

California State Auditor

B U R E A U O F S T A T E A U D I T S

State Legal Contracts:

**The State Could Reduce Its Reliance
on Outside Counsel and Better Manage
Contracts**



December 1997
97102

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CALIFORNIA STATE AUDITOR

KURT R. SJOBERG
STATE AUDITOR

MARIANNE P. EVASHENK
CHIEF DEPUTY STATE AUDITOR

December 23, 1997

97102

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the State's process for contracting with outside counsel for litigation services. This report concludes that of the requests for litigation services that the Department of Justice (DOJ) declined in fiscal year 1995-96, a substantial portion were the result of DOJ's determination that it lacked resources to provide the service. Further, consent by the DOJ to use other counsel usually results in departments contracting with outside counsel for litigation services. Nevertheless, the DOJ's decision not to provide services because of insufficient resources is not a statutory basis for contracting for legal services. Further, departments do not use adequate management tools to monitor legal contracts and do not consistently use restrictive contract provisions to help control contract costs.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

BUREAU OF STATE AUDITS

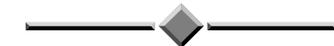
660 J Street, Suite 300, Sacramento, California 95814 Telephone: (916) 445-0255 Fax: (916) 327-0019

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Summary



Audit Highlights . . .

Our review of contracts that state departments have with outside counsel disclosed that:

- ✓ Departments spent \$12.3 million on outside counsel during fiscal year 1995-96 because the DOJ determined it had insufficient resources to provide the service;***
- ✓ State law does not allow departments to contract with outside counsel solely because the DOJ lacks the resources to provide legal representation. As a result, these contracts are open to challenge by employee unions; and***
- ✓ Departments could use better methods to control and monitor costs of outside counsel.***



Results in Brief

The State is involved in many matters requiring legal representation. The Department of Justice (DOJ), under the direction of the Office of the Attorney General, represents most state departments in legal matters. A few departments have been authorized by statute to employ civil service counsel for all their legal needs. Other departments employ civil service counsel for limited purposes, such as providing advice on administrative and program matters. The DOJ represents these departments in litigation.

During fiscal year 1995-96, DOJ client departments spent \$29.6 million on outside counsel. Of this amount, approximately \$12.3 million, or 42 percent, resulted from the DOJ's determination that it had insufficient staff to provide counsel. According to the DOJ, changes in laws and practices in litigation, among other factors, have greatly increased its workload, causing the DOJ to assign staff to different types of litigation than they would otherwise take on. Further, the DOJ asserts that its workload has historically exceeded its resources. These conditions have contributed to the DOJ's decision not to represent departments in litigation.

Moreover, although the DOJ may authorize departments to use other counsel for litigation, the law does not explicitly allow DOJ consent as justification for departments to contract with outside counsel for these services. As a result, departments that contract with outside counsel may not comply with the state law mandating use of civil service employees for work that civil service employees normally perform. However, a DOJ official believes that the DOJ's decision not to represent departments, together with the lack of other options, justifies the use of private counsel because of insufficient staffing at the DOJ. Nevertheless, recent actions by the State Personnel Board and courts cloud this issue.

We also noted that departments did not take advantage of opportunities to better manage contracts with outside counsel. Specifically, they have not exercised the management tools, such as litigation plans and budgets, already available to

administer and control legal services contracts. As a result, they may have overpaid for some services or paid for disallowed costs.

The private sector has recently focused on improving the management and oversight of its legal contracts and developed the Uniform Task-Based Management System. The system is a standardized, industrywide approach to task-based planning, budgeting, and billing. It is being adopted by proactive corporations and law firms.

Recommendations

The State's current policy makes the DOJ the primary litigator for most departments. If the Legislature believes this policy continues to be appropriate, it should have the DOJ complete a study to determine if it has sufficient resources. Based on the results of such a study, the Legislature should authorize sufficient staffing and funding so that the DOJ does not decline work because of insufficient resources.

The Legislature should consider modifying state laws to permit departments to contract for litigation services when the DOJ declines to represent them because of insufficient staff and make the departments' use of management tools mandatory for legal services contracts.

The Department of General Services should give more direction and guidance to help departments better manage their legal services contracts.

Departments should better manage their legal services contracts by using management tools.

Agency Comments

With the exception of the Department of General Services (DGS) and the California Department of Corrections (CDC), the departments generally agreed with our findings and recommendations.

The DGS agrees with the concept of developing guidelines for managing legal services contracts. However, the DGS believes that a considerable amount of study will be required, thus making it a long-range project. Also, the DGS is concerned

that under a task-based billing system, some outside counsel would be unwilling to work for the State or would charge more to provide this information.

The CDC generally agrees with the findings and recommendations, but believes that any management system to control the legal and business aspects of litigation needs to be flexible.

Introduction

Background

Many matters of the State require legal representation. For example, a department requires legal counsel when employees sue the department or its employees for employment discrimination. A department also needs legal counsel if it is sued by an individual or entity that believes it has been harmed by a state regulatory practice. A few departments have been authorized by statute to employ civil service counsel for all their legal needs. Other departments employ civil service counsel for limited purposes, such as providing advice on administrative and program matters, attending administrative hearings, or providing litigation support. Most departments are represented in litigation by the Department of Justice (DOJ), which is under the direction of the Office of the Attorney General. The California Government Code specifies that it is the Legislature's intent that the state government's overall efficiency and economy be enhanced by the DOJ's legal representation of departments and employees. The Legislature has found that it is in the State's best interests to provide the DOJ with the resources for this representation.

For fiscal year 1995-96, the DOJ assigned 741 of its attorneys, at a cost of approximately \$109 million, to represent departments in litigation of civil, criminal, and public rights matters. The DOJ's civil law program protects and preserves the public interest through legal services in such areas as licensing; health, education, and welfare; and enforcement, regulation, and administration. The criminal law program represents the State in all criminal matters before the appellate and Supreme courts and in civil suits filed by prison inmates. Finally, the public rights program provides legal services in such areas as natural resources and environmental law.

Unless specifically exempted, departments needing legal representation are required by state law to use DOJ attorneys. However, under certain circumstances the DOJ may decline to represent a department or its employees and give consent to the department to use civil service counsel or to contract with outside counsel. Circumstances for these exceptions, listed in order of expenditures, include:

- Insufficient staffing.
- Lack of expert or specialized legal services the DOJ historically has not performed and does not expect to offer.
- Lack of expertise or specialized legal services the DOJ does not currently perform but could perform with additional staffing.
- Representational conflicts involving multiple departments or employees.
- A requirement specifying co-counsel with the DOJ because the court directs it or because the case involves expertise the DOJ does not possess.
- A requirement specifying out-of-state counsel in other jurisdictions.

As previously mentioned, some departments may have their own civil service counsel in addition to the DOJ attorneys. For fiscal year 1995-96, the State authorized client departments of the DOJ to employ 840 civil service counsel primarily to furnish advice on administrative and program matters. Some civil service counsel also represent their departments in administrative and court hearings. In fiscal year 1995-96, departments reported that they spent \$29.6 million on outside counsel. In Chapter 1, Table 1, we provide a breakdown of expenditures departments incurred and the reasons they used outside counsel.

When departments contract with outside counsel for legal services, they must follow various laws and regulations. For example, state law mandates that departments must have DOJ consent and the approval of the Department of General Services to contract for legal services. For the contract to be valid, another provision requires that departments meet one of the specific state law exceptions for contracting with outside counsel.

Scope and Methodology

At the request of the Joint Legislative Audit Committee, we reviewed the State's process for contracting for legal services with outside counsel. Specifically, we determined the nature and amount of the State's expenditures for legal services supplied by outside counsel. Additionally, we assessed

whether departments complied with laws and regulations and whether they obtained appropriate approvals for legal services contracts with outside counsel. We also evaluated whether the departments followed adequate internal controls when paying invoices from outside counsel to ensure that expenditures were legal, appropriate, and consistent with contract terms. Finally, we determined if departments used management tools, such as budgets and litigation plans, as a means of managing contracts and controlling payments to outside counsel.

For our review, we selected from each of four areas of state government one department that employs its own civil service counsel: the California Department of Corrections, the Commission on Teacher Credentialing, the Department of Social Services, and the Department of Water Resources. These departments had large dollar amounts in contracts or expenditures for outside counsel during fiscal year 1995-96 compared to other departments. Overall, these departments represent over one half of the \$29.6 million spent by DOJ client departments on outside counsel. In addition, during the same fiscal year, the four departments received DOJ attorney services of \$14 million, or approximately 20 percent of the total DOJ billings for client departments.

To assess the nature and amount of the State's expenditures for legal services with outside counsel, we interviewed staff at the DOJ and these four departments. We also reviewed the DOJ and the departments' records and reports on reasons for DOJ consent to use other counsel and on the types of litigation involved.

To determine whether the departments complied with laws and regulations and obtained appropriate approvals for private legal services contracts, we reviewed the selected departments' contracting processes.

In addition, we reviewed the State Personnel Board's response to challenges to legal services contracts brought by the Association of California State Attorneys and Administrative Law Judges on behalf of all civil service counsel the departments employ.

To evaluate whether departments followed good internal controls when paying invoices from outside counsel, we determined if they adequately reviewed the invoices against the terms of the contract, checked invoices for mathematical accuracy, and verified that the services were actually performed.

To determine if the departments use management tools in managing contracts and controlling payments, we determined if contracts, litigation plans, and budgets included sufficient detail to monitor the progress of legal services and to compare invoices against budgets. We also determined if the departments used management tools suggested by state contract law.

Chapter 1

The Department of Justice's Determination of Insufficient Resources Is Not a Statutory Basis for Contracting

Chapter Summary

Of \$29.6 million that client departments of the Department of Justice (DOJ) spent on outside counsel during fiscal year 1995-96, approximately \$12.3 million, or 42 percent, resulted from the DOJ's determination that it had insufficient staffing to provide counsel. Moreover, although the DOJ can authorize departments to use other counsel for litigation services, the law does not explicitly allow this consent as justification to contract with outside counsel. As a result, departments may violate state law mandating use of civil service (state) employees for work these employees normally perform. In addition, departments failing to comply with this law risk challenges to their contracts for legal services.

The DOJ's Decision Not To Represent Departments Results in the State Using Outside Counsel

The DOJ reports that of those departmental requests for litigation services it declined for fiscal year 1995-96, a substantial portion was because of insufficient staffing. When the DOJ declines to represent a department in legal proceedings, the department faces an urgency to respond to the lawsuit. Upon receiving the DOJ's consent to use other counsel, the department is then left with several alternatives. One possibility is that it could do the work with its own civil service counsel. However, the role of most department counsels is to provide advice on administrative and program matters, while the role of litigator is primarily reserved for the DOJ. Another option is that the department could contract with one of the few departments with civil service counsel possessing the required litigation expertise and knowledge. However, it is unrealistic to expect the department to search for litigators at other departments or to expect another department's

counsel and support staff to have time to devote to litigation that could take up to several years to complete. Departments are thus left with little choice but to hire outside counsel.

Table 1 shows the amount the four departments we reviewed spent for outside counsel in fiscal year 1995-96 because the DOJ declined to represent them. It also indicates the total expenditures of DOJ client departments contracting with outside counsel.

Table 1

Fiscal Year 1995-96 Expenditures by Client Departments for Outside Counsel Authorized by the Department of Justice

Reasons for Consent	California Department of Corrections	Commission on Teacher Credentialing	Department of Social Services	Department of Water Resources	Total of Departments Reviewed	Total, All Client Departments ¹
Insufficient staffing	\$11,160,900 ²		\$ 38,000	\$ 25,700	\$11,224,600	\$12,272,400
Lack of expert or specialized legal services the DOJ historically has not performed and does not expect to offer	281,900		176,500	1,056,600	1,515,000	8,671,400
Lack of expertise or specialized legal services the DOJ does not currently perform but could perform with additional staffing	44,000	\$1,816,800		233,600	2,094,400	4,830,300
Representational conflicts involving multiple departments or employees	1,117,400			10,200	1,127,600	3,213,500
A requirement specifying co-counsel with the DOJ because the court directs it or because the case involves expertise the DOJ does not possess				224,900	224,900	765,500
A requirement specifying out-of-state counsel in other jurisdictions				224,900	224,900	424,300
Agencies not normally represented by DOJ						443,200
Other						66,500
Less adjustment for expenditures already included above—consent given for multiple reasons				(449,800)	(449,800)	(1,133,400)
Totals	\$12,604,200	\$1,816,800	\$214,500	\$1,326,100	\$15,961,600	\$29,553,700

¹ The amounts above represent information compiled by the Department of Justice and include adjustments we made during our review of the departments.

² A portion of the expenditures reported for the Department of Corrections because of insufficient staffing may also be for representational conflicts.


The State spent \$12.3 million on outside counsel during fiscal year 1995-96 because the DOJ had insufficient resources to represent departments.

Approximately \$12.3 million, or 42 percent, of the \$29.6 million that client departments of the DOJ spent for outside counsel in fiscal year 1995-96 resulted from insufficient DOJ staff. For example, the California Department of Corrections (CDC) reported legal expenditures of \$11.2 million because the DOJ lacked the staff to represent it, primarily in employment discrimination and inmate lawsuits. This trend of insufficient staff continued into fiscal year 1996-97.


The chief assistant attorney general for the DOJ's civil law division (chief assistant for civil law) maintains that his legal staff is fully utilized. Most staff attorneys therefore work at a level of 102 percent to 110 percent of the annual standard of 1,820 hours per year. The DOJ will decline cases if it believes that current or anticipated workload indicates that acceptance of a request will not result in responsible, competent representation.

Workload Is a Key Factor in DOJ's Decision To Represent Departments

The DOJ asserts that its workload has historically exceeded its resources. According to the chief assistant for civil law, changes in laws and practices, among other factors, have greatly increased the DOJ's workload and caused it to provide legal services in areas not previously performed or not performed often. He noted that although the DOJ declined a number of requests for representation in employment discrimination during fiscal year 1995-96, the total number of employment discrimination requests the DOJ accepted increased, with one consequence being that some requests for representation in other areas of practice were declined.

Another factor affecting the DOJ workload was the Trial Court Delay Reduction Act of 1990, commonly known as the "fast track." It applied to all court proceedings. Because fast track mandates that 95 percent of all civil cases are to be resolved in 12 months and the remaining 5 percent are to be resolved in 24 months, attorneys now have less flexibility in managing their caseloads. The chief assistant for civil law noted that fast track resulted in an accelerated pace at which newly filed litigation was prepared for trial, at the same time that earlier filed litigation was working its way through the court system, thus increasing the DOJ's overall workload.

In fact, the DOJ has declined to represent departments in specific areas of work. Between August 1990 and October 1993, the DOJ, because of insufficient staffing, declined to represent all departments supported by the

General Fund in personnel matters and later in employment discrimination cases. In its consent letter to departments, the DOJ informed them that the insufficient staffing was caused by reductions in General Fund support. As a result, the DOJ authorized departments to handle their own litigation or to contract with outside counsel. During this period, however, it was able to represent departments supported by special funds on a reimbursed basis. (The General Fund usually receives its resources from taxes assessed on all taxpayers such as personal income tax, while special funds receive their resources from taxes or fees charged for specific purposes such as gasoline tax or licensing fees.)

The State has acted to reduce its reliance on outside counsel. Beginning in October 1993, the DOJ resumed representing departments supported by the General Fund in employment discrimination cases on a reimbursed basis and began granting consents for outside counsel only on a case-by-case basis in this area of litigation. Also, in October 1993, the Governor's Office authorized the Department of Personnel Administration to represent departments in personnel matters before the State Personnel Board (personnel board). More recently, the fiscal year 1997-98 state budget authorized the DOJ to establish and ultimately fill up to 37 new counsel positions on a reimbursement basis, with the intention to reduce reliance on outside counsel. As of mid-November, 15 of the 37 positions had been filled or advertised based on current workload and availability of funding. The chief assistant for civil law stated that the DOJ will continually monitor the need to increase staff up to the total counsel authorized based on the DOJ's major clients' legal service demands.


During fiscal year 1993-94, the DOJ could not represent the Department of Corrections in 750 inmate cases.


In addition, for ten months during fiscal year 1993-94, the DOJ could not represent the CDC in lawsuits brought by inmates because of the excessive number of cases. During this period, the CDC hired outside counsel for approximately 750 inmate cases. The chief assistant attorney general for the DOJ's criminal law division states that, since then, the DOJ hired more attorneys for inmate cases and has not declined new cases because of insufficient staff. However, outside counsel continues to represent the CDC for cases begun in fiscal year 1993-94.

Table 2 summarizes the expenditures for and number of contracts with outside counsel by category of litigation during fiscal year 1995-96 for the departments we reviewed.

Table 2

***Expenditures and Number of Contracts
With Outside Counsel by Category of Litigation
for Fiscal Year 1995-96***

Category of Litigation	California Department of Corrections	Commission on Teacher Credentialing	Department of Social Services	Department of Water Resources	Total, Expenditures and Contracts
<u>Employment discrimination</u> Number of contracts:	\$ 9,507,200 33		\$ 38,000 2	\$ 5,700 1	\$ 9,550,900 36
<u>Inmate lawsuits</u> Number of contracts:	\$ 2,096,900 8				\$ 2,096,900 8
<u>Construction arbitration</u> Number of contracts:	\$ 196,900 4			\$ 831,700 3	\$ 1,028,600 7
<u>Contract negotiations</u> Number of contracts:	\$ 88,100 1		\$ 176,500 1		\$ 264,600 2
<u>Program matters</u> Number of contracts:		\$1,816,800 1		\$ 64,100 5	\$ 1,880,900 6
<u>Bond counsel</u> Number of contracts:				\$ 199,700 1	\$ 199,700 1
<u>Regulatory</u> Number of contracts:				\$ 224,900 1	\$ 224,900 1
<u>Dispute with local government</u> Number of contracts:	\$ 693,400 2				\$ 693,400 2
<u>Personnel matters</u> Number of contracts:	\$ 21,700 1				\$ 21,700 1
Total Expenditures	\$12,604,200	\$1,816,800	\$214,500	\$1,326,100	\$15,961,600
Total Number of Contracts	49	1	3	11	64

Departments will likely incur substantially higher costs when they use outside counsel. The DOJ charged departments \$98 per hour for legal counsel in fiscal year 1995-96. Based on a weighted average of a sample of invoices we reviewed, the rates private attorneys charged averaged \$182, with a range of \$90 to \$325 per hour. When computing the weighted average, we weighted each hourly rate by the number of hours worked at that rate.

***The DOJ's Lack of Resources Is
Not a Statutory Basis for
Contracting for Litigation Services***

Although the DOJ declines departments' requests for representation, the law does not explicitly allow departments to enter into contracts for personal services solely because there is a lack of civil service staff to perform the work. The California Government Code allows contracting for personal services only if departments meet certain conditions. When stating reasons for personal services contracts with outside counsel, departments that we reviewed most frequently cite the following provisions of Section 19130(b) of the California Government Code:

—◆—
State law does not explicitly allow departments to contract for legal services solely because the DOJ lacks staff to represent them.
—◆—

- The services cannot be performed satisfactorily by civil service employees, or are of such a highly specialized or technical nature that the necessary expert knowledge, experience, and ability are not available through the civil service system.
- The DOJ has a conflict of interest in the legal matter.
- The services are of such an urgent, temporary, or occasional nature that a delay until the availability of a civil service employee would impair the department and the State's position.

In addition to other contracting requirements, departments must cite one or more of the provisions of Section 19130(b) to obtain contract approval from the Department of General Services. However, the Department of General Services usually does not seek further inquiry beyond the representation of the department on the standard contract transmittal form before approving contracts. Nevertheless, even after the legal services have been performed, a department may need to justify the basis of its decision to contract out if the personnel board so requests. Under Section 19132, the personnel board, when requested by an employee union, will ask the department to provide its rationale for contracting in lieu of using civil service counsel.

The chief assistant for civil law believes that when the DOJ must decline to represent a department and use of department counsel is not an available option, employment of outside counsel is typically justified as an urgent and temporary need within the meaning of the government code. Further, because the Legislature has given the DOJ responsibility to provide legal representation to departments, he states that

increasing other departments' civil service counsel should not be an alternative to providing the DOJ with adequate legal staffing. Nevertheless, he added that primary responsibility for enforcement of Section 19130(b) lies with the personnel board, and consent by the DOJ to employ outside counsel neither precludes nor controls the personnel board's action with respect to that section. However, courts have not always agreed with departments using contractors when the work has traditionally been performed by civil service employees.

Furthermore, according to the acting executive officer of the personnel board, a staff shortage alone is not a sufficient reason for personal services contracts. He notes that courts interpret the law to mean that work that can be performed adequately and competently by civil service employees should in fact be performed by civil service employees.

Consequently, departments that contract with outside counsel may risk a challenge by the Association of California State Attorneys and Administrative Law Judges (union). The union represents all rank-and-file counsel and administrative law judges employed by the State. Although the DOJ may decline to represent a department because of insufficient resources, the department must appropriately prove its compliance with one of the provisions of Section 19130(b) for its contract to be valid upon review by the personnel board. The personnel board can invalidate a contract if the department fails to adequately justify it.

Legal Contracts Challenged by Employee Union

Three times between September 1996 and January 1997 the union brought challenges to the personnel board. The personnel board's reviews of contracts of the CDC, the Department of Transportation (Caltrans), and the DOJ resulted in mixed decisions.



The union challenged 20 CDC contracts entered into mainly for employment discrimination and inmate lawsuits.



The union challenged 20 CDC contracts. The CDC entered into these contracts, mainly for employment discrimination and inmate lawsuits, after the DOJ declined to represent the CDC because of insufficient staff. In his decision, the executive officer of the personnel board ruled that the CDC failed to prove that its contracts with outside counsel met the government code requirements. Specifically, the executive officer found that the CDC failed to prove that civil service counsel could not perform the legal services. Further, because some of the contracts had lasted over four years and because of the large number of cases represented by outside counsel, the executive officer did not


The State Personnel Board invalidated the 20 contracts because the CDC failed to prove that using outside counsel met the government code requirements.

believe that the contracts were urgent, temporary, or occasional in nature. The CDC requested a hearing before the personnel board to present additional justification of its contracts. However, before the hearing was held, the CDC and the union reached an agreement allowing the CDC to complete cases already being handled by outside counsel and to notify the union if the DOJ declines any future cases because of lack of staff.

The personnel board also ruled that one Caltrans contract failed to comply with the government code. This contract was for filing a petition with the California Supreme Court after a Court of Appeals decision in the same matter. Caltrans requested DOJ approval to hire outside counsel because of the limited time to petition the court. The DOJ gave its consent to employ counsel outside the DOJ. In April 1997, the personnel board adopted a resolution disapproving the contract on the grounds that Caltrans did not establish that the civil service attorneys had a conflict of interest; that the services could not be performed satisfactorily by civil service employees; that the required expert knowledge, experience, and ability was not available through the civil service system; or that the services contracted for were of an urgent, temporary, or occasional nature. As a result of its ruling, the personnel board instructed Caltrans to terminate the contract within 30 days. Before this time passed, the outside counsel completed its work and the contract expired. The personnel board has taken no further action on this contract since issuing the resolution.

In another case, the personnel board agreed with the justification the department provided. In October 1996, the union requested that the personnel board review five DOJ contracts for outside counsel to appear in courts in remote areas of the state. The personnel board ruled that the contracts were valid. However, the union disagreed with the personnel board's decision. It then took its challenge to the Superior Court, which ordered the personnel board to void its decision. As ordered by the Superior Court, the personnel board adopted a resolution voiding its earlier decision. By the time the Superior Court issued its order and the personnel board adopted the resolution, four of the five contracts had expired or were about to expire. The DOJ terminated the use of services of the fifth contract.

Conclusion

The State is involved in many matters requiring legal representation. The Legislature has given the DOJ the responsibility of providing counsel for most departments.

However, at times the DOJ declines department requests for legal counsel because of insufficient staffing. Nevertheless, this reason is not a statutory basis for contracting for litigation services.

Recommendations

The State's current policy makes the DOJ the primary litigator for most departments in judicial matters. If the Legislature believes this policy continues to be appropriate, it should then have the DOJ complete a staffing and workload study to determine if the DOJ has sufficient staff to represent departments.

Based on the results of such a study, the Legislature should authorize sufficient staffing and funding so that the DOJ does not decline work because of a lack of staff.

The Legislature should consider modifying California Government Code Section 19130(b) to permit departments to contract for litigation services when the DOJ declines to represent departments because of insufficient resources.

Unless the Legislature modifies California Government Code Section 19130(b) as recommended, departments should provide appropriate justification to allow the Department of General Services to review contracts for compliance with this section. Further, the Department of General Services and the State Personnel Board should develop criteria for determining whether contracts are adequately justified under this section.

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Chapter 2

Opportunities Exist for Departments To Better Manage Legal Contracts

Chapter Summary

The departments we reviewed have not taken advantage of opportunities to better manage contracts with outside counsel. Specifically, they have not exercised the management tools already available to administer and control legal contracts, such as requiring that the outside counsel adhere to legal cost and billing guidelines, litigation plans, and budgets. Furthermore, the departments did not consistently include contract provisions giving them additional control to contain costs. Finally, three of the departments had weaknesses in their administration of these contracts. As a result, they may have overpaid for some services or paid for disallowed costs.

Background

Good internal controls dictate that departments write clear contracts and ensure compliance with contract provisions. To promote sound business decisions and to help ensure that departments properly manage their contracts with outside counsel, the Public Contract Code (code) suggests that departments use specialized legal management tools. Specifically, Section 10353.5 of the code provides that legal services contracts contain the following language: the legal contractor shall adhere to legal cost and billing guidelines, litigation plans, case phasing of activities, and budgets as designated by the department. However, the provision in the code “as designated by the department” makes it voluntary rather than compulsory for departments to require these items from outside counsel. The other terms from this code section are defined as follows.

Legal cost and billing guidelines are the contract provisions that direct and limit the outside counsel. Sometimes these provisions simply tell the outside counsel to submit monthly invoices, or the guidelines may dictate that the outside counsel secure the department’s approval prior to using expert witnesses or consultants. A litigation plan is a detailed statement of all anticipated activity and resources—including staffing—required during a legal matter. Litigation plans are common in public

practice and are organized by the case phasing of activities. For example, as litigation progresses the plan may include all or part of the following: case assessment and development, pre-trial pleadings and motions, discovery, trial preparation and trial, and appeal. In addition, a litigation plan might include alternatives to litigation such as settlement or mediation. The budget estimate is built from the litigation plan or scope of services and lists the cost associated with each phase, including staffing and billing rates.

When contracting with outside counsel, departments must develop a clear, concise, detailed description of the work to be performed and monitor the outside counsel's progress. A litigation plan and budget, whether in the contract or a separate document, would fulfill the requirement for a detailed description of the work. The departments can then monitor and measure outside counsel's compliance against the performance criteria by communicating with outside counsel, reviewing progress reports, and comparing invoices to the litigation plan and budget to determine whether services are performed according to the contract. As a case progresses, the department has a record of activities and costs, and thereby the materials to analyze any contract amendments.

***Departments Do Not Use
Adequate Management Tools
To Monitor Legal Contract Costs***


While the code suggests using litigation plans, none of the four departments used them to manage legal services contracts.

Despite the fact that all the contracts we reviewed included the language required by the code, none of the departments documented their use of the suggested management tools. For example, while the code suggests using litigation plans, none of the four departments used them to manage legal services contracts. In addition, even though all four departments received budget estimates for some contracts, they used the estimates only to determine contract or amendment amounts, rather than to manage progress and costs. Departments accepted outside counsels' invoices itemizing the work done by each attorney per day but did not request invoices organizing each attorney's total hours or expenses by task. Without such a summary, it is difficult for a department to determine how much effort its outside counsel spent on a particular task or phase of a case.

Further, even though the legal services contracts we reviewed included descriptions of the expected work, the descriptions were written in general terms and did not contain performance criteria against which to measure the outside

counsel's performance. For example, the Department of Water Resources' (DWR) contract for a construction arbitration case described the outside counsel's duties as follows:

"Contractor shall, as requested by State, furnish legal services, including but not limited to research, investigation, negotiation, selection and preparation of witnesses, preparation of written materials, arbitration and shall, as requested by State, represent the State in all matters pertaining to the construction claim filed against the Department of Water Resources by [entity]."

Although this statement provides a good overview of the outside counsel's duties, it lacks the detail of an effective litigation plan. The DWR received estimates of costs from outside counsel and used these estimates to determine the contract amount. As the case proceeded, the DWR received additional cost estimates that it generally used to track costs and project future costs, which in several instances necessitated amending the contract. However, the DWR did not perform formal detailed comparisons between the budget and actual costs because its attorneys felt they understood the reasons for the differences without the additional time and expense to prepare such an analysis. The original contract covered a year and a half and no more than \$300,000. The DWR eventually amended this contract to cover five years and up to no more than approximately \$3 million, but did not amend the duties. The DWR civil service counsel managed the legal aspects of the case by requiring a weekly written report and frequent oral reports from the outside counsel and attending some of the court proceedings. However, the DWR did not link the weekly reports to invoices to measure the outside counsel's progress on the case.


The departments we reviewed focused on managing the legal rather than the business aspects of their contracts.

The preceding example is typical of the legal contracts we reviewed at the four departments. The DWR, like the other departments, used different methods to verify the value of the legal services. However, these methods focus on managing the legal rather than the business aspects of the contracts. Legal staff in all of the departments we reviewed told us that they communicated regularly with outside counsel to discuss progress on a case. In addition, department staff received copies of all court documents and attended depositions, hearings, and trials.

Departments Are Not Systematically Managing Legal Expenses

Even though departments appear to be overseeing how their outside counsels handle the legal aspects of the cases, departments are not systematically managing their legal expenses. For several reasons, the departments did not invoke the provisions of the code to obtain litigation plans and related budget estimates from outside counsel. One reason they did not is that the language in the code makes the use of litigation plans and budget estimates voluntary. Further, the Department of General Services (DGS) has not provided guidance on using the management tools suggested in the code. Although each department is responsible for its own contracting program, the DGS has a central role in ensuring good contract management. The State Contracting Manual, which the DGS publishes as a resource guide to departments, only reiterates the provisions of the code rather than providing additional guidance.


Departments failing to maintain control over their contracts risk inefficiently using or overpaying outside counsel.

Furthermore, department staff indicated that legal contracts are subject to change and need to be flexible because conditions of litigation change, and that legal services are hard to measure. Departments also believe that they can judge the validity of the invoices without budget estimates or litigation plans. They therefore do not have a documented management process to ensure that they have received the legal services. Because departments do not exercise all their options in managing their legal services contracts, the potential exists for inefficient use of outside attorneys and overpayments to them.

It is precisely because of the preceding reasons cited by the departments that we believe it is indeed necessary to use litigation plans and budget estimates to effectively monitor legal contracts. There are ways to effectively use these common legal management tools and still address the departments' concerns. The State can look to the private sector for ideas and methods. Recently, the private sector has focused on improving the management and oversight of its legal contracts. Some corporations now ask outside counsel to provide detailed cost estimates and more useful invoices. To allow for the changing nature of litigation, some corporations also request that litigation plans include contingency provisions and that detailed budget estimates cover 60- to 90-day periods. The budget estimates for the entire contract period are general and may be adjusted. Departments could adopt these monitoring practices.

The Uniform Task-Based Management System is an Additional Management Tool

Recognizing that a standardized budget and billing system would be useful, a consortium of corporate counsel and outside counsel developed the Uniform Task-Based Management System (UTBMS) in cooperation with two leading law associations, the American Bar Association and the American Corporate Counsel Association. Departments could also use the UTBMS to implement code provisions.



Simple and straightforward, the UTBMS supports business objectives including planning, budgeting, and analysis.



Published in 1995, the UTBMS is a budget and billing system designed to provide clients and outside counsel with meaningful cost information on legal services by using standard codes and descriptions. The UTBMS also requires outside counsel to provide budget estimates by the phase or activity of the case and to organize invoices to match the estimates. Although it was designed to be simple and straightforward to ensure widespread use, the UTBMS was also designed to support a number of business objectives, including planning and budgeting, status monitoring and reporting, invoice preparation, and invoice review and analysis. In a recent survey of corporations by the national accounting and consulting firm, Price Waterhouse, 12 percent were already using and 29 percent planned to use the UTBMS. Outside counsel are likely to comply with a department's request to use the UTBMS because it is becoming widely accepted.

Appendix A contains a sample litigation budget and invoice format that includes the litigation phases from the UTBMS.

Departments Do Not Consistently Use Contract Provisions To Help Control Legal Contract Costs

In our review of legal services contracts, we found inconsistent use of contract provisions among departments. Although we found some good examples of contract provisions, all departments were not using similar provisions. For instance, only two departments we reviewed, the California Department of Corrections and the Department of Social Services, included a provision in some of their legal services contracts that outside counsel provide the necessary representation by staff qualified to perform the legal tasks at the least costly billing category.



Explicit contract provisions minimize misunderstandings and are another method to control costs.



Departments cannot hold outside counsel to specific terms if the provisions are not included in their contracts or other documents. In addition, departments should not have to negotiate with their outside counsel when costs appear too high or are not within contract provisions. Departments should instead make their expectations and requirements clear when initiating the contract. Including restrictive but reasonable contract provisions in legal services contracts gives the department another method to control costs.

Some contracts we reviewed limited outside counsel's use of additional attorneys while others did not. Specifically, the Commission on Teacher Credentialing (CTC) did not include a provision to limit the reimbursement for the number of outside counsel attending a hearing or working on the case without prior authorization. The CTC staff could only question why six attorneys were working on the case when it reviewed the invoice after the work was complete. If it had included a contract provision that limited the number of attorneys working on the case, the outside counsel would have needed the CTC's approval before adding more attorneys to the case. Without this provision, it was obligated to pay the invoice or negotiate with outside counsel to reduce charges. It decided to pay the invoice.

On the other hand, the DWR included a provision in its contract for bond counsel services that outside counsel must notify the department in advance regarding new or replacement counsel. Its outside counsel did decide later to add more attorneys to work on the contract. However, as required in the contract, the outside counsel notified the DWR of the names of new attorneys and their hourly rates prior to the new attorneys' work on the contract. This provision allowed the DWR to verify that more attorneys were necessary before incurring any costs.

The departments said that when they had concerns with charges, they successfully negotiated with outside counsel to reduce them. However, in our opinion, departments were limited in their ability to control costs because they did not consistently include provisions in their legal services contracts.

Departments also lack guidance on the use of contract provisions. Legal staff from different departments periodically consult with one another, but there is no systematic method to share information about legal services contracts. The DGS is in a position as the entity that approves all legal contracts to help departments improve their contracting practices. However, it has not published a list of suggested contract provisions.

Appendix B contains examples of contract provisions we found during our contract review and research. By using these provisions, departments may be able to better manage their legal services contracts and contain costs.

***Departments Need To Improve
Their Internal Controls
Over Payment of Invoices***

Three of the four departments we reviewed did not consistently follow good internal controls to ensure compliance with their legal services contract provisions. Specifically, these departments did not always determine that invoices were adequately supported or mathematically accurate before making payments. In addition, they approved invoices with charges that were not consistent with contract terms. Further, the California Department of Corrections paid 14 of the 17 invoices we tested without reviewing them for mathematical accuracy and paid all 17 invoices we tested without matching hourly rates with the contract. However, we found no instances when the services were not performed. See Table 3 for the results of our testing.

Table 3

***Weaknesses in Processing Invoices for Payment
Fiscal Year 1995-96 Contracts***

Departments	California Department of Corrections	Commission on Teacher Credentialing	Department of Social Services	Department of Water Resources	Total
Number of contracts tested	6	1	2	5	14
Number of invoices tested	17	1	3	12	33
Missing documentation for nonlegal services, such as phone, photocopy charges, or computer research	14		1	9	24
Invoices not checked for mathematical accuracy	14				14
Attorney and rates shown in invoices not matched to contract	17				17
Travel expense claims not checked for compliance with contract provisions	3				3

Staff at these departments said they were not consistently reviewing invoices before payment because of staff oversights. Unless departments adequately review their invoices, errors may go undetected and departments may pay too much for some services or pay for costs not in contracts.

Recommendations

To ensure better and more cost-effective management of legal contracts, the Legislature should amend the Public Contract Code, Section 10353.5, to mandate, rather than make voluntary, that departments require their legal contractors to adhere to legal cost and billing guidelines, litigation plans, case phasing of activities, and budgets.

To guide departments in more closely managing their legal services contracts, the DGS should:

- Include more explicit direction in the State Contracting Manual to help departments implement management tools.
- Consider adopting the UTBMS in the State Contracting Manual.
- In cooperation with other departments, develop standard contract provisions for legal services contracts to ensure that departments retain proper control and contain costs.

To use state funds as economically as possible, departments should ensure that contracts with outside counsel or separate documents include all the elements necessary to evaluate the services received. Departments should take the following actions:

- Exercise the options already available under the Public Contract Code to require outside counsel to provide budget estimates and litigation plans.
- Until the DGS acts, consider adopting the UTBMS as a process to manage contracts with outside counsel.
- Ensure that invoices are adequately supported, mathematically accurate, and consistent with contract terms before paying them.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,

A handwritten signature in black ink, reading "Kurt R. Sjoberg". The signature is written in a cursive, flowing style.

KURT R. SJOBERG
State Auditor

Date: December 23, 1997

Staff: John Baier, CPA
Jeffrey Winston, CPA
Arn Gittlemen
Virginia Anderson Johnson

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Appendix A

Sample Budget and Invoice Summary Format by Activity

Case Name or Number		For Budget Period		From Beginning of Contract	
		Budget	Billed to Date	Budget	Billed to Date
Services Provided	Current Month Billed				
L100	<u>Case Assessment, Development and Administration</u>				
	L110 Fact Investigation/Development				
	L120 Analysis/Strategy				
	L130 Experts/Consultants				
	L140 Document/File Management				
	L150 Budgeting				
	L160 Settlement/Non-Binding Alternative Dispute Resolution				
	L190 Other Case Assessment, Development and Administration				
L200	<u>Pre-Trial Pleadings and Motions</u>				
	L210 Pleadings				
	L220 Preliminary Injunctions/Provisional Remedies				
	L230 Court Mandated Conferences				
	L240 Dispositive Motions				
	L250 Other Written Motions and Submissions				
	L260 Class Action Certification and Notice				
L300	<u>Discovery</u>				
	L310 Written Discovery				
	L320 Document Production				
	L330 Depositions				
	L340 Expert Discovery				
	L350 Discovery Motions				
	L390 Other Discovery				
L400	<u>Trial Preparation and Trial</u>				
	L410 Fact Witnesses				
	L420 Expert Witnesses				
	L430 Written Motions and Submissions				
	L440 Other Trial Preparation and Support				
	L450 Trial and Hearing Attendance				
	L460 Post-Trial Motions and Submissions				
	L470 Enforcement				
L500	<u>Appeal</u>				
	L510 Appellate Motions and Submissions				
	L520 Appellate Briefs				
	L530 Oral Arguments				
Total					

Source: American Bar Association, Uniform Task-Based Management System Litigation Codes (with minor modifications).

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Appendix B

Contract Provisions for Legal Services Contracts

In our review of legal services contracts, we found some contracts contained one or more of the following provisions. We found other provisions in our review of information from organizations that review and audit legal contracts and invoices. These provisions may provide departments with better control and additional tools to manage their legal services contracts and contain costs.

- The department will reimburse all travel at state rates unless an exception is granted in writing before travel occurs.
- The department will not reimburse outside counsel for travel time unless outside counsel is completing work during the travel time on the department's behalf.
- The department will not reimburse outside counsel for administrative costs, including any time needed to resolve billing matters.
- The department will approve in advance replacement or additional attorneys working on the case. Changes in staff will not result in unnecessary or unreasonable charges to the department for training, internal conferences or management.
- The department will approve in advance any extraordinary expenses such as the use of expert witnesses or consultants.
- Outside counsel will provide the minimum number of staff necessary to adequately complete the required task or achieve the desired result.
- Outside counsel will list the specific staff working on the case by name with applicable hourly rate.
- Outside counsel must provide documentation for nonlegal services such as phone and photocopy charges, computer research, or messenger services for which they request reimbursement.

- Outside counsel shall provide the necessary representation by staff qualified to perform the legal tasks at the least costly billing category.
- Outside counsel will use department staff when possible to complete research or attend meetings.
- Outside counsel will track expenses and immediately notify the department when it expects to reach 75 percent to 80 percent of the current phase or contract amount.

Response to the report provided as text only

State and Consumer Services Agency
OFFICE OF THE SECRETARY
915 CAPITOL MALL, SUITE 200
SACRAMENTO CA 95814

December 17, 1997

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

RE: STATE LEGAL CONTRACTS: THE STATE COULD REDUCE ITS RELIANCE
ON OUTSIDE COUNSEL AND BETTER MANAGE CONTRACTS

Enclosed is our response prepared by the Department of General Services and the State Personnel Board to the Bureau of State Audits' Report No. 97102 entitled "State Legal Contracts: The State Could Reduce Its Reliance on Outside Counsel and Better Manage Contracts," as well as a copy of the responses on a diskette.

If you have any questions or need additional information, please contact me at 653-4090.

Sincerely,

GEORGE VALVERDE
Deputy Secretary

Enclosures

M e m o r a n d u m

Date: December 16, 1997

File No.: 97102

To: Joanne C. Kozberg, Secretary
State and Consumer Services Agency
915 Capitol Mall, Room 200
Sacramento, CA 95814

From: **Department of General Services
Executive Office**

Subject: **RESPONSE TO BUREAU OF STATE AUDITS' REPORT NO. 97102 — "STATE LEGAL CONTRACTS:
THE STATE COULD REDUCE ITS RELIANCE ON OUTSIDE COUNSEL AND BETTER MANAGE
CONTRACTS."**

Thank you for the opportunity to respond to Bureau of State Audits' (BSA) Report No. 97102 which addresses two recommendations to the Department of General Services (DGS). The following response addresses each of the recommendations.

OVERVIEW OF THE REPORT

The DGS has reviewed the findings, conclusions and recommendations presented in Report No. 97102. As discussed in this response, the DGS will take appropriate actions to address the recommendations.

As noted in the report, each state department is responsible for its own contracting program. To assist state departments in complying with their responsibilities and to accomplish its oversight responsibilities, the DGS has implemented numerous administrative control activities. The DGS has also established and works closely on contracting issues with a group comprised of state department contracting personnel, i.e., the State Contracting Advisory Network (SCAN). The results of the BSA's audit of legal services contracts will be presented to the SCAN.

The BSA's primary area of concern within the DGS' preview involves the adequacy of the practices used by state departments in managing their legal services contracts. The DGS has already recognized the need for improved contract management and taken a number of significant actions, including issuing an extensive toolbox on state contracting, i.e., the State Contracting Manual (SCM), and implementing a comprehensive contract training course. As deemed necessary, additional actions will be taken to specifically address management practices for legal services contracts.

RECOMMENDATIONS

CHAPTER 1

RECOMMENDATION # 1: *The Department of General Services and the State Personnel Board should develop criteria for determining whether contracts are adequately justified under this section.*

DGS RESPONSE # 1:

The DGS has always been committed to ensuring that the legal services contracts it reviews are adequately justified including having a legally sufficient justification in accordance with Government Code Section 19130(b). Although simple documentation of the justifications has historically been deemed sufficient, the recent challenges of these contracts may make it prudent to expand the documentation. Therefore, the DGS will consult with both the State Personnel Board and the Department of Justice to determine the extent that the justifications need to be documented during the contract approval process and what information needs to be present for acceptance of a justification.

CHAPTER 2

RECOMMENDATION # 1: *To guide departments in more closely managing their legal services contracts, the DGS should:*

- *Include more explicit direction in the State Contracting Manual to help departments implement management tools.*
- *Consider adopting the UTBMS in the State Contracting Manual.*
- *In cooperation with other departments, develop standard contract provisions for legal services contracts to ensure that departments retain proper control and contain costs.*

DGS RESPONSE # 1:

The DGS has been actively working with its client agencies to improve communications and provide additional direction in contracting. This has resulted in the formation of the SCAN and, working with the SCAN, the development of the SCM. Prior to issuing the SCM in July 1996, the state's contracting policies did not address the management of contracts after award. By addressing this important issue in the SCM, the DGS provided better tools for the management of contracts. The SCM contains a separate chapter specifically addressing contract management issues. In addition, during the 1996/97 fiscal year, the DGS' Office of Legal Services developed and implemented a more comprehensive contract training course. This three-day course includes a contract management module that stresses cost containment and the need for close attention to ensuring that the state is receiving best value.

At this time, the DGS is emphasizing the overall utilization of contract management tools. However, with the help of SCAN, the department expects this evolutionary effort to yield the development of detailed guidelines and management tools for different types of contracts, including legal services. As these guidelines are developed, the DGS will disseminate the information to state departments.

When guidelines for legal services contracts are developed, the DGS will ensure that the use of task-based budgeting and billing processes are considered either through adoption of the UTBMS or an alternative system; however, this will likely be a long range project since a

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*The California State Auditor's comments on this response begin on page 33.

2 considerable amount of study will be required. As indicated in the BSA's report, a recent survey by Price Waterhouse found that only 12% of corporate law firms surveyed were using the UTBMS. Consequently, requiring use of such a system could limit the state's choice of law firms. Therefore, a determination would need to be made as to if adding such a requirement would have any negative effects on the state's contracting program. Of particular concern would be if any of the law firms commonly used by the state would be unwilling to work for the state if required to use a task-based fiscal system. Further, if willing to work for the state, would the firms increase their billing rates to cover the extra costs of providing additional billing details.

For the final action recommended, the DGS has been working with the SCAN in developing standard contract provisions. Currently, the project has resulted in both the identification of provisions to be used in all contracts and additional provisions to be used in specific types of contracts. After finalization of the provisions, they will be disseminated to all state departments. The DGS will review the BSA's recommended contract provisions for legal services with SCAN and will ensure that they are given appropriate consideration.

CONCLUSION

The DGS has a firm commitment to provide efficient and effective oversight of the state's contracting program. As part of its continuing efforts to improve policies over this program, the DGS will take appropriate actions to address the issues presented in the report.

If you need further information or assistance on this issue, please call me at 445-3441.

PETER G. STAMISON, Director
Department of General Services

PGS:RG:ac:worddata:director:97102res

Comments

California State Auditor's Comments on the Response From the Department of General Services

To provide clarity and perspective, we are commenting on the Department of General Services' (DGS) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① We are encouraged that the DGS, through the help of the State Contracting Advisory Network, expects to eventually develop detailed guidelines and management tools for different types of contracts, including legal services contracts. Considering the high cost of outside counsel and the lack of adequate management tools used by departments, we would expect the DGS to act quickly to provide this guidance.
- ② The DGS is concerned that, under a task-based billing system, some outside counsel would be unwilling to work for the State or would charge more to provide this information. However, this concern should not prevent the DGS from determining the feasibility of task-based budgeting and billing.

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Response to the report provided as text only

California State Personnel Board
801 Capitol Mall
Sacramento, California 95814

Date: December 16, 1997

To: Kurt R. Sjoberg
State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

From: State Personnel Board

Subject: Bureau of State Audits Report "State Contract: The State Could Reduce Its Reliance on Outside Contracts and Better Manage Contracts"

I appreciate the opportunity to comment on the excerpts of the report that directly involve the State Personnel Board (Board)

Recommendation:

The current policy of the state is that the DOJ is the primary litigator for most departments in judicial matters. If the Legislature believes this policy continues to be appropriate, it should then have the DOJ complete a staffing and workload study to determine if the DOJ has sufficient staff to represent departments.

Based on the results of this study, the Legislature should authorize sufficient staffing and funding so that the DOJ does not decline work because of a lack of staff.

The Legislature should consider modifying California Government Code Section 19130(b) to permit departments to contract for litigation services when the DOJ declines to represent departments due to insufficient staff.

Unless the Legislature modifies California Government Code, Section 19130(b), as recommended, departments should provide appropriate justification to allow the Department of General Services to review contracts for compliance with this section. Further, the Department of General Services and the State Personnel Board should develop criteria for determining whether contracts are adequately justified under this section.

Board Response:

The Board fully supports the recommendation to complete a study of the state's litigation and staffing needs and the authorization of sufficient staffing and resources to ensure that the Department of Justice (DOJ) does not decline work because of inadequate staff. The Board will work with DOJ to ensure that the Civil Service System provides highly qualified and timely personnel to staff the department on a timely basis.

Upon implementation of the results of the above study, the Board would support a revision to Government Code section 19130(b) that would permit contracting¹ for legal services in those limited instances when DOJ and the department do not have staff available and cannot acquire staff through the civil service system to adequately and competently represent the departments in litigation. We believe that this revision will comply with requirements of Article VII of the Constitution.

Finally, we agree that the Board and the Department of General Services (DGS) should develop criteria for determining when contracts are adequately justified and departments should submit necessary justification to (DGS) to ensure that contracts comply with Government Code section 19130(b). The Board has already initiated discussion with DGS and will work with the department to develop criteria consistent with the law.

The Board believes that the study and recommendations will result in improvements in the management of the state's legal services and will work with departments and the Legislature to implement the recommendations.

Walter Vaughn
Acting Executive Officer
(916) 653-1028

¹ In addition to those provisions already provided in Government Code section 19130(b) for contracting for legal services (conflict of interest, expertise, etc).

Response to the report provided as text only

Daniel E. Lundgren
Attorney General

State of California
Department of Justice
1300 I Street, Suite 125
P.O. Box 944255
Sacramento, CA 94244-2550
(916) 445-9555
(916) 323-5317
(916) 324-5431

December 17, 1997

Kurt R. Sjoberg, California State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

RE: Draft of Report to Joint Legislative Budget Committee

Dear Mr. Sjoberg:

The Bureau of State Audits has provided this office draft text of certain portions of its report to the Joint Legislative Budget Committee entitled, "State Legal Contracts: The State Could Reduce its Reliance on Outside Counsel and Better Manage Contracts." The excerpted portions of the report address the role of the Attorney General's Office as the principal law office within California State Government, and its responsibilities connected with consent to employment of outside counsel.

The excerpted portions have been reviewed by me as Chief Assistant Attorney General for the Civil Law Division of the Attorney General's Office. The portion thereof pertaining to this office's services in the area of prison inmate litigation has also been reviewed by George Williamson, Chief Assistant Attorney General for the Criminal Law Division. My review reflects that the information reported is substantially accurate, and I have no additional comments concerning the portions of the report thus reviewed. Mr. Williamson states that the portion of the report reviewed by him is in his view likewise substantially accurate, and that he has no comments on its contents.

We have appreciated the opportunity to comment upon the draft text provided to the Attorney General's Office for review.

Sincerely,

DANIELE L. LUNGREN
Attorney General

ROBERT L. MUKAI
Chief Assistant Attorney General
Civil Law Division

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Response to the report provided as text only

STATE OF CALIFORNIA

PETE WILSON, Governor

COMMISSION ON TEACHER CREDENTIALING
1812 Ninth Street
Sacramento, California 95814-7000
(916) 445-0184
FAX (916) 327-3166

OFFICE OF THE EXECUTIVE DIRECTOR

December 18, 1997

Kurt R. Sjoberg, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

Thank you for making the modified recommendations on page 2-5 of the audit report concerning our CBEST contract for legal services.

With this amended version of the language in the first paragraph on the above page, I hereby concur with the recommendations presented and respectfully withdraw our proposed changes to the Bureau's report.

Sincerely,

Sam W. Swofford, Ed.D.
Executive Director

cc: John Baier, State Auditor's Office
Paul Longo, CCTC General Counsel

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Response to the report provided as text only

STATE OF CALIFORNIA

PETE WILSON, Governor

YOUTH AND ADULT CORRECTIONAL AGENCY

Office of the Secretary
1100 11th Street, Suite 400
Sacramento, CA 95814
(916) 323-5565/FAX (916) 442-2637

December 17, 1997

Kurt R. Sjoberg
California State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

Thank you for the opportunity to comment on the excerpts from your draft report on State legal contracts. My staff and I appreciate the diligence and hard work that went into your review. I particularly appreciate your admonishment that "[t]he State can look to the private sector for ideas and methods [to improve management]." I wholeheartedly concur. Indeed, my staff have advised me that the temporarily increased use of private counsel that has occurred in the last few years will have a beneficial "seeding" effect on the more effective use of lawyers (contract or civil service) by the State for years to come.

Enclosed are some comments on the excerpts of the report you provided to us. Let me assure you that we will be using your findings and recommendations to continue to improve our management of this function.

As requested, enclosed is a copy of our response on a PC compatible file in text format.

Please do not hesitate to contact Pamela Smith-Steward, Deputy Director (A), Legal Affairs, at (916) 327-4544 if you wish to discuss this further.

Sincerely,

THOMAS M. MADDOCK
Agency Secretary (A)

Enclosures

Report Title: The State Could Reduce Its Reliance On Outside Counsel.

CDC Comment: The department believes that the findings and recommendations in the report address the effective and appropriate use of outside counsel rather than an overall reduction in the department's need for the legal services provided by outside counsel or other resources. Presently, we are experiencing a decline in the need for outside counsel (other than conflict counsel) and we anticipate that this trend will continue, however, as permitted by Government Code §996, this department will continue to rely on outside counsel to provide these services when civil service staff cannot provide them.

Finding: Department of Justice's Assertion of Insufficient Staff Is Not a Statutory Basis for Contracting.

Recommendation: a. Amend Government Code §19130(b) [proposed language not provided in draft report].
b. The Department of General Services should review all contracts for compliance with Government Code §19130.

CDC Response: The department concurs that some amendments to Government Code §19130 may be appropriate to increase our flexibility in meeting our responsibilities. The department is statutorily obligated to provide a legal defense for its employees pursuant to Government Code §995. If the Department of Justice cannot obtain the staff, this department is not excused from its obligations. Rather than just shifting the immediate burden of finding a lawyer to the employee defendants, this department will continue to look to other alternatives, including outside counsel, to meet its obligation.

Since no further information on the proposed amendment language was provided, it is not possible to comment in any more detail on this finding.

Finding: Departments Do Not Use Adequate Management Tools To Monitor Legal Contracts.

Recommendation 1: The department should require the outside counsel to provide budget estimates and litigation plans as is permitted by Public Contract Code §10353.5.

CDC Response: The department concurs that litigation plans and budgets should be utilized where appropriate and has already been utilizing these tools in many respects. To the extent that outside contracting for legal services

continues, the department will increase its emphasis and use of these management tools.

In the correctional law area, the volume and relatively small size of the cases led the department to use contract budgets and litigation plans rather than budgets and plans specific to each case. These efforts were followed by random audits of case files by department staff counsel to ensure consistency of the litigation plans and contractor billings. In the employment law area and contract dispute area, litigation plans and budgets were often but not always required. In the future, the department will mandate this requirement in all but the simplest of matters.

The department does not concur that it is in the state's best interest to rigidly force the firms to remain within an original budget plan or litigation plan for each case because that assumes a certain amount of predictability and control over the litigation which does not exist. A hallmark feature of almost all of these cases is that the department or a department employee is a defendant and as a defendant is only partially in control of the litigation. The plaintiff sets the pace and the defendant must react. While it is safe to assume that not every case will be hard fought, it is difficult to predict in the early stages which cases will. Thus, a strict adherence to case budgeting will not be successful. The department believes that it is better to retain some flexibility to respond to the most active cases even though the original budgets and litigation plans may later be exceeded.

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Recommendation 2: The department should consider adopting the "Uniform Task-Based Management System" (UTBMS) as a process to manage contracts with legal counsel.

CDC Response: The department has been monitoring the development of this system since its inception, however the department believes the system is still too developmental to adopt except as a possible pilot project. The UTBMS is a standard format for describing the tasks, activities and expenses of a legal services contractor. It is a definitional system and not, in and of itself, a mechanism for preparing budget estimates and litigation plans. The UTBMS was proposed in 1995 (the period of the audit) by the American Bar Association Section of Litigation, the American Corporate Counsel Association and a group of corporate law departments and law firms. In September 1997, Price Waterhouse completed a survey of 251 law departments (51% correspond to Fortune 500 companies). Of those surveyed, 12% indicated that they used the UTBMS and another 29% indicated that they planned to implement the system. Therefore, approximately 30 of the 251 law departments queried currently use the

UTBMS. While the system's usage appears to be increasing, at this time it is unknown whether it will gain widespread acceptance in the legal industry.

It is our opinion that some form of task-based billing may be useful in comparisons between firms for matters which are relatively uniform and simple, such as routine inmate or employee litigation, however, some process changes would need to be established within both the firms and the department to collect and evaluate the data. A recent literature survey indicates that software to assist in this activity must be custom designed and "off the shelf" packages are still under development. In the long term, the department does believe that the UTBMS or a similar system may mature into a cost-effective tool for the management of legal services in much the same way that building construction is now managed with project management tools. However, until such time, the department is hesitant to adopt a system which is still emerging and developing.

②

In addition, we should note the somewhat sensitive relationship between the department and outside firms serving as conflict counsel. Although the department monitors the activity of its conflict counsel, it must proceed more cautiously. This situation is analogous to a practice in the insurance industry whereby insurance companies must pay for special conflict counsel to represent insureds when a conflict of interest arises.¹ Some years ago, in an attempt to curb purported overbilling and unnecessary litigation by such counsel, insurance companies began aggressively auditing the outside firms and questioning litigation plans and billing practices. This "total warfare" approach resulted in unhealthy tensions between insurance companies and insurance defense lawyers to the detriment of both the insurance industry as well as the insureds.² The department has been successful in not creating similar tensions while maintaining a satisfactory relationship with conflict counsel.

③

1 Such practice was established in the case of San Diego Navy Federal Credit Union v. Cumis Insurance Society Inc. (1984) 162 Cal.App.3d 358. In 1988, California Civil Code §2860 was enacted, which controls the rates that can be charged by outside counsel and requires outside counsel to report to the insurance company and cooperate with defense attorneys provided by the insurance companies.

2 J. Stratton Shartel, "Tensions Between Insurers, Outside Counsel Remain Near the Boiling Point," Inside Litigation, October 1993.

Finding: Departments Do Not Consistently Use Contract Provisions To Help Control Legal Contract Costs.

Recommendation: Adopt the recommended provisos in all state legal services contracts.

CDC Response: The department concurs that clear expectations and requirements improve the management of legal services contracts and is pleased to note the Bureau of State Audits' recognition of our efforts in this area. Long before the audit by the Bureau of State Audits, the department developed a standard form agreement to be used just with legal service contractors. In addition to the proviso on the least costly billing category noted in your report, our form agreement has included almost all of the provisos in your recommendation, including a documentation requirement for all expenses, vendor certification of the correctness of the invoice, and a limitation of travel expense reimbursement rates and conditions to the same offered to excluded employees by the Department of Personnel Administration. The department believes it has achieved additional savings over normal state contracting processes even though these new requirements increase the burden of review on department staff and increase the potential for technical errors leading to audit findings such as occurred here.

The department is not prepared to adopt the recommended proviso mandating when possible the use of department staff to complete research or attend meetings. For matters where there is a representational conflict, it would be unethical to use state staff. For other matters, the outside counsel are usually being employed because state staff are not available or lack the technical expertise to handle the work. However, the department does remain vigilant to avoid duplication and efficiently utilize all of its resources. (4)

Finding: Departments Need To Improve Their Internal Controls Over Payment of Invoices

Recommendation: The department should ensure that invoices are adequately supported, mathematically accurate, and consistent with contract terms before payment.

CDC Response: The department concurs that invoices should be adequately supported and the appropriate staff are assigned to review invoices for mathematical accuracy, and consistency with contract terms. These are standard procedures stated in the State Administrative Manual which are followed by this department. However, due to staff turnover, specific individuals did not follow the procedures, which resulted in a weakness in the internal control of the invoice review process during the period covered by the

audit. This deficiency was detected by the department early in Fiscal Year 1996/97, prior to the start of the audit, and steps had been initiated to correct the situation. The audit reinforced the need to maintain proper internal controls. Since the audit, more detailed procedures have been written and training has been provided to appropriate staff.

The department has reviewed the specific contracts and invoices reviewed by the Bureau of State Audits to determine whether there were erroneous payments made. In addition, the department has initiated a sample review of contracts and invoices paid subsequent to the audit period. None of the 14 invoices reviewed by the Bureau of State Audits or selected in the department's review of subsequent invoices, were found to have mathematical errors. However, several of the 14 invoices reviewed had supporting documentation missing. The internal control deficiency during the audited period and the subsequent fiscal year does not appear to have resulted in any significant erroneous payments, however, the department recognizes the importance of good internal controls and accounting procedures. Efforts will be continued to improve the invoice review and payment process. In addition, the department intends to continue to perform sample reviews of these contract payments made during Fiscal Years 1995/96 and 1996/97. If erroneous payments are found, corrective steps will be taken with the contracted firm and overpayments will be collected.

Comments

California State Auditor's Comments on the Response From the California Department of Corrections

To provide clarity and perspective, we are commenting on the California Department of Corrections' (CDC) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① The CDC misinterprets our recommendation. Our intent was not that departments should rigidly enforce the original budget estimate or litigation plan. As we state on page 18, long-term budgets and litigation plans need to be flexible to reflect the changing needs of litigation. Further, we suggest that departments use detailed budgets in the short term such as the 60- to 90-day budgets that some corporations use. As the cases progress, departments need to use their judgment in determining the extent of detail in the budgets and litigation plans.
- ② The CDC is too quick to dismiss the usefulness of the Uniform Task-Based Management System (UTBMS), particularly since the CDC lacks sufficient management tools to monitor its legal contracts. The UTBMS provides a detailed framework, organized by phases and tasks, for developing litigation plans, budgets, and billing documents. If used properly, the UTBMS can be an additional management tool to monitor the activities and costs of outside counsel.
- ③ We appreciate that the CDC must maintain an arm's length distance with conflict counsel. However, the use of good management tools need not lead to "total warfare" or unsatisfactory relations with outside counsel.
- ④ We recognize that judgment plays an important part in determining which contract provisions are applicable to a given contract.

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Response to the report provided as text only

STATE OF CALIFORNIA - HEALTH AND WELFARE AGENCY PETE WILSON, Governor

DEPARTMENT OF SOCIAL SERVICES
744 P Street, Sacramento, CA 95814

December 16, 1997

KURT R. SJOBERG, State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

**SUBJECT: BUREAU OF STATE AUDITS (BSA) REPORT ON THE
CALIFORNIA DEPARTMENT OF SOCIAL SERVICES' (CDSS)
PROCESS FOR CONTRACTING WITH PRIVATE COUNSEL
FOR LEGAL SERVICES/BSA AUDIT 9-7102**

The Secretary, Health and Welfare Agency, has requested CDSS' comments regarding the findings and recommendations contained in the above cited BSA audit report. Our comments are enclosed.

We appreciate the many opportunities your staff have provided our Department to furnish information and respond to the auditors' findings during the audit process.

If you have any questions regarding our comments, please have your staff contact Lawrence Bolton, Deputy Director, Legal Division at (916) 567-2353.

Sincerely,

ELOISE ANDERSON
Director

Enclosure

c: Burt Cohen
 Lawrence Bolton
 Jarvio Grevious

**CALIFORNIA DEPARTMENT OF SOCIAL SERVICES (CDSS)
COMMENTS IN RESPONSE TO BSA AUDIT 9-1702**

Findings:

Departments do not use adequate management tools to monitor legal contracts. Contracts do not contain performance criteria. Contracts do not use Uniform Task-Based Management System (UTBMS) guidelines (ABA-approved budget and billing system/requires contractor to provide budget estimate for each phase or activity; requires litigation plan; etc.).

- Departments Do Not Consistently Use Restrictive Contract Provisions.
- Departments Need To Improve Their Internal Control Over Payment For Services.

Recommendations:

Departments should ensure their contracts include all elements necessary to assess contractors progress and evaluate the services received. To achieve these objectives, departments should take the following actions:

- I. The CDSS should exercise the options already available under the Public Contract Code (PCC) to require private legal counsel to provide budget estimates and litigations plans.**

CDSS Response:

Concur. Some needs for legal services are sufficiently contingent and uncertain that the CDSS could not require budget estimates and litigation plans at the outset. An example would be a dispute with a vendor which could potentially lead to settlement, to cancellation of the contract, or to litigation. The number of variables outside the control of CDSS would make a budget estimate impracticable at that point. However, as a legal matter advances, the number of variables will be reduced and budget estimates will become more realistic. A detailed litigation plan is a reasonable requirement once a matter goes into litigation. The specificity which CDSS can request in the litigation plan will vary with the stage of the litigation and the nature of the litigation. Nonetheless, CDSS agrees that it should request estimates and litigation plans from outside counsel as soon as those estimates and plans become practical, and should request estimates and plans of increasing specificity as a matter evolves. CDSS will include a requirement of contractors to provide budget estimates and litigation plans, to the degree of specificity reasonably possible in the circumstances, in contracts and amendments of contracts for legal services contracts.

II. The CDSS should consider adopting the “Uniform Task-Based Management System” as a process to manage contracts with private legal counsel.

CDSS Response:

Concur. The UTBMS sponsored by the American Bar Association (ABA) is a standard format for describing the tasks, activities and expenses a legal services contractor might charge to the state. The only purpose of the UTBMS is to provide a single vocabulary for describing those tasks, activities and expenses. The UTBMS would thereby help avoid confusion about the nature of invoiced items and would help the reviewer of the invoice confirm the validity of the charges. The UTBMS is not of itself a mechanism for preparing budget estimates and litigation plans, although the UTBMS terminology could certainly be used in describing the cost items in budget estimates. Within its inherent limits, the UTBMS would be of benefit in reviewing billings by legal services contractors. The CDSS will therefore consider incorporating a requirement of its use or that of a comparable litigation management system in contracts and in amendments to contracts for legal services.

III. The CDSS should ensure that invoices are adequately supported, mathematically accurate, and consistent with contract terms before paying them.

CDSS Response:

Concur. The CDSS agrees that only invoices which are adequately supported, mathematically accurate and consistent with contract terms should be paid. The CDSS pays only such invoices. The CDSS does not currently require legal services contractors to document all claimed business expenses such as photocopy, courier and facsimile costs, provided that the claimed expenses appear reasonable and accurate in light of the contractor’s known work. The CDSS will consider incorporating a requirement of such documentation of other than minor business expenses in contracts or amendments of contracts for legal services.

Findings:

Department of Justice’s assertion of insufficient staff is not a statutory basis for contracting.

Recommendations:

Unless the Legislature modifies California Government Code, Section 19130(b), as recommended, departments should provide appropriate justification to allow the Department of General Services to review contracts for compliance with this section.

CDSS Response:

Concur. However, until such legislative modifications occur, departments lack options for responding to lawsuits when the Department of Justice declines to represent departments because of insufficient staff resources. CDSS believes this is a matter which is more appropriately directed to Department of Justice.

Response to the report provided as text only

State of California

The Resources Agency

M e m o r a n d u m

Date: December 17, 1997

To: Kurt Sjoberg
State Auditor
Bureau of State Audits
660 J Street, Suite 300
Sacramento, California 95814

From: **Department of Water Resources**

Subject: Response to Draft Report re: State Legal Contracts

Secretary for The Resources Agency Douglas P. Wheeler has referred the above-referenced draft report, "State Legal Contracts," dated December 1997, to the Department of Water Resources for review and comment.

We have reviewed the draft report, and we appreciate the recommendations that you have provided. The Department continually strives to identify ways to improve its process for closely overseeing outside counsel contracts and intends to look for opportunities to incorporate the audit recommendations in these efforts.

Your suggestion regarding the Uniform Task-Based Management System is of particular interest. We plan to pursue opportunities to experiment with its use. We note, however, that many of the corporate participants in developing the system, as indicated in the materials found at the American Bar Association website, are large, multi-national corporations, presumably with many outside counsel contracts, which is different from our situation.

If you have any questions, please contact me or your staff may contact Susan Weber, DWR's Chief Counsel, at (916) 653-6186.

David N. Kennedy
Director
(916) 653-7007

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps