

Chairperson
W. Harold Tuck

President and CEO
Rudolph A. Johnson, III

May 13, 2011

VIA: Overnight Mail

Gale R. Walker
President
Children of the Rainbow Head Start LLC
3078 L Street
San Diego, California 92102

Re: Notice of Non-Renewal of Contract #10-002553

Dear Ms. Walker:

During the meeting held on May 9, 2011 with you at The Neighborhood House Association (NHA), we discussed the regulations, policies, guidelines and requirements as they relate to the use of federal funds for federally assisted projects that Children of the Rainbow Head Start's LLC (COTR-LLC) is required to follow pursuant to the above-referenced contract. NHA asked for, but did not receive, adequate assurance from COTR that it will make available the requested business records to allow a verification of the approximately \$347,000 over expenditure during the current contract year ending June 30, 2011. Several hours after the May 9th meeting, NHA received two email communications from COTR that caused a renewal of the concerns stated in NHA's letter of April 29, 2011. The emails contained a serious misstatement of the "meeting points" and required next steps.

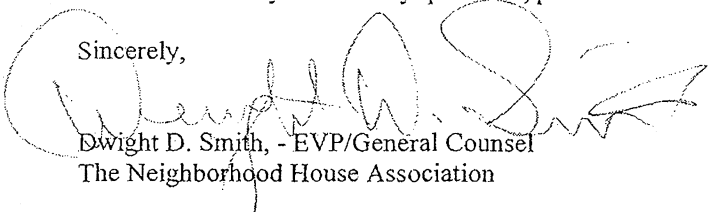
As a result, NHA has decided not to renew the contract that will expire on June 30, 2011. During the remaining 45 days of the term, Norma Johnson will be contacting you to coordinate and discuss a transition plan to assure a minimal disruption of service to the children and families receiving Head Start services.

Please note that section 5.9 of the contract requires COTR to submit all invoices or claims for reimbursement within sixty (60) days after the expiration/termination date (June 30, 2011). Invoices, submitted after this period are time-barred and will be deemed disallowed. Also, section 9.4 requires COTR to surrender possession of any property belonging to NHA within 30 days after termination of the contract.

NHA will consider assisting COTR cover its unauthorized over expenditure for your cooperation in the transition (i.e., transfer/surrender of licenses, assignment of leases, maintaining the centers in their current operational condition, as well as, retaining all materials and supplies to operate the centers) and for full-resolution of matters between the parties.

We appreciate the relationship that has helped us to provide health and social services to children and their families. Should you have any questions, please contact Norman Johnson.

Sincerely,


Dwight D. Smith, - EVP/General Counsel
The Neighborhood House Association

cc: Rudolph A. Johnson, III - President/CEO
Norma Johnson, V.P. - CYFS
Kim Peck, V.P. - CFO



ELDESMAN
UCKER
EIFER
IDELL LLP

EDWARD T. WATERS
ewaters@ftlf.com

June 15, 2011

Via Facsimile and Electronic Mail

Jeffrey L. Caufield, Esq.
Caufield & James LLP
2851 Camino Del Rio South
Suite 410
San Diego, California 92108

Re: Children of the Rainbow Head Start LLC ("COTR")

Dear Mr. Caufield:

We write on behalf of our client, the Neighborhood House Association ("NHA"), in response to your letter of June 3, 2011 (the "June 3 Letter") as well as in response to the memorandum from the law firm of Shapiro & Clamon (the "S&C Memorandum") that was referenced in your letter. As discussed below, both your letter and the S&C Memorandum have seriously misconstrued applicable federal law and fail to understand the legal relationship between COTR and NHA. Accordingly, we would like to clarify a few salient points, ask, on behalf of NHA, that COTR return all "profits" earned on the contracts between COTR and NHA (or justify retention of those payments by providing documentation of other, allowable costs), comply with the record access requirements of the contracts between COTR and NHA and to make COTR's senior management available for interview within the next few days.¹

As an initial matter, with respect to the legal relationship between the two entities, it appears that both sides agree that COTR and NHA entered into a contract or as described in OMB Circular A-133 (quoted liberally in the S&C Memorandum), a vendor agreement. Such relationships are, for a non-profit recipient of federal funds like NHA, governed by 45 C.F.R. §§ 74.40 through 74.48. These are the requirements for procuring goods and services with federal grant funds. A few of the provisions of the procurement requirements are relevant here.

First, under 45 C.F.R. § 74.41, "Recipient responsibilities," NHA is "the responsible authority, without recourse to the HHS awarding agency [the federal agency that administers the Head Start program], regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into in support of an award or other agreement." In other words, the legal relationship between NHA and COTR is wholly the business of those two parties, "without recourse" to the federal

¹ It is our understanding that there are three annual agreements between NHA and COTR covering the periods July 1, 2008 to June 30, 2009, July 1, 2009 to June 30, 2010 and July 1, 2010 to June 30, 2011 and that the relevant terms for the purposes of this letter are the same. We will, therefore, refer to the specific provisions in the last agreement in this letter.

government. Since there is no federal involvement in the NHA/COTR relationship, the assertions of Constitutional and similar issues in the S&C Memorandum are of no moment.

Second, under 45 C.F.R. 74.44(c), it is up to NHA to select the type of contract that is "appropriate for the particular procurement and for promoting the best interest of the program or project involved." Here, NHA selected, and COTR agreed to, a cost reimbursement contract that did not contain any provision for profit. Specifically, under ¶ 5.1, "any amount payable to COTR for Services it provides under this Agreement shall only be for costs that are allowable **and** actually incurred, including an allocation of administrative costs to be no more than ten percent (10%) of expenses related to the performance of COTR's Services under this Agreement." (emphasis in the original). In addition, the allowability of salary costs under the Agreement was expressly limited in a subsequent Addendum to the Agreement by the Head Start salary cap.

As your letter admits, the \$30,000 per month "management fee" was, in fact, profit, and, despite your claims to the contrary, there is no support, legally or otherwise, for the assertion that profit is a cost.² Therefore, your client is in material breach of its agreements with NHA by claiming as a cost a substantial profit. COTR needs to remedy that breach by either returning the management fee for all three years covered by the agreements between NHA and COTR immediately or, in the alternative, demonstrating that COTR incurred actual, allowable costs in furtherance of the activities under the agreements that support the full amount paid by NHA to COTR.

Third, under 45 C.F.R. § 74.48, NHA was obligated to include in federally funded contracts over \$100,000 a provision:

. . . to the effect that the recipient, the HHS awarding agency, the U.S. Comptroller General, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.

Consistent with this obligation, the Agreement between NHA and COTR contains a number of provisions that allow NHA to meet its obligations under federal law. Specifically, ¶ 10.7 of the Agreement requires, among other things, that COTR make available for a period of four years after the period covered by the Agreement "books, documents, and records of COTR that are necessary to certify the nature and extent of all costs and charges . . ." In addition, the specific access rights from § 74.48 are repeated in item 9 of the "Assurances," Exhibit D to the Agreement.

² Indeed, the very definition of profit is "any amount in excess of allowable direct and indirect costs." 45 C.F.R. § 74.81. This unremarkable definition from the federal grant administration regulations demonstrates how off base the assertion in the S&C Memorandum is that the federal cost principles allow profit to be treated as a cost. Indeed, the very definition of profit is an amount above cost.

In your letter, you state, in essence, that it is COTR's position that NHA has received access to those records at one point in time and therefore COTR has met its obligation to allow access to its books and records. Further, it appears that COTR will not allow any further access to NHA. As there is no limit on NHA's right to access COTR's records under the Agreement during the four year period in which COTR is required to maintain those records and as these access rights are required by federal law, we ask that COTR provide immediate access to its books and records and allow NHA to review and copy those records to determine whether the costs claimed by COTR are in fact allowable. If COTR continues to refuse access, it will remain in material breach of this requirement of the Agreement.

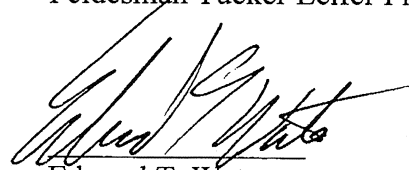
Finally, your letter makes a number of very serious allegations about NHA's operation of its Head Start program. Under the Head Start Act, NHA's Board of Directors has an obligation to address and resolve any complaints about the operation of NHA's Head Start program and to conduct "investigations, when appropriate." § 642(c)(1)(E)(iv)(X)(bb) of the Head Start Act. NHA's Board intends to comply with those obligations and, as necessary, make appropriate disclosures to the federal government. However, many of the allegations in your letter are not specific enough for NHA to conduct a complete investigation. Accordingly, we would ask that COTR make Gale Walker, Kursat Misirlioglu, Ramona Mitchell and any other persons who have knowledge of the circumstances surrounding COTR's allegations available for interview at a convenient time no later than the close of business on Tuesday, June 21, 2011. The purpose of these interviews would be for them to fully describe the source and nature of the allegations contained in your letter.

As you must know, time is of the essence for both access to COTR's records and interviews of COTR's personnel. We would ask therefore, that you provide at least an initial response by the close of business today about the following: 1) whether COTR will make its records available for review and copying starting on June 16 or June 17, 2011 at 9:00 am and continuing until finished and 2) whether Ms. Walker, Mr. Misirlioglu and Ms. Mitchell as well as any other employees of COTR will be available for interviews at any time on the following dates, June 16, 17, 20 or 21, 2011. Thank you in advance for your cooperation.

Sincerely,

Feldesman Tucker Leifer Fidell LLP

By:


Edward T. Waters

cc: Dwight D. Smith, Esq.



WELDESMAN
WUCKER
EIFER
WIDELL LLP

June 17, 2011

Via Facsimile (858)202-1308

Kent L. Sharp, Esq.
La Jolla Law Group
4330 La Jolla Village Dr.
Suite 220
San Diego, California 92122

Re: Children of the Rainbow Head Start LLC ("COTR")

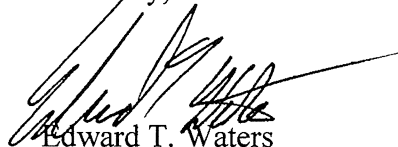
Dear Mr. Sharp:

I write in response to your letter of June 16, 2011 in which you ask my client, Neighborhood House Association ("NHA") to hold off on its review of COTR records for "at least two weeks." In short this delay is unacceptable, inconsistent with the provisions of the contract that I cited in my letter to COTR's prior counsel (which I understand that you have a copy) and, more importantly, at odds with NHA's obligations to the federal government to monitor its contractors, particularly a major contractor like COTR.

However, my client is willing to delay its review of COTR's records until 10 a.m. on June 22 provided that I receive from your client a letter that is in substance equivalent to the attached by Monday. Please return the executed letter by Noon, Monday June 20, 2011 *via* email to both Dwight Smith and to me as stated in the draft letter.

Thank you for your cooperation in this matter.

Sincerely,



Edward T. Waters

Attachment

cc: Dwight Smith w/attachment



FELDESMAN
TUCKER
LEIFER
FIDELL LLP

EDWARD T. WATERS
EWATERS@FTLF.COM

June 22, 2011

Via Facsimile (858)202-1308

Kent L. Sharp, Esq.
La Jolla Law Group
4330 La Jolla Village Dr.
Suite 220
San Diego, California 92122

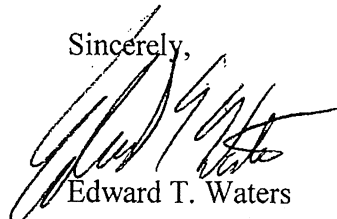
Re: Children of the Rainbow Head Start LLC ("COTR")

Dear Mr. Sharp:

I write in response to your letter of June 20, 2011 in which you again ask my client, Neighborhood House Association ("NHA") to hold off on its review of COTR records and ask why NHA would want to review those records. I believe that I was clear in my letter of June 15, 2011 as to why NHA seeks to review COTR's records particularly those records that 1) support COTR's invoices over the past few years and 2) support the claims of mismanagement and worse leveled by your client in the June 3, 2011 letter from Caufield & James against NHA and its management team. As stated in my June 15 letter, under applicable federal law, NHA as a Head Start grant recipient is, among other things, obligated to monitor its contractors and to investigate complaints. Moreover, since the events that prompted my letter only recently arose and since NHA would not have known about those events when it reviewed COTR's records in the past, your assertion that COTR met its current contractual obligations by providing past access simply does not make sense.

In any event, with respect to NHA's investigation, as I also stated previously, that investigation is proceeding and, at the direction of NHA's board, it is proceeding expeditiously. I gather from your letter that your client has decided not to provide, in any timely manner, additional information about the claims made in the June 3 letter either by way of documents or interviews. I will assume therefore that the information in the letter is all the information that your client has to support its claims and will advise the NHA Board accordingly. If my assumption is incorrect and your client is willing to provide information supporting its claims, starting with interviews this week or early next, please let me know that immediately as it is NHA's intention to complete its investigation by the end of this month.

Sincerely,



Edward T. Waters

cc: Dwight D. Smith, Esq.

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FELDESMAN
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EDWARD T. WATERS
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June 30, 2011

Via Facsimile (858)202-1308

Kent L. Sharp, Esq.
La Jolla Law Group
4330 La Jolla Village Drive, Suite 220
San Diego, California 92122

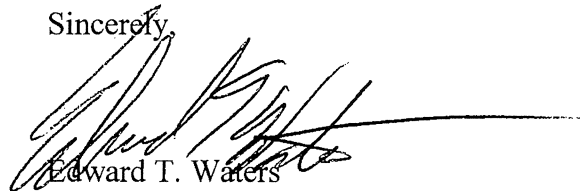
Re: Children of the Rainbow Head Start LLC ("COTR")

Dear Mr. Sharp:

In follow-up to our call Tuesday, I wanted to write to confirm that with today's conclusion of the Agreement between Neighborhood House Association ("NHA") and COTR, COTR will need to transfer all property, equipment and supplies purchased with federal funds back to NHA or its designee. NHA is particularly interested in taking possession of the three modular buildings purchased with Head Start funds (Darnell, Rolando and Johnson) as soon as possible. Michael Kemp will be taking the lead for NHA on this closeout process. His direct telephone number is (619)778-8023. NHA would prefer to schedule a smooth transition of property from COTR but, is prepared, if necessary to take possession in the next few days if COTR prefers. In any event, if the appropriate person from COTR could call him by Tuesday, July 5 to schedule the closeout steps, that would be much appreciated.

I am hopeful, as I am sure you are, that the closeout process can proceed without the involvement of counsel. Thank you in advance for your assistance in this matter.

Sincerely,



Edward T. Waters

cc: Dwight D. Smith, Esq.

Kim Peck

From: Kursat <kursat.cotr@gmail.com>
Sent: Sunday, April 10, 2011 9:22 AM
To: Kim Peck; Michael G Kemp; Norma Johnson; Yolanda Perez
Cc: galerwalker@aol.com
Subject: Reasons of the py 45 shortfall / Clarification

Dear Norma and Kim,

We would like to follow up on our Thursday meeting and further clarify what caused the shortfall for py 45. Please see below the factors that caused the negative balance:

1. **3.5% salary increase across the whole organization:** We have approximately (plus/minus) 150 teachers and related program staff who have had very good evaluations for two years in a row without any CCL violations; therefore the President and CEO decided to reward the hard working staff for one time and gave them a 3.5% permanent increase. We have approximately 5.0mm as gross salary base without any fringe so $5.0\text{mm} \times 3.5\% \times 1.35 = \$236,000$ additional cost for py 45
2. **Health Insurance costs coverage for employees that work less than 52 weeks:** We analyzed our health insurance cost this program year versus the cost NHA reported on our behalf and realized that even though we have gone through a very competitive process for selection and was successful in having no rate hikes, we had more costs for the whole year. The reason is, the health coverage for employees (such as teachers and associate teachers), who work approximately 40-42 weeks, is paid for 52 weeks as opposed to charging the cost of the insurance for the weeks not worked to employees themselves gradually over the course of their work weeks in the program year. The individual cost for the health insurance for three months that they do not work is approximately \$1,500 per employee (some cases include dependents as well). So if you consider the approximately 150 employees then the result is $150 \times \$1,500 = \$225,000$ additional cost for py 45
3. **Additional rent increases for SUSD sites and Sherman:** Approximately \$40,000 additional cost for py 45
4. **Additional maintenance and IT costs:** When NHA decided, around March/April 2010, not to provide IT services to COTR effective 6.30.2010, we have hired Crown Computers as our IT firm, and with additional cost per month for regular IT services and some set up/start up costs, we spent approximately \$40,000 to \$50,000 as an additional cost for py 45. Also we had approximately \$80,000 - \$100,000 additional cost for py 45 as maintenance costs over and above the level that was expected on a regular basis.

The solution to deal with the py 45 negative balance for one time only: We have had some savings in some other expense categories and plus we have talked about committing the management fee up to \$360,000 towards the negative balance. If we do that, that still leaves us approximately \$200,000 plus need for cash, which we are asking NHA to cover.

In order to not to deal with these issues in py 46, we have taken the following management decisions:

1. **Changed the program options for part-day from a five day program to a four day program with teachers doing the portfolios on Friday and ATs not working on that day**
2. **We will prorate the insurance cost per employee for the number of weeks they work and charge them over the course of the weeks they are employed in py 46**
3. **We have committed to no salary increase across the board in py 46**

4. **Any additional measures the President and CEO may decide appropriate if any additional sources needed at all.**

We hope this additional information will help you better clarify the reasons of the py 45 shortfall and help you with your letter. Should you have any questions, please do not hesitate to contact me.

We look forward to the NHA's letter and have a good Sunday.

Regards,

Kursat Misirlioglu, MBA, CEDFP
Chief Financial Officer
Children of the Rainbow
619.507.7837

Cc President & CEO

Afsaneh Ahmadi, P.E.
Chief Building Official/Deputy Director
City of San Diego / Development Services
aahmadi@sandiego.gov
619-446-5406
1222 First Ave., MS 401
San Diego, CA 92101

From: Law Offices of Shapiro & Clamon [mailto:shapiroclamon@gmail.com]
Sent: Tuesday, September 29, 2009 4:35 PM
To: Ahmadi, Afsaneh
Cc: Benoit, Mike
Subject: Children of The Rainbow Head Start at 2918 Imperial Ave.

Dear Ms. Ahmadi:

According to the City Attorney's Office and the Fire Marshall my client needs for you to make a factual occupancy determination and correct the occupancy classification records.

My client is Children of the Rainbow Head Start located at 2918 Imperial Ave., San Diego. In 1979 the building was permitted as an F2 occupancy.

In 1987, the Fire Marshall's records show that the building's occupancy classification was E-3. The building has been continuously used as a Federal Head Start Program since 1987. However, no City records regarding the E-3 classification can be located.

It was suggested by Dep. Fire Marshal Eddie Villavicencio and the City attorney's office that I contact you because the school is now closed and the 60 Head Start children no longer have a school. (Mr. Villavicencio's e-mail is attached below.)

What Children of the Rainbow requests is that the occupancy classification be corrected to E-3 for 2918 Imperial Ave. back to 1987 as verified by the Fire Marshall's own records.

According to Evidence Code sections 1530 and 1532 the Fire Marshall's records are conclusive proof that 2918 Imperial Ave. has had an E-3 occupancy classification from the City since 1987.

Your help is greatly needed. Thank you for your attention.

Sincerely,

C. Hartzog Clamon
FOR SHAPIRO & CLAMON

From: "Villavicencio, Eddie"
Date: Tue, 22 Sep 2009 15:07:16 -0700
To: 'kursat.cotr@gmail.com' <kursat.cotr@gmail.com>
Subject: Inner City Head Start 2918-2920 Imperial Ave
Kursat,

Just wanted to update you on the status of the fire inspection request for the Inner City Head Start located at, 2918 & 2920 Imperial Ave. After extensive research, as far back as 1960, we were unable to locate any city documents or permits' indicating this location has at anytime obtained an "E" Occupancy Classification.

To: Villavicencio, Eddie; 'Law Offices of Shapiro & Clamon'
Cc: Benoit, Mike; 'Waddell, Michele@DSS'; galerwalker@aol.com
Subject: Re: Children of The Rainbow Head Start at 2918 Imperial Ave.

As a matter of fact, yes...we have discussed with Mr. Luckey, the owner, and he already hired consultants as the owner to apply for "e" occupancy...

I will follow up with him and let you know where he stands.

Thanks for the follow up. And we look forward to an expedited process to get our permit.

Regards

Kursat

Sent from my Verizon Wireless BlackBerry

From: "Villavicencio, Eddie" <EddieV@sandiego.gov>
Date: Thu, 15 Oct 2009 14:12:09 -0700
To: 'Law Offices of Shapiro & Clamon'<shapiroclamon@gmail.com>;
'kursat.cotr@gmail.com'<kursat.cotr@gmail.com>
Cc: Benoit, Mike<MBenoit@sandiego.gov>; 'Waddell, Michele@DSS'<mwaddell@dss.ca.gov>
Subject: RE: Children of The Rainbow Head Start at 2918 Imperial Ave.

Kursat,

It has been over 2 weeks and I have not received a response regarding your intend pertaining to this matter. Can you please advise if you will be moving forward and obtaining the required occupancy classification or will you be withdrawing your 850 request for this location.

Thank You, Eddie

Eddie Villavicencio
Deputy Fire Marshal
San Diego Fire-Rescue
1010 Second Ave Suite 300
Office (619) 533-4435
Fax (619) 544-6806

From: Ahmadi, Afsaneh
Sent: Wednesday, September 30, 2009 10:46 AM
To: 'Law Offices of Shapiro & Clamon'
Cc: Benoit, Mike; Villavicencio, Eddie
Subject: RE: Children of The Rainbow Head Start at 2918 Imperial Ave.

Dear Mr. Clamon,

In order for us to factually make an occupancy determination, we will need a design professional's analysis of the building per California Building Code. The building should be evaluated for all Fire Life Safety and Structural provisions of the code.

The design and analysis of your design professional should be submitted for our review and approval.