responsibility and accountability for specific monitoring tasks to specific individuals, and then ensure each has sufficient training and experience to make the judgments required to evaluate monitoring data.
>
> **Recommendation #2d:** The SCDC should consider more safeguards or protections be negotiated in the contract, such as the company contributing capital first to a project, thereby lowering the overall project risk and, correspondingly, less time and effort required for grant monitoring.
>
> **Recommendation #2e:** The SCDC should consider adding interim formal reviews of projects prior to the full five year deadline for project performance for earlier identification of project issues, along with enhanced controls over Grantee compliance with quarterly reports of project progress and issues. [SCDC has already implemented in September 2014 in response to Marion County grants]

**Administrative Note:** The Department of Commerce Response to this report can be found at the following link: http://oig.sc.gov/Documents/Department_of_Commerce_Response_to_Report.pdf