

California State Auditor

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

City of Los Angeles:

*Outside Counsel Costs Have Increased,
and Continued Improvement in the City's
Selection and Monitoring Is Warranted*



January 2006
2004-136

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CALIFORNIA STATE AUDITOR

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January 26, 2006

2004-136

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 City of Los Angeles (City) and the Office of the City Attorney (Attorney's Office) and the City's use of outside counsel including the costs associated with outside counsel, the manner in which the Attorney's Office fulfills its role in selecting outside counsel, and the oversight that office provides.

This report concludes that outside counsel costs for the City over the six-year period ending in fiscal year 2004–05 almost doubled, rising from \$17.5 million to \$31.9 million. Two of the City's proprietary departments—the Department of Water and Power and the Los Angeles World Airports—greatly contributed to these costs. Our review of the outside counsel costs the City reported in response to a special inquiry revealed several significant inaccuracies and inconsistencies by various city departments. The Attorney's Office will need to keep these in mind as it moves forward with its recently implemented procedure for periodically reporting outside counsel costs on a citywide basis. Moreover, the Attorney's Office could not provide documents to demonstrate that it had followed its policies for assessing the need for outside counsel and in performing its role in selecting outside counsel. In addition, although its policies for monitoring outside counsel's work provided sufficient direction for good case management, the Attorney's Office did not always follow them. Finally, the Attorney's Office eliminated numerous charges that conflicted with its comprehensive invoicing policies, but it could improve its review of invoices as it paid outside counsel for some costs that were not allowed by its policies.

Respectfully submitted,

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SUMMARY

Audit Highlights . . .

Our review of the Office of the City Attorney's (Attorney's Office) use of outside counsel revealed:

- ☑ *The costs for outside counsel have risen from \$17.5 million to \$31.9 million over the six-year period ending in fiscal year 2004–05.*
 - ☑ *The Attorney's Office lacked documents necessary to demonstrate it followed its policies and procedures when assessing the need to retain outside counsel and when performing its role in selecting outside counsel.*
 - ☑ *Although its policies for monitoring the work performed by outside counsel provided sufficient direction for good case management, the Attorney's Office did not always follow them.*
 - ☑ *The Attorney's Office eliminated numerous charges from outside counsel invoices, but it could improve its invoice review as it paid outside counsel for some costs its policies did not allow.*
-

RESULTS IN BRIEF

As an elected official within the City of Los Angeles (City), the city attorney serves as chief legal adviser to the mayor, the Los Angeles City Council (city council), and all city boards, officers, and entities. The city attorney controls and manages the Office of the City Attorney (Attorney's Office), which comprises more than 500 attorneys who provide the day-to-day legal services the City needs. The city charter allows the City to retain outside legal counsel to assist the Attorney's Office in meeting the City's legal needs.

Outside counsel costs for the City over the six-year period ending in fiscal year 2004–05 almost doubled, rising from \$17.5 million to \$31.9 million. Some of the largest increases involved the use of outside counsel by the City's proprietary departments—in particular, the Department of Water and Power (DWP) and the Los Angeles World Airports (Airports). For example, the City retained outside counsel for litigation related to the California energy crisis and a comprehensive revision to the master plan for Los Angeles International Airport. The Attorney's Office recommended outside counsel for those matters because it believed it lacked the necessary expertise and resources to handle them.

The City could improve its reporting of outside counsel costs. Our review of the outside counsel costs reported by city departments in response to a special inquiry by a member of the city council revealed several significant inaccuracies and inconsistencies. Although the Attorney's Office recently implemented a procedure for periodically reporting outside counsel costs on a citywide basis, it will need to keep in mind the inaccuracies and inconsistencies we found in data reported by various city departments as it moves forward with the new reporting procedure.

Despite the costs involved, the Attorney's Office believes that its use of outside counsel has resulted in two quantifiable benefits: reductions in amounts paid through settlements or judgments of cases (liability payouts) and significant revenue from litigation in which the City is the plaintiff. Although it is true that liability payouts from the City's General Fund have decreased, the extent to which the use of outside counsel has contributed to the decrease is unknown. Similarly, the Attorney's Office points to certain litigation for which it used outside counsel in matters that have benefited

or are expected to benefit the City or its residents. However, the extent to which the City could have achieved similar results without outside counsel is also unknown.

When retaining outside counsel the Attorney's Office first assesses the need for counsel and, if necessary, conducts a competitive or noncompetitive selection process. The selection process culminates in the Attorney's Office making a recommendation to the city council or appropriate governing board, which makes the final contracting decision. Overall, we found that the Attorney's Office could not provide documents to demonstrate that it had followed the policies and procedures it has in place for making its assessment and performing its role in selecting outside counsel. For example, the Attorney's Office lacked documentation such as written evaluations and rating sheets to demonstrate that it conducted a fair and objective process when performing its role in selecting outside counsel in a competitive manner. Without adequate documentation, the Attorney's Office leaves itself vulnerable to criticisms that its recommendations on outside counsel are not fair and objective.

Although the policies it had in place at the time of our fieldwork for monitoring the work performed by outside counsel provided sufficient direction for good case management, the Attorney's Office did not always follow those policies. As a result, the Attorney's Office risked paying more to outside counsel than was necessary. For example, the Attorney's Office often did not require outside counsel to submit comprehensive budgets. Further, despite their obvious involvement in the matters for which outside counsel were retained, managing attorneys did not consistently ensure that outside counsel submitted the required quarterly reports. Instead, managing attorneys often relied on informal methods of monitoring outside counsel, through telephone, e-mail, or in-person communications.

In November 2005 the Attorney's Office changed its policy on the use of outside counsel. For example, it eliminated the requirement for outside counsel to submit quarterly reports. Instead, it plans to work with outside counsel to provide status reports when the Attorney's Office prepares for updates, at least twice a year, to the city council and others on significant legal cases. Although it is too early to tell what the long-term effects of the policy change will be, the Attorney's Office may be limiting its insight into outside counsel's activities.

The Attorney's Office has established comprehensive policies related to the invoices outside counsel submit, and our testing demonstrated that the Attorney's Office eliminated numerous charges that conflicted with its policies. However, the Attorney's Office could

improve its review of invoices. We found that the Attorney's Office paid some outside counsel costs that were not allowed by its policies. Although its invoicing policies seek to establish a standard for reasonable billing practices, the Attorney's Office undermines those efforts by not consistently identifying all unallowable costs.

An opportunity exists for the Attorney's Office to more efficiently and effectively monitor outside counsel costs. It could do so by preparing budgets detailed by activity and requiring outside counsel to submit invoices with the same level of detail, allowing Attorney's Office staff to compare the invoices to the budgets. From December 2001 to November 2005, Attorney's Office policy directed managing attorneys to help outside counsel create detailed litigation budgets and to periodically compare actual costs against budgeted costs. However, in our review of selected contracts, we found no evidence that Attorney's Office staff made such comparisons. Even though the staff have ensured that total invoices do not exceed total contract costs and have reviewed outside counsel invoices, the invoice review the Attorney's Office performs is labor intensive, and its comprehensiveness and effectiveness are limited. Comparing outside counsel costs to budgeted costs by activity within a given litigation or project phase should enable the Attorney's Office to better facilitate effective communication on the progress of its cases and any deviations from budgets. In November 2005 the Attorney's Office changed its policy by eliminating the requirement to periodically compare actual costs to budgeted costs. However, we continue to believe that those comparisons are an important cost control mechanism.

When the Attorney's Office has an actual or potential conflict of interest in which it cannot ethically represent a city employee whose interests may be adverse to those of the City, it refers the matter to the attorney conflicts panel (conflicts panel), which is made up of attorneys from outside law firms. The Office of the City Administrative Officer (CAO), an entity separate from the Attorney's Office whose primary role is chief financial adviser to the mayor and the city council, is the day-to-day overseer of the conflicts panel. In performing its daily duties, the CAO adequately reviews invoices for compliance with its billing guidelines. However, although the use of budgets can help control costs, the contracts the CAO used did not require outside counsel to submit budgets in all instances.

RECOMMENDATIONS

The City should ensure that the outside counsel costs it reports are accurate and prepared consistently and that costs are adequately supported by source documentation.

To ensure that the decisions it reaches to retain outside counsel are justified in accordance with its policy and to enable it to demonstrate those justifications to interested parties, the Attorney's Office should sufficiently document the analysis used in reaching its decisions to recommend the retention of outside counsel. Also, to ensure that its recommendations for contract awards are less vulnerable to criticisms, the Attorney's Office should develop and implement comprehensive policies and procedures that specify standards for applying evaluation criteria, such as the use of rating sheets, and for retaining documents.

To help control the costs involved in using outside counsel, the Attorney's Office should ensure that outside counsel submit comprehensive budgets. It should also periodically evaluate its process of obtaining status updates to report to the city council or appropriate board on significant outside counsel cases and modify that approach if necessary. Finally, to help control the costs of outside counsel, the Attorney's Office should not allow costs that are prohibited by its policies.

To achieve a comprehensive view of how legal dollars are spent and to facilitate a comparison of budgeted costs with costs to date, the Attorney's Office should require outside counsel to prepare monthly invoices and cumulative cost reports that both sort charges by attorney within an activity and by activity within a litigation or project phase. Further, the Attorney's Office should compare cumulative charges to agreed-on budgets.

Finally, to help control the costs of outside counsel, the CAO should require budgets for all contracts with outside counsel that it manages.

AGENCY COMMENTS

The Attorney's Office expressed appreciation for the audit work and noted that improving the oversight of outside counsel is an ongoing process. The Attorney's Office states that it intends to fully explore the report's recommendations for ensuring continued improvement.

The CAO also expressed appreciation for the audit work and acknowledged the importance of budgets as a mechanism for controlling outside counsel costs. The CAO stated that it will require budgets in all cases in the future. ■

INTRODUCTION

BACKGROUND

As an elected official within the City of Los Angeles (City), the city attorney serves as chief legal adviser and prosecutor and general counsel to the mayor, the Los Angeles City Council (city council), and all city boards, officers, departments, and entities. The city attorney controls and manages the Office of the City Attorney (Attorney's Office), which comprises more than 500 attorneys who provide the day-to-day legal services that the City needs, such as defending the City in legal proceedings, initiating legal proceedings on the City's behalf, providing legal advice or written opinions when requested, and prosecuting misdemeanor criminal offenses and infractions occurring in the City.

The Attorney's Office has its main location in downtown Los Angeles. Much of the legal work the Attorney's Office performs occurs there. However, for certain city departments, the Attorney's Office has dedicated staff to meet the departments' needs. For instance, the Department of Water and Power (DWP), Los Angeles World Airports (Airports), and the Port of Los Angeles (Harbor) each have a dedicated legal staff. Although those staff are employees of the Attorney's Office, they work on site at the DWP, Airports, or Harbor and are focused exclusively on the legal issues each entity faces.

With specific recommendations and approvals, the city charter allows the City to retain outside legal counsel to assist the Attorney's Office in meeting the City's legal needs. The Attorney's Office policy is to rely on outside counsel primarily when it has a conflict of interest, when it needs specialized expertise, when the duration of a case does not justify full-time staff assignment, or when the Attorney's Office does not have a sufficient number of appropriate attorneys available to handle a case. According to its chief financial and administrative officer (CFO), the Attorney's Office views the judicious use of outside counsel as an obligation for any responsible entity of the City's size and knows of no comparably sized entity that functions without outside counsel.

The Attorney's Office has established policies and procedures for retaining outside counsel. In general, the process includes determining the need and obtaining internal approval for

outside counsel, selecting an appropriate law firm through a competitive or noncompetitive process, and recommending contract approval to the city council or other governing body. The City's government structure is made up of various departments, agencies, offices, and other entities. For the purposes of this report, we refer to them as departments. The departments fall into two main categories: those controlled by the city council and those with independent boards. The Attorney's Office provides legal services to departments in both categories and, when it considers it necessary, facilitates and recommends the retention of outside counsel on behalf of departments in both categories. However, before executing a contract with outside counsel, city council or governing board approval is required. This report focuses on the departments that are under city council control and have outside counsel costs paid by the City's General Fund, and on departments that are governed by independent boards and are proprietary departments. The proprietary departments are the DWP, Airports, and Harbor.

According to the CFO, outside counsel operate in three general capacities: litigating cases in which the City is a plaintiff; litigating cases in which the City is a defendant; and providing legal assistance and consulting on transactional matters, such as bond issuance or interpreting environmental requirements. Table 1 summarizes the estimated distribution of the types of services paid by the General Fund and the proprietary departments in fiscal year 2004–05.

TABLE 1

**Estimated Distribution of Services Provided by
Outside Counsel for Certain Funding Sources
Fiscal Year 2004–05**

Funding Source	Transactions and Advice	Litigation (Plaintiff)	Litigation (Defense)
General Fund*	5%	0%	95%
DWP	21	56	23
Airports	44	18	38
Harbor	6	32	62

Source: Office of the City Attorney.

Note: Cost data analyzed for fiscal year 2004–05 may not reflect other fiscal years.

* Does not include cases involving workers' compensation or the attorney conflicts panel.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (audit committee) directed the Bureau of State Audits to review the City's contracting practices for outside legal services. Specifically, the audit committee asked us to review trends in the use of outside legal services in recent years, including costs associated with outside consultants and experts, and to assess the potential impact of legal expenses on the City's budget. Additionally, the audit committee asked us to examine the processes the City uses for selecting outside counsel, including justification for noncompetitive processes, and to determine whether departments sufficiently monitor the services provided by outside legal counsel and associated services such as consultants and experts. Finally, the audit committee asked us to determine what steps departments take to identify and address potential conflicts of interest on the part of outside legal counsel.

Of the various departments responsible for managing outside counsel costs, we selected six departments to review in this audit, based on cost data reported to a city council member in October 2004: the Attorney's Office, which manages outside counsel costs paid by the City's General Fund; the Office of the City Administrative Officer, which manages outside counsel costs incurred by the attorney conflicts panel; the Personnel Department, which manages outside counsel costs related to workers' compensation; and the City's three proprietary departments: Harbor, Airports, and DWP. Beginning in November 2005 the Attorney's Office informed us that the Department of Public Works significantly revised the cost data reported in the October 2004 memo, increasing reported costs by \$18.9 million over the initial five-year reporting period. However, because we did not receive that information until after our fieldwork was substantially completed, we did not revise our methodology to include the Department of Public Works in our review. The combined costs of the six departments we reviewed constituted 76 percent of the revised total outside counsel costs the City reported for fiscal years 1999–2000 through 2004–05.¹

To compile and note trends in outside counsel costs incurred by the City from fiscal years 1999–2000 through 2004–05, we reviewed accounting and other records maintained by the Attorney's Office and other departments we selected. We determined whether the information included in those records

¹ The Housing Authority of the City of Los Angeles (Housing Authority) also incurred outside counsel costs; however, these costs are not included in the City's reported costs because the Housing Authority is considered fiscally independent for financial reporting purposes.

was sufficiently reliable by gaining an understanding of how the information was compiled and testing sample data for accuracy and completeness. For departments whose outside counsel costs were paid from the General Fund, documents were not always readily available to test for completeness for fiscal years 1999–2000 and 2000–01. Nevertheless, nothing came to our attention that would lead us to believe that the information was materially inaccurate. We did not perform tests for accuracy and completeness on the costs we report for the departments we did not select for review. Instead, we present those costs as they were reported to a city council member in October 2004 or to the Attorney’s Office in the fall of 2005 (fiscal year 2004–05 costs). Additionally, we interviewed Attorney’s Office staff to identify and analyze the reasons for major changes in outside counsel costs over the six-year period of review and determined whether the explanations were reasonable in light of the other work we performed during the audit. Further, we determined the extent to which the Attorney’s Office could support its claims that its use of outside counsel resulted in certain quantifiable benefits. We assessed the potential impact of outside legal counsel costs on the City’s budget by reviewing relevant data.

To assess the Attorney’s Office’s role in selecting outside counsel, we identified the relevant policies and procedures it has in place and assessed their reasonableness. We then assessed the Attorney’s Office’s compliance with the same policies and procedures in fiscal years 2003–04 and 2004–05. Our assessment covered the process for determining whether outside counsel were needed to assist with a legal matter and the processes for selecting outside counsel in a competitive or noncompetitive manner.

To determine whether the Attorney’s Office sufficiently monitors the services outside counsel provide and adequately controls costs, we identified the relevant policies and procedures the Attorney’s Office had in place and assessed their reasonableness. To determine the degree to which staff in the Attorney’s Office followed its monitoring policies, for a sample of contracts, we interviewed the managing attorneys and reviewed case files for relevant documents. To determine if the Attorney’s Office has followed its invoice review process, we examined a sample of invoices from fiscal years 2003–04 and 2004–05 for costs the policies prohibit. We performed the same procedures at the Office of the City Administrative Officer with regard to its responsibilities for managing the attorney conflicts panel. We focused our review of invoices on attorney and other fees because those costs represented the bulk of the charges.

To assess the steps the Attorney's Office takes to identify and address potential conflicts of interest on the part of outside counsel, we reviewed relevant sections of the California Rules of Professional Conduct and determined whether the process the Attorney's Office uses to address potential conflicts of interests is reasonable and in compliance with the rules. Finally, we reviewed requests outside counsel made to waive conflict-of-interest requirements to determine whether the Attorney's Office had followed its policies and procedures for handling such requests. ■

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CHAPTER 1

The Costs Incurred by the City of Los Angeles for Outside Counsel Have Increased in Recent Years

CHAPTER SUMMARY

Outside counsel costs for the City of Los Angeles (City) over the six-year period ending in fiscal year 2004–05 increased from \$17.5 million to \$31.9 million. Some of the largest increases in outside counsel costs occurred at two of the City’s proprietary departments: the Department of Water and Power (DWP) and the Los Angeles World Airports (Airports). In explaining some of the cost increases, staff with the Office of the City Attorney (Attorney’s Office) pointed to a need for outside counsel because the City lacked the necessary expertise and resources to handle several significant matters, such as litigation related to the energy crisis and a comprehensive revision to the master plan for Los Angeles International Airport (LAX).

The City could improve its reporting of outside counsel costs. Our review of the outside counsel costs reported by city departments in response to a special inquiry by a member of the Los Angeles City Council (city council) revealed several significant inaccuracies and inconsistencies. The Attorney’s Office recently has implemented a procedure for all city departments to periodically report their outside counsel costs, which will allow it to report the costs on a citywide basis. As the Attorney’s Office moves forward with its new reporting procedure, its staff should keep in mind the inaccuracies and inconsistencies in data reported by various city departments that we identify in this report.

Finally, the Attorney’s Office believes that its use of outside counsel has resulted in two quantifiable benefits: reductions in amounts paid through settlements or judgments of cases (liability payouts), and significant revenue or other monetary benefits from certain litigation in which the City is the plaintiff. Although it is true that liability payouts from the General Fund have decreased, the extent to which using outside counsel has

contributed to the decrease is unknown. Further, although litigation we reviewed in which the City is the plaintiff has achieved or is expected to achieve benefits, the extent to which the City could have achieved similar results without outside counsel is also unknown.

THE CITY'S OVERALL OUTSIDE COUNSEL COSTS HAVE INCREASED FOR VARIOUS REASONS

As shown in Table 2, annual outside counsel costs for the City increased from \$17.5 million in fiscal year 1999–2000 to \$31.9 million in fiscal year 2004–05, an increase of more than 82 percent. For the six-year period, outside counsel costs totaled \$162.5 million and consisted of both legal fees (costs related to attorneys and paralegals working on cases) and expenses (other goods and services incurred by law firms, such as the costs of expert witnesses and consultants). The proprietary departments—DWP, Airports, and the Port of Los Angeles (Harbor)—accounted for some of the largest increases. Typically funded by revenue generated by providing services, each proprietary department is controlled by a board of commissioners rather than the city council and has control over its own funds. The outside counsel costs for those three entities increased from \$7.9 million in fiscal year 1999–2000 to \$16.2 million in fiscal year 2004–05, an increase of \$8.3 million, or about 105 percent. DWP and Airports accounted for most of the overall increase.

DWP's outside counsel costs increased from \$2.7 million to \$7.4 million—litigation related to the California energy crisis of 2001 played a significant role in these increases.

DWP's outside counsel costs increased from \$2.7 million in fiscal year 1999–2000 to \$7.4 million in fiscal year 2004–05. According to Attorney's Office staff who work at DWP, litigation related to the California energy crisis of 2001 played a significant role in the recent increases. DWP is responsible for supplying the City and its inhabitants with water and electric energy by constructing, operating, and maintaining works for that purpose. It is also responsible for setting rates for water and electric service subject to city council approval.

As an energy provider, DWP became embroiled in the California energy crisis. DWP's records indicate that outside counsel retained for significant litigation related to the energy crisis cost DWP \$6.9 million from fiscal year 2001–02 through fiscal year 2004–05, more than 30 percent of its total outside counsel costs for the four-year period. Most of those costs occurred in years beginning with fiscal year 2002–03, the point at which DWP's total outside counsel costs increased sharply, as shown in Table 2.

TABLE 2

Outside Counsel Costs
Fiscal Years 1999–2000 Through 2004–05
(in Thousands)

	Fiscal Year*						Totals
	1999–2000	2000–01	2001–02	2002–03	2003–04	2004–05	
General Fund							
Police and other litigation	\$ 3,768	\$ 3,029	\$ 3,000	\$ 3,139	\$ 5,722	\$ 2,562	\$ 21,220
Workers' compensation	1,618	1,959	2,541	3,829	5,071	5,455	20,473
Attorney conflicts panel	608	1,074	1,186	1,632	3,094	2,485	10,079
Proprietary Departments							
DWP	2,727	2,430	2,983	6,044	6,058	7,401	27,643
Harbor	2,565	4,084	5,923	5,487	4,981	2,821	25,861
Airports	2,559	2,430	1,501	1,728	3,734	5,948	17,900
Special Funds[†]							
Public Works, Information Technology, Community Development, Housing, Recreation and Parks	2,648	5,987	3,023	5,866	8,262	3,053	28,839
Community Redevelopment Agency[‡]							
	668	633	2,041	1,971	1,808	1,801	8,922
Pension Funds							
	290	95	339	173	330	370	1,597
Totals	\$17,451	\$21,721	\$22,537	\$29,869	\$39,060	\$31,896	\$162,534

Sources: General Fund and proprietary departments: Bureau of State Audits' review of city departments' accounting and other records. Special and pension funds and Community Redevelopment Agency: October 2004 memorandum to a city council member as updated by the Office of the City Attorney (Attorney's Office) in November 2005 for the Department of Public Works (fiscal years 1999–2000 through 2003–04); Attorney's Office (fiscal year 2004–05).

Note: We did not include \$11.7 million in outside counsel costs reported for the Housing Authority of the City of Los Angeles (City) because it is considered fiscally independent for the City's financial reporting purposes.

* Fiscal year is calculated on various bases, described in a discussion in the report. We did not determine the fiscal year basis for special and pension funds or the Community Redevelopment Agency.

† Special funds are established for specific purposes that are primarily administered by city-controlled departments.

‡ The Community Redevelopment Agency is a legally separate entity from the City; however, it is considered a part of the City for financial reporting purposes.

The way in which outside counsel contracts are structured can affect the amount and timing of the costs incurred. For example, in one of the energy-related cases, DWP retained outside counsel to recover damages; the outside counsel's compensation was to be a percentage of the settlement. The case resulted in a \$16 million settlement in favor of DWP, which caused DWP's outside counsel costs to spike upward by \$2.5 million in fiscal year 2004–05, although the increase in costs for DWP overall was less than that because of declining costs for other cases.

Attorney's Office staff also cited a few significant cases unrelated to the energy crisis that caused DWP's outside counsel costs to increase. DWP spent about \$4.0 million on outside counsel costs for those significant cases from fiscal year 2001–02 through fiscal year 2004–05, with most of the costs occurring beginning in fiscal year 2002–03.

More than half of Airports' outside counsel costs were related to master plans at LAX and other airports.

Airports' costs increased from \$2.6 million in fiscal year 1999–2000 to \$5.9 million in fiscal year 2004–05. Attorney's Office staff asserted that the increases were related to planning for \$11 billion in renovation projects at LAX. Airports is responsible for the management, supervision, and control of all airports and airport facilities under the jurisdiction of the City. As part of that responsibility, it constructs and maintains its own buildings. In December 2004 the city council approved the LAX Master Plan, a strategic framework for future development of LAX. The plan is the first comprehensive improvement plan for LAX since 1956 and involves the first major renovations since 1984. Airports is also currently in various stages of planning for master plans at the City's other three airports: Ontario, Palmdale Regional, and Van Nuys. We found that from fiscal years 1999–2000 through 2004–05, more than half of Airports' outside counsel costs were related to the LAX and other master plan projects, with the majority of costs occurring beginning in fiscal year 2003–04. Further, according to Attorney's Office staff, significant outside counsel costs related to LAX projects are expected in the future.

Outside counsel costs related to workers' compensation, which are paid by the General Fund, increased sharply, from \$1.6 million in fiscal year 1999–2000 to \$5.5 million in fiscal year 2004–05. The City retains outside counsel for workers' compensation cases involving sworn officers—namely, police and firefighters—and it retains outside counsel for cases involving civilian claims on an as-needed basis. Although outside counsel costs for sworn officers increased during

the six-year period, the larger increase occurred for cases involving civilians: from \$200,000 in fiscal year 1999–2000 to \$2.4 million in fiscal year 2004–05. According to the chief financial and administrative officer of the Attorney’s Office (CFO), that increase occurred because the unit handling workers’ compensation cases was understaffed and only recently received additional resources. The CFO commented that before additional staff were authorized, roughly 1,300 civilian cases normally handled by Attorney’s Office staff were sent to outside counsel. The CFO further stated that although no new civilian cases were referred to outside counsel after it received additional staffing in 2004, the old referrals continued to account for an increased level of costs.

Certain departments experienced some large increases during the six-year period ending in fiscal year 2004–05 before seeing their outside counsel costs decline.

Although certain departments did not contribute significantly to the overall increase in outside counsel costs between fiscal years 1999–2000 and 2004–2005, they experienced some large increases during the six-year period before seeing their outside counsel costs decline. For example, costs of the other proprietary department, Harbor, peaked at \$5.9 million in fiscal year 2001–02 before declining to \$2.8 million in fiscal year 2004–05. According to Attorney’s Office staff who work at Harbor, the decrease in costs is primarily attributable to the settlement of two cases, one of which was a large and complex construction dispute, and to decreased activity in a third case. Additionally, outside counsel costs of the Department of Public Works (Public Works), which are within the special funds category, increased from \$2.6 million in fiscal year 1999–2000 to \$7.4 million in fiscal year 2003–04 before dropping back down to \$2.8 million the next year. According to Attorney’s Office staff, the increase was primarily the result of litigation related to the recently completed \$1.4 billion upgrade of the City’s wastewater and collection system and to sewer spills during the 1998 “El Niño” rains. Finally, although outside counsel costs for police and other litigation, paid by the General Fund, decreased by about \$1.2 million from fiscal year 1999–2000 to fiscal year 2004–05, they peaked at \$5.7 million in fiscal year 2003–04. According to Attorney’s Office staff, litigation that was initially a single class action discrimination lawsuit accounted for \$4 million in outside counsel costs in that year, as well as significant costs in fiscal years 2001–02 and 2002–03. The plaintiffs in that case originally demanded \$100 million. Resolution of the case caused costs in that area to decline sharply in fiscal year 2004–05.

A lack of expertise and/or staff resources are the reasons the Attorney's Office generally cites for retaining outside counsel.

The Attorney's Office generally cites a lack of expertise and/or staff resources as the reason for retaining outside counsel. For example, Attorney's Office staff at DWP asserted that they did not have the internal expertise to handle the cases related to the energy crisis. In an August 2004 letter outlining certain reforms regarding the use of outside counsel, the city attorney discussed the formation of an outside counsel committee (committee) responsible for reviewing and approving all requests for outside counsel. The city attorney's letter also said the committee would review trends in the use of outside counsel and recommend when it would be more prudent to build capacity and hire additional in-house attorneys and support staff. The committee was formed, and according to the CFO, in October 2005 the committee considered trends in the use of outside counsel and ultimately decided to request internal staff to reduce outside counsel costs for cases involving workers' compensation, intellectual property, and labor employment. Additionally, as of November 2005 the Attorney's Office planned to discuss with the proprietary departments the possibility of hiring more internal staff to reduce outside counsel costs in the near future. However, we note that the CFO also told us that the Attorney's Office has had limited success in the past with its requests for additional staff for the purposes of reducing the use of outside counsel.

Although outside counsel costs have increased by more than 82 percent since fiscal year 1999–2000, the CFO comments that spending 0.2 percent of the City's total expenditures on outside counsel is "appropriate for a \$10 billion plus organization." The total expenditures that the CFO refers to are expenditures as recorded against the City's budget (budgetary basis expenditures). Although the relative size of the percentage may vary somewhat from year to year, we recognize that outside counsel costs represent a small share of the City's budgetary basis expenditures—whether viewed in total or focused on the General Fund, where the City has more discretion in its funding choices. Nevertheless, the funds spent on outside counsel are not insubstantial and are funds that are not available for other city purposes. Thus, it is important to ensure that the City is prudently identifying the need for and monitoring the costs of outside counsel. We discuss those matters in Chapter 2.

THE CITY COULD IMPROVE ITS REPORTING OF OUTSIDE COUNSEL COSTS

We noted several significant inaccuracies and inconsistencies in an October 2004 memorandum reporting citywide costs for outside counsel.

Until recently, the City did not have a process to periodically and comprehensively report on the amount that it spent citywide on outside counsel costs. However, in response to questions from a city council member about the City's outside counsel costs, city staff gathered information from various departments and reported citywide information in an October 2004 memorandum (memo). The memo listed outside counsel costs by city department for fiscal years 1999–2000 through 2003–04. In August 2005 the Attorney's Office requested and subsequently received outside counsel cost data from the same departments for fiscal year 2004–05. Using the data reported in the memo and gathered by the Attorney's Office, we performed various tests on the costs paid by the General Fund and the proprietary departments, which constituted 76 percent of the total outside counsel costs over the six years reported. Table 2, presented earlier, reflects adjustments we made as a result of our review. The following are several of the more significant inaccuracies and inconsistencies we noted:

- Airports underreported outside counsel costs by \$2.2 million, or 23 percent, over the five-year period initially reported in October 2004. It omitted costs for nine transactions involving outside counsel services as well as portions of the costs it incurred through contracts. However, Airports generally reported accurate costs for fiscal year 2004–05.
- DWP did not accurately report its outside counsel costs for the initial five-year reporting period: it double-counted costs for work performed by two firms totaling more than \$2.2 million (11 percent of costs), and it entirely omitted a third contract's costs of more than \$740,000 (4 percent of costs). Additionally, in reporting its fiscal year 2004–05 costs, DWP did not include the costs for its four bond counsel contracts totaling \$697,000 or 9 percent of its total costs for that period. The individual inaccuracies offset each other to a great extent over our six-year review period; however, they caused inaccurate reporting within individual fiscal years, such as costs being overstated by 33 percent in fiscal year 2000–01 and understated by 44 percent in fiscal year 2003–04.
- Although Harbor appropriately provided data for outside counsel fees, related expert fees, and other costs for both reports, city staff compiling the October 2004 memo omitted Harbor's expert fees and other costs, which constituted

22 percent of Harbor's total outside counsel costs (\$5.1 million of \$23 million) over the initially reported five-year period. However, the Attorney's Office included complete reported cost information when it subsequently provided fiscal year 2004–05 cost data.

- Departments did not categorize costs by fiscal year on a consistent basis in the October 2004 memo:
 - Airports, the Attorney's Office (which reported police and other litigation costs), and the Personnel Department (which reported workers' compensation costs) reported costs by fiscal year based on the date of payment.
 - Harbor reported costs by fiscal year based on when services were performed.
 - DWP used date of payment to report some contracts and reported others based on when services were performed.
 - The Office of the Chief Administrative Officer reported attorney conflicts panel costs by fiscal year of appropriation.

When reporting fiscal year 2004–05 data, all of these departments reported costs by fiscal year of payment except DWP, which used fiscal year of payment for some costs and fiscal year of services rendered for others.

Additionally, although Public Works was not one of the areas in which we tested the City's reported outside counsel costs, the Attorney's Office, while researching answers in November 2005 to questions we had about why costs appeared to have increased over time, found that Public Works had significantly understated its costs as reported in the October 2004 memo. Specifically, the City initially reported \$5.1 million in costs for Public Works for the five-year period ending June 30, 2004; it subsequently found that it should have reported \$24.0 million in costs for that period.

Public Works significantly understated its costs for the five-year period ending June 30, 2004; it reported \$5.1 million rather than \$24.0 million.

Since issuing the October 2004 memo, the City has taken steps that may help improve reporting of outside counsel costs. According to the CFO, the Attorney's Office in the past has been asked to report only on General Fund "police and other litigation" costs of outside counsel, which are the only costs for which the Attorney's Office has direct

*In September 2005
the Attorney's Office
asked city departments
to report quarterly on
outside counsel costs.*

accounting responsibilities. Noting that members of the city council had expressed interest in having the Attorney's Office provide a periodic report of all outside counsel costs incurred on a citywide basis, the Attorney's Office issued a letter in September 2005, asking city departments to report quarterly on outside counsel costs and to maintain all the necessary source documents substantiating cost data submitted. The letter directed departments to report costs based on payment date, which might help address the inconsistency in reporting we noted during our review. Additionally, the letter asked departments to designate an outside counsel coordinator, which might help decrease inaccuracies and could increase the consistency of reporting. When requesting fiscal year 2004–05 data, the Attorney's Office also specifically indicated that it needed departments to report costs by date of payment. As previously mentioned in this report, some of the inconsistencies and inaccuracies we found in the costs reported in the October 2004 memo did not occur in the fiscal year 2004–05 report, which may be a result of the instructions for preparing the quarterly report and fiscal year 2004–05 cost information.

However, the CFO is concerned that having the various city departments maintain and periodically report their outside counsel costs may not be the best way to ensure accurate reporting. The CFO noted that departments report information on a voluntary basis and that the Attorney's Office cannot ensure the information's accuracy. In an effort to provide better control, accountability, and reporting of outside counsel costs, the CFO indicated that the Attorney's Office requested the creation of a new citywide Outside Counsel Fund in August 2004 and again in July 2005. The Attorney's Office would manage the account, to which all appropriations for outside counsel would be transferred, regardless of funding source. The Attorney's Office believes that such an account would enable all city departments to report outside counsel costs regularly, as well as complement the Attorney's Office's invoice review process. According to the CFO, in August 2005 staff in the mayor's office asked for input from the city controller's office regarding the matter. As of December 2005 the Attorney's Office was unaware of any further action.

THE ATTORNEY’S OFFICE BELIEVES THAT ITS USE OF OUTSIDE COUNSEL HAS RESULTED IN CERTAIN QUANTIFIABLE BENEFITS

The Attorney’s Office cites two quantifiable benefits of its use of outside counsel: reductions in liability payouts and significant revenue or other monetary benefits from certain litigation in which the City is the plaintiff. Although it is true that General Fund liability payouts have decreased, the extent to which the use of outside counsel has contributed to the decrease is unknown. Further, the Attorney’s Office retains outside counsel in certain instances in which it pursues litigation that would benefit the City or its residents. Although the litigation it points to has achieved or is expected to achieve benefits, the extent to which the City could have achieved similar results without outside counsel is also unknown.

The Extent to Which the Attorney’s Office’s Use of Outside Counsel Has Contributed to a Reduction in Liability Payouts Is Unknown

The Attorney’s Office has linked the use of outside counsel to a reduction in the City’s liability payouts. When asked directly about the benefits of the use of outside counsel, the CFO responded to us that the results of using outside counsel “speak for themselves—among other things, liability payouts have gone down [and] significant revenue from affirmative litigation has occurred that would not otherwise have been received.” Further, in a June 2004 letter to a city council member who had made inquiries about the City’s use of outside counsel, the city attorney asserted that “the selective and strategic use of outside counsel by the [Attorney’s Office] has supplemented the talents of our deputy city attorneys and resulted in lower liability payouts.” In the same letter the city attorney made the following statements linking the use of outside counsel to reduced liability payouts:

Ultimately, the City needs to view the use of outside counsel as a short-term investment for long-term savings. In 2000–2001, the City spent \$3.1 million on outside counsel and paid out \$92 million in settlements and verdicts from the General Fund. In 2003–2004, the City will spend an estimated \$5.3 million on outside counsel and liability payouts will be an estimated \$46 million from the General Fund. This is a savings of \$46 million (50%) in General Fund liability payouts

for the taxpayers. This is also an indication of what we can do when the success of our deputy city attorneys is supplemented by outside attorneys.

In November 2005, in response to our questions, the CFO expanded on those assertions. The CFO stated that the Attorney's Office believes that "the strategic management of litigation, including but not limited to the judicious use of outside counsel in appropriate cases, has led to a substantial decline in liability payouts." According to the CFO, the use of outside counsel is one important factor, but not the only factor.

Our review confirmed that General Fund liability payouts have decreased in recent years. In its *2003-04 Annual Report* and the June 2004 letter, the Attorney's Office pointed to a reduction of roughly 50 percent in General Fund liability payouts in fiscal year 2003-04 compared with fiscal year 2000-01. Our work confirmed that General Fund liability payouts decreased from a peak of approximately \$92 million in fiscal year 2000-01 to \$45 million in fiscal year 2003-04. Additionally, our review of recent information showed that liability payouts decreased to \$28 million in fiscal year 2004-05, a 69 percent reduction from fiscal year 2000-01. However, it is important to note that the payouts reflect cases that did not use outside counsel as well as those that did.

General Fund liability payouts decreased 69 percent from fiscal years 2000-01 to 2004-05; however, the payouts reflect cases that did not use outside counsel as well as those that did.

Further, the General Fund liability payouts that the Attorney's Office highlights do not include payouts for the Rampart litigation. That litigation consisted of cases based on allegations of corruption and abuse within an elite antigang unit of the Los Angeles Police Department. The allegations led to more than 200 lawsuits and liability payouts of \$70.1 million spread over several fiscal years. According to the CFO, Rampart payments were not included in the liability payout figures because the situation is a unique occurrence for which the Attorney's Office has been directed to track funds separately. The CFO stated that the mayor and city council set up a separate funding account for Rampart payouts, and funds in the account were treated differently from other funds. For example, unused Rampart funding did not revert at the end of the fiscal year to be available for other purposes. Although significant in magnitude, the Rampart payouts, if included in the liability payout figures, would not have greatly affected the Attorney's Office's claims regarding reductions in General Fund liability payouts. Including Rampart payments would have resulted in a

64 percent decrease in liability payouts from fiscal year 2000–01 to 2004–05, rather than the 69 percent decrease reported by the Attorney’s Office.

We were unable to determine the extent to which the trend in liability payouts was influenced by cases that could be considered unique, because the Attorney’s Office was unable to provide information detailing payouts by case before fiscal year 2001–02, when the current city attorney began his administration. When specifically asked about possible causes of the spike in General Fund liability payouts in fiscal years 1999–2000 and 2000–01, the CFO brought to our attention a significant case with a large settlement affecting both those years. That large settlement resulted in a liability payout totaling \$39 million, \$26.7 million in fiscal year 1999–2000 and \$12.3 million in fiscal year 2000–01. When we excluded those two payouts, we found that the General Fund liability payouts from fiscal years 1998–99 through 2004–05 remained relatively stable in five of the seven years, ranging from \$44.5 million to \$56.9 million. (General Fund liability payouts in fiscal years 2000–01 and 2004–05 were outside that range at \$79.9 million and \$28.2 million, respectively.) The CFO believes that the liability payouts relating to the settlement should not be excluded from the figures because the case revolved around the City’s violation of the Fair Labor Standards Act, which is not a unique type of lawsuit for the City to face. According to the CFO, the only unique aspect of the case was how poorly the City fared (that is, the settlement amount), and a bad outcome is not a reason to back any case out of the City’s numbers.

Regardless of the cases it includes or does not include in its analysis, the fact remains that the extent to which the Attorney’s Office’s use of outside counsel has contributed to the reduction in liability payouts in recent years is unknown. The ultimate resolution of a case depends on many factors, including the underlying facts of the case, and isolating any one factor is difficult, if not impossible. Thus, even if all liability payouts were related to cases in which outside counsel were used—and they were not—the extent to which the use of outside counsel affected the size of the payouts that resulted from the cases would be unknown.

The Extent to Which Outside Counsel Can Be Credited With Generating Monetary Benefits in Affirmative Litigation Cases Is Unknown

The City or its residents have benefited or will benefit monetarily from certain cases, but the extent to which the City could have achieved similar results without outside counsel is unknown.

The Attorney's Office asserted that the City's use of outside counsel in affirmative litigation cases generated significant revenues or other monetary benefits that would not otherwise have been received. The affirmative litigation cases to which the Attorney's Office pointed are civil cases in which the plaintiff is the City seeking damages or injunctive relief for some wrong done to its interests.² The Attorney's Office provided a list of affirmative litigation cases that have been resolved since 2001, in which the City or residents received or expected monetary returns, and for which the City hired outside counsel to represent its interests. The list contains 12 cases, with cited monetary benefits ranging from \$50,000 (annually) to \$170 million (a one-time settlement). Our review of the documentation related to several of those cases confirmed that the City or its residents have received or could expect to receive monetary benefits; however, the extent to which the City could have achieved similar results without outside counsel is unknown.

For example, \$170 million in "revenue" that the Attorney's Office cited is actually money that was due to DWP as a result of its normal operations. According to Attorney's Office staff, certain bankruptcies during the energy crisis threatened to prevent the DWP from recovering \$170 million. DWP retained outside counsel to protect its interests in the bankruptcies and retained separate outside counsel to resolve a related jurisdictional dispute. Attorney's Office staff believe that the outside counsel representation on the jurisdictional dispute prevented the loss of the \$170 million and the imposition of additional penalties. As of October 2005 an appellate court had made a ruling on the jurisdictional dispute; however, according to Attorney's Office staff, a stay imposed by the appellate court has prevented the payment until issues unrelated to DWP are resolved.

As in our discussion of liability payouts, the extent to which outside counsel are responsible for DWP's ability to recover the amounts owed to it is unknown. Certainly, the Attorney's Office believes that it did not have the staff resources and expertise to handle the matter internally. However, as noted earlier in

² According to the CFO, the Attorney's Office is also involved in affirmative litigation cases of another type—those concerned with pursuing civil claims in the name of the People of the State of California—which are typically handled in house. Those cases are not the subject of our discussion.

the report, the ultimate resolution of a case depends on many factors, including the underlying facts of the case. Further, other entities were involved in the jurisdictional dispute. It is difficult to know what part any single entity played in the ultimate resolution of the matter.

The City can incur significant costs in pursuing affirmative litigation cases.

Additionally, the City can incur significant costs in pursuing affirmative litigation cases. In some cases outside counsel are paid based on a percentage of any settlement achieved. However, for at least one case we reviewed, the costs paid to outside counsel were not based on the result of the case and were significant. Initially, a construction company sued the City, alleging damages associated with its contract with the City for a construction project. Subsequently, the City filed a cross-complaint against the construction company. The Attorney's Office claimed that the City saved \$8 million through affirmative litigation because its cross-complaint resulted in Harbor paying \$34 million for a construction project with a contracted cost of \$42 million. Our review revealed that the amount "saved" was actually \$7.1 million rather than \$8 million. We also found that the reported costs paid to outside counsel for the litigation were \$12.2 million. The Attorney's Office believes that the result was positive because in its initial lawsuit against the City, the construction company had also sought to recover \$27 million for additional costs that it claimed to have incurred and was unsuccessful. Also, the Attorney's Office estimates that no more than 20 percent (\$2.4 million) of the outside counsel's costs were associated with the City's cross-complaint. Harbor did not separately account for the amounts that outside counsel spent on the cross-complaint rather than the defense of the City in the initial lawsuit; thus, we could not verify the estimate. Further, it is difficult to know what part the cross-complaint played in the City's recovery of the \$7.1 million. Finally, although the Attorney's Office strongly believes that it could not have properly defended the City or successfully pursued the cross-complaint without outside counsel given the scope and complexity of the case, the extent to which the City could have received similar results without outside counsel is unknown.

Finally, it is important to point out how the method the City used to engage outside counsel in some affirmative litigation cases contrasts with the City's traditional process. According to the CFO, in some instances an outside law firm approached the City and presented it with the opportunity to pursue litigation that would benefit the City. Once the City made the business

decision to pursue the litigation, the City elected to contract with that one firm. Traditionally, however, the City engages outside counsel for an existing case, after deciding that it cannot handle the case without outside counsel and then determining how it should select the firm. We discuss the manner in which the City selects outside counsel in Chapter 2. Whether the City or an outside firm initiates consideration of the case, the Attorney's Office contended that it uses outside counsel because of the staffing and expertise that the outside firms possess. Nevertheless, the extent to which the City could have achieved similar results without the use of outside counsel is unknown.

RECOMMENDATIONS

The Attorney's Office should continue its efforts to ensure that the outside counsel committee periodically reviews trends in the use of outside counsel and makes recommendations regarding areas in which it would be prudent to build capacity and hire additional in-house attorneys and support staff. The Attorney's Office should consider that information when evaluating its overall staffing needs and requesting resources.

The City should ensure that the outside counsel costs it reports are accurate and prepared consistently and that costs are adequately supported by source documentation. ■

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CHAPTER 2

The Office of the City Attorney Could Further Improve Aspects of Its Role in the Selection and Administration of Outside Counsel

CHAPTER SUMMARY

In making decisions regarding outside counsel for the City of Los Angeles (City), the policy of the Office of the City Attorney (Attorney's Office) is to first assess the need for counsel and then, if necessary, conduct a selection process. Selection can take the form of a competitive or noncompetitive process, depending on the specific requirements of the legal matter at hand. It is important to note that this selection process culminates in the Attorney's Office making a recommendation to the Los Angeles City Council (city council) or appropriate board, which makes the final contracting decision. Overall, we found that the Attorney's Office could not provide documents to demonstrate that it had followed the policies and procedures it has in place to guide it through its decisions to retain outside counsel and the subsequent selection process. For example, it lacked written evaluations and rating sheets to demonstrate that it conducted a fair and objective process when performing its role in selecting outside counsel in a competitive manner. Without adequate documentation, the Attorney's Office leaves itself vulnerable to criticisms that its recommendations on outside counsel are not prudent or made in a fair and objective manner.

In managing contracts with outside counsel, the Attorney's Office's policies in effect at the time of our fieldwork generally involved the use of recommended case management tools, such as budgets and formal status updates, to help control costs. Although its policies provided sufficient direction for good case management, Attorney's Office staff did not always follow them. As a result, the Attorney's Office risked paying more to outside counsel than was necessary. In November 2005 the Attorney's Office changed its policy on the use of outside counsel. For example, it eliminated its requirement for outside counsel to submit quarterly reports. Instead, the Attorney's Office plans to work with outside counsel to provide status reports when it

prepares for updates to the city council and others at least twice a year. In doing so the Attorney's Office may be limiting its insight into outside counsel's activities. However, it is too early to tell what the long-term effects of this particular policy change will be.

The Attorney's Office could also improve its review of invoices. It has established comprehensive policies related to the invoices submitted by outside counsel, and our testing demonstrated that the Attorney's Office eliminated numerous invoiced charges that conflicted with its policies. However, it paid outside counsel for some costs that were not allowed by its policies. Although the Attorney's Office's invoicing policies seek to establish a standard for reasonable billing practices, the Attorney's Office undermines those efforts by not consistently identifying all unallowable costs.

An opportunity exists for the Attorney's Office to more efficiently and effectively monitor outside counsel costs. It could do so by preparing budgets detailed by activity and requiring outside counsel to submit invoices with the same level of detail, allowing Attorney's Office staff to compare the invoices to the budgets. Although Attorney's Office policy at the time of our fieldwork required managing attorneys to work with outside counsel in creating detailed litigation budgets and to periodically compare outside counsel's actual costs against budgeted costs, our review of files for selected contracts found no evidence that Attorney's Office staff had made these comparisons. Comparing outside counsel costs to budgeted costs by activity within litigation or project phases should enable the Attorney's Office to better facilitate effective communication on the progress of its cases and any deviations from established budgets.

When the Attorney's Office has an actual or potential conflict of interest in which it cannot ethically represent a city employee whose interests may be adverse to those of the City, it refers the matter to the attorney conflicts panel (conflicts panel). The conflicts panel consists of attorneys from outside law firms that the Attorney's Office, in conjunction with the Office of the City Administrative Officer (CAO), selects to provide legal services to the City in the event of a conflict. The CAO, an entity separate from the Attorney's Office, is the day-to-day overseer of the conflicts panel. In performing its daily duties, the CAO adequately reviews invoices for compliance with its

billing guidelines. However, the contracts that the CAO used did not require outside counsel to submit budgets in all instances. Finally, the Attorney's Office has a policy for addressing outside counsel's conflicts of interest and takes the necessary steps when granting a waiver regarding a conflict.

THE ATTORNEY'S OFFICE LACKS NECESSARY INFORMATION TO DEMONSTRATE THAT IT FOLLOWS ITS NEEDS ASSESSMENT POLICY AND THAT ITS OUTSIDE COUNSEL RECOMMENDATIONS ARE BASED ON A COMPETITIVE PROCESS

After the city attorney took office in July 2001, the Attorney's Office established policies and procedures on the use of outside counsel.

After the city attorney took office in July 2001, the Attorney's Office established policies and procedures on the use of outside counsel. Those policies and procedures require the Attorney's Office first to establish a need for outside counsel and then to select a firm through either a competitive or noncompetitive process. As discussed previously, the selection process culminates in the Attorney's Office making a recommendation to the city council or appropriate board, which makes the final contracting decision. Although the Attorney's Office's December 2001 policy, as enhanced by reforms outlined in an August 2004 memorandum (memo) on the use of outside counsel, are generally sound, they do not require the Attorney's Office to document how it reaches its decisions for recommending outside counsel or to prepare key documents, such as rating sheets and interview notes, when it conducts a competitive selection process. As a result, the Attorney's Office lacks the necessary documentation to demonstrate that it follows its policies and procedures when performing its role in determining the need to contract with outside counsel and selecting a law firm. The reports the Attorney's Office typically prepares and presents to the city council or appropriate board contain recommendations to contract with outside counsel. However, those reports do not provide sufficient evidence of the Attorney's Office decision-making process. Without sufficient documentation of the decision-making process that takes place within the Attorney's Office when determining the need for and selecting outside counsel, the Attorney's Office leaves itself vulnerable to criticisms that its recommendations on outside counsel are not prudent or made in a fair and objective manner.

The Attorney's Office Has Established Policies Governing How to Assess the Need for Outside Counsel

The city attorney is an elected official who took office in July 2001. Shortly thereafter, in December 2001, the Attorney's Office instituted a policy regarding the use of outside counsel. According to the Attorney's Office, no policy on the use of outside counsel existed before December 2001. The December 2001 policy applied to all members of Attorney's Office staff, including those in the proprietary departments. It required staff first to determine the need for outside counsel and provide a written request and justification to the city attorney. Then, according to the policy, Attorney's Office staff were to obtain written approval from the city attorney or chief deputy before outside counsel could be retained.

In August 2004 the Attorney's Office issued a memo outlining certain reforms aimed at further improving the financial oversight and transparency of the use of outside counsel (August 2004 reforms). The city attorney noted in the August 2004 reforms that certain departments, including the proprietary departments, had often ignored the December 2001 policy in deciding to use outside counsel without the review and approval of the Attorney's Office. Thus, the city attorney believed it was necessary to bring all city agencies into compliance with the existing policy.

Based on our review of the August 2004 reforms, we determined that the prescribed manner in which the Attorney's Office assesses the need for outside counsel generally appears sound. The August 2004 reforms built on the December 2001 policy by establishing the outside counsel committee (committee) and charging it with reviewing all requests for outside counsel, including those for the proprietary departments. Composed of the chief deputy, branch chiefs, the chief financial and administrative officer (CFO), the managing assistant over the proprietary departments, and the budget director, the committee provides for a broader and more vigorous discussion of the use of outside counsel among the various interests within the Attorney's Office. Further, the committee's centralized and comprehensive review allows for greater consistency in decision making and identifying internal needs, such as increasing resources or developing subject area expertise.

The prescribed manner in which the Attorney's Office assesses the need for outside counsel generally appears sound.

The Attorney's Office Lacked Sufficient Documentation to Demonstrate That It Followed Its Needs Assessment Policies

Although the policies and procedures that the Attorney's Office has in place to determine the need to retain outside counsel are generally sound, in practice the process the Attorney's Office followed was not well documented. Thus, the Attorney's Office could not demonstrate it engaged in the decision-making process that its policies outline.

We reviewed the Attorney's Office's compliance with its needs assessment policies and procedures over two periods: from July 2003 to mid-September 2004 and from mid-September 2004 through June 2005. Those periods align with the periods before and after the Attorney's Office issued its August 2004 reforms and with the committee's first meeting on September 22, 2004. In all, we reviewed 11 instances where outside counsel was retained and paid by the General Fund or the proprietary departments.

For the first period—governed by the December 2001 policy—we reviewed the Attorney's Office assessment of need for outside counsel in seven instances. Although the policy of the Attorney's Office specifies written justification to be submitted to the city attorney for written approval with a copy to the chief deputy, the Attorney's Office was able to provide only one e-mail indicating that it had had internal discussions regarding whether to assign a case to outside counsel. The Attorney's Office could not provide the required written justification or the city attorney's or chief deputy's internal approval of the need for outside counsel in the remaining six instances.

For the second period, which was after the Attorney's Office's August 2004 reforms, we reviewed four instances in which the Attorney's Office assessed the need for outside counsel. Because the period under review was limited, our sample size was limited. Nevertheless, our findings for the second period were similar to those for the first. The Attorney's Office generally lacked sufficient documentation to demonstrate that it had followed the policies and procedures it had in place for determining the need to retain outside counsel.

The Attorney's Office made available to us agendas from certain committee meetings and the personal notes of the committee member who led the meetings. However, those agendas and notes did not provide adequate evidence that the Attorney's Office followed its policies and procedures. Using the committee

The Attorney's Office generally lacked sufficient documentation demonstrating it followed its policies and procedures for determining the need to retain outside counsel.

agendas, we could determine that the committee scheduled discussions regarding legal matters that might require outside counsel. In addition, using the committee member's personal notes, we could usually determine that the committee addressed the matters on its agenda and approved requests to retain outside counsel. However, neither the notes nor the agendas represented a formal record of the committee's business, and neither provided sufficient insight into the committee's decision-making process.

According to the Attorney's Office, reports that it submits to the board of commissioners presiding over the affected proprietary department (board reports) or reports to the city council (council reports) provide sufficient documentation that the Attorney's Office follows its needs determination process. The CFO directed us to the council and board reports as evidence of the Attorney's Office's process. According to the CFO, the city council or appropriate board, in addition to the city attorney, always signs off on the use of outside counsel. She stated that both a transmittal to the council or board and a verbal presentation when requested are part of the Attorney's Office's process. She emphasized that the reports and presentations are not periodic in nature but accompany every request for approval to use outside counsel. The CFO noted that the reports and presentations describe why outside counsel are needed and the process used to select them.

According to flowcharts the Attorney's Office prepared to illustrate when to use outside counsel, it is appropriate to retain outside counsel when the need for specialized expertise exists, when the duration of a case does not justify full-time staff assignment, or when the Attorney's Office does not have a sufficient number of attorneys to handle the matter. However, the board and council reports we reviewed did not provide sufficient evidence of the decision-making process. For example, our review of five reports for cases in which insufficient staff was cited as a reason for using outside counsel revealed that the reports did not compare expected staff needs for the case with the existing staff demands of the Attorney's Office. Further, five of the board and council reports we reviewed cited a lack of necessary expertise as an issue. However, only one report contained a detailed description of the expertise the Attorney's Office lacked. We would expect an analysis of available resources and staff expertise to be provided by the committee because it is at committee meetings where the process of deciding when to recommend the use of outside counsel takes place.

Without sufficient documentation of its decision-making process, the Attorney's Office cannot demonstrate that its recommendations pertaining to the use of outside counsel are prudent.

Additionally, board reports were not available in every instance. The Attorney's Office's chief assistant city attorney, municipal counsel branch (chief assistant) confirmed that the city charter and administrative code do not specifically require these reports but stated that the Attorney's Office prepares board and council reports to facilitate presentation of such matters to the applicable meetings. Further, the chief assistant confirmed that the Attorney's Office does not prepare board reports for proprietary department contracts with outside counsel that are less than \$150,000 because in those instances the general managers of the departments have authority to contract without board approval. Without sufficient documentation of the decision-making process that takes place within the Attorney's Office, the Attorney's Office cannot demonstrate that its recommendations pertaining to the use of outside counsel are prudent.

In November 2005, after we had substantially completed our fieldwork, the Attorney's Office issued a new policy on the use of outside counsel. In a transmittal memo the city attorney stated that the November 2005 policy supersedes the December 2001 policy and represents the Attorney's Office's latest refinement related to the use of outside counsel. Although we reviewed the November 2005 policy, we did not evaluate the Attorney's Office's performance in connection with it. The policy outlines the procedures for assessing the need for outside counsel and states that the committee will now "generate a brief decision memo" following a request to use outside counsel. It does not specify the nature or extent of the analysis to be included in the decision memo.

The Attorney's Office Lacks the Necessary Documentation to Demonstrate That Its Selection Practices Are Truly Competitive

The city charter requires the use of competitive bidding procedures in selecting contractors for the acquisition of services and goods, except in specified instances. Exceptions to the requirement include contracts involving the performance of professional, scientific, expert, technical, or other special services of a temporary or occasional nature for which the City finds that competitive bidding is not practicable or advantageous. Because outside counsel fall into those categories, the Attorney's Office has discretion in determining whether to administer a competitive process when performing its role in selecting outside counsel.

However, according to the chief assistant, the Attorney's Office, as a matter of business preference, generally chooses to competitively select outside counsel. Moreover, the chief assistant stated that the Attorney's Office business preference is based on the benefits that generally come from comparing law firms as part of the selection process.

Neither the December 2001 policy nor the August 2004 reforms guided staff in the administration of a competitive selection process.

Because the Attorney's Office's preference is to use a competitive selection process, we expected to find policies and procedures in place to direct the administration of selections. Although the policies and procedures concerning the use of outside counsel have evolved over time, neither the Attorney's Office's December 2001 policy nor its August 2004 reforms guided staff in the administration of a competitive selection process. Specifically, the policies and procedures indicated that outside counsel should be selected through a competitive request for proposals (RFP) or request for qualifications (RFQ) process, but they did not address the documentation the Attorney's Office must prepare and retain to support decisions regarding its recommendations to award contracts.³ Without sufficient documentation of its selection process, the Attorney's Office leaves itself vulnerable to criticisms that its competitive selection processes are not conducted in a consistent, fair, and objective manner.

Although the Attorney's Office's policies and procedures do not address the type of documentation to be prepared or retained, other guidance for city departments exists regarding contracting and offers best business practices. Specifically, we found that the City's Department of General Services gives guidance in its procedures manual for professional or personal service contracts (contracting manual) and sets standards for city departments on how to administer the competitive selection process. For example, the contracting manual indicates that it is imperative to maintain a complete record of the evaluation process and to document all information in an RFP/contract master file (RFP file). According to the contracting manual, the RFP file should contain items like a copy of the RFP; a list of all parties asked to submit a proposal; all proposals received; and all documentation from the evaluation committee, including evaluation forms, summary sheets, notes, references, oral interview scores, and rating sheets.

³ An RFQ is similar to an RFP except that it focuses on the firms' qualifications to provide a service, rather than on various other criteria in addition to qualifications.

Even though the RFPs we reviewed cited evaluation criteria, the Attorney's Office could not provide documentation supporting how it scored the criteria.

We reviewed a total of eight RFPs and RFQs (henceforth referred to collectively as RFPs) the Attorney's Office administered between July 2003 and June 2005 to determine the fairness and objectivity of the RFP processes conducted to select outside counsel to serve the departments funded by the City's General Fund and the proprietary departments. Based on our review, we determined that the Attorney's Office lacked sufficient documentation to demonstrate that its RFP processes were competitive. For example, even though the RFPs cited evaluation criteria, the Attorney's Office could not provide documentation supporting how it scored the criteria, such as its evaluation committee's written evaluation of responses, rating sheets, or notes of interviews. As a result, we could not conclude that the RFP processes we reviewed were conducted in a fair and objective manner.

Although we believe the RFP guidelines contained in the City's contracting manual represent best practices for conducting a competitive selection process, the chief assistant stated that the Attorney's Office is not obligated to follow the contracting manual. According to the chief assistant, the contracting manual is meant for city employees who have little or no experience with contracts, unlike the staff at the Attorney's Office. Moreover, the chief assistant stated that scoring sheets, rating forms, and the like can be helpful in comparing the attributes of routine personal services, such as janitorial services, but that the documents do not provide assistance in comparing the more subtle differences typically found among highly specialized professional organizations, such as law firms.

Although staff within the Attorney's Office may be highly specialized in matters of law, that does not replace the need for a sound policy establishing the retention of documentation. We recognize that the evaluation criteria applied to selecting legal counsel would differ from those needed to select firms to provide other services. However, to have a competitive process, it is important to demonstrate that the criteria are applied equally, regardless of the contracted service. Because the Attorney's Office's business preference is to use a competitive selection process, it needs to be able to demonstrate that it evaluates the proposals it receives in a fair and competitive way based on the criteria outlined in its RFP.

Without documentation such as rating sheets and interview notes, the Attorney's Office is vulnerable to criticisms that its recommendations on outside counsel are not fair and objective.

When the Attorney's Office issued its August 2004 reforms, the city attorney expressed interest in further improving the financial oversight and transparency of the use of outside counsel by the City. Without documentation like rating sheets and interview notes, the process lacks the desired transparency. Moreover, the Attorney's Office's lack of documentation leaves it vulnerable to criticisms that its recommendations on outside counsel are not fair and objective.

As mentioned previously, in November 2005 the Attorney's Office issued a new policy on the use of outside counsel. The November 2005 policy states that the majority of contracts with outside counsel should be issued through a competitive selection process. Further, the policy indicates that the committee must oversee the selection process and draft a recommendation to the city council or appropriate board as to what firm or firms should be hired. However, it does not require the creation or retention of the documents necessary to demonstrate the fairness and objectivity of the competitive process.

Without the Necessary Information, the Attorney's Office Cannot Demonstrate That Its Selection Process for the Workers' Compensation Panel Was Truly Competitive

The Attorney's Office works with the Personnel Department to manage the City's Workers' Compensation Program. Workers' compensation claims can be either for civilian employees or for sworn officers, such as police and fire personnel. The Attorney's Office is responsible for recommending law firms for a panel dedicated to litigating workers' compensation claims filed by the City's sworn officers. The city council is responsible for approving the Attorney's Office's recommendations. It uses a competitive process to select outside counsel for the panel. Although the Attorney's Office is responsible for litigating all civilian claims, it has used the workers' compensation panel to assist with civilian claims when the workload associated with those claims exceeded its resources.

In 2003 the Attorney's Office initiated a competitive selection process as part of its efforts to implement changes in the Workers' Compensation Program. The Attorney's Office had concluded that a new workers' compensation panel was needed because the panel in place under the former city attorney had been selected several years before and was providing services to the City without contracts. The Attorney's Office issued an RFQ to various firms as part of the selection process.

As with our review of the competitive selection processes used by the General Fund and proprietary departments, the Attorney's Office could not provide documentation such as evaluation forms and rating sheets.

As with our review of the competitive selection processes used by the General Fund and proprietary departments, we found that the RFQ the Attorney's Office released cited evaluation criteria, but that the Attorney's Office could not provide documentation, such as evaluation forms and rating sheets, supporting how it scored the criteria. Additionally, the Attorney's Office could not provide interview notes or proposal evaluation notes.

As discussed earlier in the report, the Attorney's Office stated that it is not obligated to maintain documents to demonstrate the competitiveness of its selection process. Additionally, according to the CFO, the Attorney's Office offered a place on the panel to each of the 15 law firms that applied, although only 10 accepted. Nevertheless, it is important for the Attorney's Office to be able to demonstrate that it determined that all the firms had the appropriate qualifications. Without retaining the proper documentation to demonstrate how the Attorney's Office reaches its decisions on which firms to recommend for the panel, the Attorney's Office cannot demonstrate that its recommendations are made in a fair and objective manner.

THE ATTORNEY'S OFFICE DOES NOT ADEQUATELY DOCUMENT HOW IT JUSTIFIES USING A NONCOMPETITIVE PROCESS

Under the city charter, the Attorney's Office has the discretion to select outside counsel in a noncompetitive manner. Noncompetitive selection still requires the approval of the city council or the appropriate board. The Attorney's Office has outlined the types of situations in which it uses a noncompetitive selection process. However, it has not established a policy for retaining the documents necessary to demonstrate its decision-making process. The Attorney's Office provided only limited documentation to justify its noncompetitive selection of outside counsel in three of the five contracts we reviewed and had no documentation for two of the selections. As a result, in an area where the Attorney's Office is particularly vulnerable to criticism—selecting outside counsel without a competitive process—it lacks all the necessary documentation to demonstrate how it made its decisions on recommending outside counsel.

Although the Attorney's Office has modified its noncompetitive selection policy and procedures over time, it still lacks requirements to document its justification for noncompetitive

Despite modifying its noncompetitive selection policy and procedures over time, the Attorney's Office still lacks requirements to document its justification for noncompetitive selection.

selection. The December 2001 policy provides no guidance for noncompetitive selection because it does not specify the circumstances in which the Attorney's Office can recognize that noncompetitive selection is appropriate. Flowcharts the Attorney's Office prepared to illustrate the use of outside counsel, however, address noncompetitive selection specifically and clarify that the Attorney's Office uses noncompetitive selection when it determines that only one firm has the necessary qualifications, expertise, unique knowledge of the facts, and/or availability. Thus, the flowcharts clarify for staff the city attorney's expectations for selecting outside counsel in a noncompetitive way. However, because the Attorney's Office's guidance does not establish criteria for the retention of the documentation necessary to demonstrate its decision-making process, it falls short of attaining the transparency in the use of outside counsel that the city attorney expressed an interest in achieving.

Between July 2003 and June 2005, the Attorney's Office opted to recommend the selection of outside counsel in a noncompetitive manner 14 times. We reviewed five of the contracts, but the Attorney's Office provided only limited documentation explaining why the circumstances of each contract required unique qualifications and expertise and how the firm recommended fulfilled those requirements. The Attorney's Office believes that its board and council reports sufficiently document the reasons for selecting outside counsel in a noncompetitive manner. However, because of the size of the contracts, the Attorney's Office was not required to prepare a board report for two of the five contracts we assessed; the department's general manager had the authority to approve those contracts. Further, the three board and council reports we reviewed contained comments on the recommended firms' expertise and knowledge of the facts. In two of the three instances where there were board or council reports, outside counsel approached the City and presented it with the opportunity to pursue litigation that would benefit the City. Thus, once the City made the business decision to pursue the litigation, the City made a decision to contract with those firms. We discuss those types of cases further in Chapter 1. However, for one of the two cases, the Attorney's Office noted it could take over the litigation itself. Finally, in the last instance where there was a board or council report, the report only reflected the decision the Attorney's Office had already expressed in making its recommendation and did not provide sufficient insight into the analysis leading up to the decision to select the firm.

Without documenting and justifying its internal decisions, the Attorney's Office cannot achieve the transparency it desires in performing its role in selecting outside counsel.

Without documenting and justifying its internal decisions, the Attorney's Office cannot achieve the transparency it desires in performing its role in selecting outside counsel.

In its new November 2005 policy, the Attorney's Office outlined a role for the outside counsel committee (committee) with regard to selecting outside counsel in a noncompetitive manner. The November 2005 policy states that in cases in which one firm is uniquely qualified to perform the work, or in which time is of the essence, the committee can recommend a noncompetitive selection process to award the contract. Additionally, the November 2005 policy requires the committee to oversee the drafting of a transmittal recommending to the city council or appropriate board that the firm be selected as a result of the process. However, it does not specify the nature or extent of the analysis to be included in the memo.

Finally, we asked the Attorney's Office how it ensures that it obtains a reasonable price for outside counsel services contracted through a noncompetitive selection process. According to the CFO, the Attorney's Office is a sophisticated and regular consumer of legal services. Thus, the CFO stated, given the number of competitive processes it has conducted, the Attorney's Office is very familiar with the marketplace and is well positioned to make judgments about rates that are fair for the City. In addition, language within the Attorney's Office standard contract that was to be used for contracts issued before November 2005 obligated outside counsel to charge the City the lowest rate for legal services that the firm offered to any client, except not-for-profit and pro bono clients. In the new standard contract the Attorney's Office issued in November 2005, outside counsel are obligated to provide the City with the necessary representation by qualified staff at the least costly billing category.

THE ATTORNEY'S OFFICE OFTEN RELIED ON INFORMAL MEANS TO OVERSEE ITS CONTRACTS WITH OUTSIDE COUNSEL

The Attorney's Office's policies in place at the time of our fieldwork called for the use of recommended case management tools, such as budgets and formal status updates, to help control the costs of outside counsel. Although those policies provided sufficient direction for good case management, Attorney's Office staff did not always follow the policies, often relying on informal monitoring of outside counsel through telephone,

e-mail, or in-person communications. In November 2005 the Attorney's Office changed its outside counsel policy in certain respects, but it is too early to determine what effects the policy changes will have on the Attorney's Office oversight of outside counsel.

The size and length of many of its contracts with outside counsel are so great that Attorney's Office staff would not likely be able to adequately monitor them through primarily informal means. A list of contracts active from July 2001 through December 2004 provided by the Attorney's Office indicated 32 contracts were \$1 million or more, 23 were \$500,000 or more, and 64 were \$100,000 or more. If the average hourly billing rate for attorneys and paralegals is estimated at \$250 per hour, the contracts that were for \$1 million or more were for between 4,000 and 33,000 hours. The list also showed that the length of these contracts was frequently three to five years.

Contracts With Outside Counsel Often Include Recommended Tools for Managing Legal Contracts

The Attorney's Office's policies in place until November 2005 provided a reasonable framework for good case management. The standard contract the Attorney's Office policy directed staff to use when contracting with outside counsel required outside counsel to submit certain recommended management tools, such as the following:

- A comprehensive budget that is updated periodically.
- Formal status and budgetary updates, in the form of quarterly reports summarizing all activity performed in the previous quarter, all upcoming deadlines and major events in the matter, and an analysis of whether outside counsel's fees and costs are within the projected budget for the matter.

Moreover, the contract allowed the Attorney's Office to request, if circumstances warranted, a strategic plan detailing the available options for handling the matter, the major steps likely to be involved, the timing and sequence of the major steps, and the projected cost for each major phase of the representation (case plan).

Policies in place until November 2005 provided the Attorney's Office with a reasonable framework for good case management.

Each of these documents provided a means for the Attorney's Office to monitor outside counsel costs and ensure that outside counsel were delivering the agreed-on services. In addition, in its December 2001 policy on outside counsel, the Attorney's Office outlined the role and responsibilities of its staff in managing outside counsel contracts and using the required documents. For example, the policy directed managing attorneys to work with outside counsel to create budgets detailing total estimated costs. Additionally, managing attorneys were to receive outside counsel's quarterly reports. The December 2001 policy applied to all departments in which Attorney's Office personnel worked, including the three proprietary departments: the Port of Los Angeles (Harbor), Los Angeles World Airports (Airports), and the Department of Water and Power (DWP). According to the CFO, no policy for monitoring outside counsel existed before the December 2001 policy.

The Attorney's Office's December 2001 policy and related contract provisions contained certain key elements recommended as tools to help control outside counsel costs.

The Attorney's Office's December 2001 policy and its related contract provisions contained certain key elements recommended in *Successful Partnering Between Inside and Outside Counsel (Successful Partnering)* as tools to help control outside counsel costs. *Successful Partnering*, a joint endeavor of the American Corporate Counsel Association and West Group, a legal information company, is a comprehensive work detailing key aspects of the relationship between inside and outside counsel. It draws on legal experts and research from across the United States and has been updated since its publication in 2000 to reflect recent developments in the legal field. According to *Successful Partnering*, requiring outside counsel to submit and adhere to budgets is one of the most common prescriptions for containing the costs of outside counsel. In addition, using case plans focuses outside counsel on key issues so that they may establish priorities and function more effectively. The use of such plans is encouraged by *Successful Partnering* and other related best practices literature. Case plans are to be viewed as living documents that may need to be changed periodically.

Two of the three proprietary departments that we reviewed did not include in their contracts the key elements just discussed. Despite the December 2001 policy, which clearly stated that the standard contract was required for agreements with outside counsel unless prior approval had been granted, both Harbor and Airports opted to use different contracts. The standard

contract is important because it contains language describing the various documents and reports the Attorney's Office requires from outside counsel for monitoring purposes.

Even though Harbor's contracts generally directed outside counsel to submit case plans and quarterly reports, the contracts omitted the specific requirements to provide case budgets and to include budget updates with the quarterly reports. However, the case plans that Harbor's contracts generally required were to include the projected cost for each major phase of the representation. Airports' contracts, on the other hand, typically did not require outside counsel to submit any of the monitoring documents or reports that the Attorney's Office discussed in its standard contract, such as budgets, case plans, and quarterly reports. Specifically, of the five contracts we examined, only one obligated outside counsel to submit quarterly reports and case plans. Without those documents, managing attorneys lack useful information to help control outside counsel costs.

Without monitoring documents such as quarterly reports and case plans, managing attorneys lack useful information to help control outside counsel costs.

According to the attorney who oversees Harbor, he was not with Harbor in December 2001 when the Attorney's Office's policy was developed. He could not explain why Harbor did not adopt the standard contract according to the December 2001 policy. The attorney who oversees Airports informed us that he did not hold that position when the Attorney's Office issued its December 2001 policy. However, he stated that it is his understanding that Airports did not adopt the Attorney's Office's standard contract because it used a standard Airports contract tailored for its specific needs and with which its board was more familiar. We asked the CFO whether the city attorney or his chief deputy agreed to release Harbor and Airports from using the standard contract, as required by policy. The CFO informed us that the city attorney did not but that the chief deputy at the time might have granted that permission. However, the CFO added that the chief deputy and the attorneys overseeing Harbor and Airports are no longer with the City, suggesting that without input from those former staff members, it is impossible to know whether Harbor and Airports received an exemption from using the standard contract.

The Attorney's Office Did Not Always Obtain Budgets, Case Plans, or Quarterly Reports

Although it was clearly evident from our testing that managing attorneys were involved in the matters for which outside counsel were retained, they did not always require outside counsel to submit budgets, case plans, or quarterly reports. To assess the managing attorneys' level of involvement and determine how often the Attorney's Office makes use of the previously mentioned case management tools, we reviewed files for 21 contracts paid by the General Fund, DWP, Airports, or Harbor. The contracts were all entered into after the Attorney's Office's December 2001 policy went into effect.

The Attorney's Office often did not require outside counsel to submit comprehensive budgets. The Attorney's Office received comprehensive budgets for the four General Fund contracts we reviewed for which budgets were applicable. However, only two of the 16 contract files we reviewed at the proprietary departments contained budgets. Specifically, at DWP we reviewed five contract files and found none that included a comprehensive case budget. The results were the same for all but one of the four contract files we reviewed at Airports. One contract file of the seven we tested at Harbor included a comprehensive case budget.

In response to our inquiries about the lack of case budgets, some of the managing attorneys at DWP who were responsible for the contracts we reviewed indicated that the unknown or complex nature of their legal proceedings did not make budgeting practical. Additionally, staff within Harbor and Airports informed us that just because budgets were not reduced to writing did not mean that budgets were not in effect. In fact, certain staff at Harbor and Airports told us that before they enter into contracts, they have discussions with outside counsel regarding expected costs. Based on those discussions, the parties enter into a contract that includes a total budgetary amount. We recognize that any project, such as litigation, can take unexpected turns; however, even without knowing the final outcome, the creation of a budget forces outside counsel to strategize regarding their course of action, which could translate to costs savings. Moreover, by not committing a budget to writing with some degree of detail, the Attorney's Office lacks the necessary information to monitor outside counsel's performance.

When budgets are not committed to writing with some degree of detail, the Attorney's Office lacks the necessary information to monitor outside counsel's performance.

As we did with budgets, we assessed the frequency with which the Attorney's Office received case plans from outside counsel. Our testing included General Fund, DWP, and Harbor contracts but not those of Airports because its contracts with outside counsel typically did not require case plans. For the 17 contract files we reviewed, outside counsel submitted only seven case plans: three for General Fund contracts, three for Harbor contracts, and one for DWP contracts. According to staff at the Attorney's Office, formal case plans were not always obtained from outside counsel because of the unpredictable nature of the work to which outside counsel were assigned or because litigation strategies were discussed verbally. Some managing attorneys at Harbor and the Attorney's Office indicated that their frequent strategic discussions with outside counsel eliminated the need for a formal case plan. For example, one managing attorney stated that he did not require a case plan because he kept in contact with outside counsel through e-mail and telephone throughout the case. However, although the conversations may have been beneficial, they are not an adequate substitute for a case plan.

Additionally, a managing attorney at DWP contended that case plans were not practical in certain instances, particularly because of the nature of the legal services provided. The legal services the managing attorney referred to were for transactional work, such as the negotiation and preparation of energy contracts. However, as previously mentioned, the Attorney's Office's standard contracts indicate that case plans should include such items as the available options for handling the matter and the major steps likely to be involved, as well as the timing and sequence of major steps. Unless the cost of a matter is clearly inconsequential, a plan that allows for agreement on key items is valuable, whether the matter is litigational or transactional in nature. Moreover, the language in the Attorney's Office's contracts often leaves requesting a case plan to the discretion of the managing attorney. Based on the size of the contracts we reviewed, the costs associated with those cases were significant enough that we would have expected the managing attorneys to request case plans.

Although the December 2001 policy stated that managing attorneys should receive quarterly status reports, we did not always see evidence of these reports.

Finally, a third component of the monitoring policies and procedures the Attorney's Office had in place through its December 2001 policy was quarterly status reports. Although the December 2001 policy stated that "managing attorneys should receive quarterly reports from outside counsel," we did not always see evidence of the reports. Outside counsel

for Harbor submitted quarterly reports for three of the seven contracts we reviewed. Quarterly reports were submitted for three of the five General Fund contracts we reviewed and for one of the five DWP contracts. Most of the managing attorneys to whom we spoke who had not received quarterly reports indicated that they had not required them from outside counsel because they had received timely information through other means. Among those methods are e-mail correspondence, telephone conversations, receipt of court documents, and in-person strategy sessions with outside counsel.

Informal methods of monitoring do not allow for the high-level assessment that all projects require.

We typically saw evidence that those types of interactions occurred. However, we do not consider those interactions to be substitutes for the required quarterly reports. According to the Attorney's Office contract requirements, a quarterly report is to reflect a summary of activity over the past quarter, upcoming deadlines and major events, and an analysis of whether outside counsel's costs are within the projected budget. Telephone conversations, e-mails, and in-person strategy sessions do not provide that level of summarization. In addition, although contact may have been frequent, the informal methods of monitoring do not allow for the high-level assessment that all projects require. Instead, they address the day-to-day needs of a legal matter, which are far different from the periodic summarization of the project, assessing where it has been and where it is headed, that a quarterly report allows.

Outside counsel for Airports did not submit quarterly reports for any of the four contracts we tested. As discussed previously, according to the attorney who oversees Airports, his understanding, is that Airports used a contract tailored specifically for its needs. Because the contract that Airports used did not include a requirement for quarterly reports, data was not obtained. However, Airports should have been following the December 2001 policy, which called for managing attorneys to receive quarterly reports.

We also assessed the files for 10 additional contracts that were entered into before the December 2001 policy went into effect. Similar to the contracts entered into after December 2001, we found that outside counsel sometimes submitted comprehensive budgets, quarterly reports, and case plans but at other times did not.

The Attorney's Office Revised Its Policy on the Use of Outside Counsel

The November 2005 policy issued by the Attorney's Office changed the monitoring procedures for case budgets and quarterly reports; the use of case plans remains discretionary.

As part of its new policy on the use of outside counsel issued in November 2005, the Attorney's Office revised its standard contract language. Although we reviewed the November 2005 policy and contract, we did not evaluate the Attorney's Office's compliance with it. The November 2005 policy changed the Attorney's Office's monitoring procedures for case budgets and quarterly reports. The use of case plans continues to be discretionary under the new policy.

The November 2005 policy differs from the December 2001 policy in that it no longer requires that a budget be prepared within 30 days of executing the contract. Instead, the November 2005 policy indicates that the amount of funding that the outside counsel committee (committee) recommends for a particular contract is based, in part, on a firm's budgetary projections. According to the CFO, the committee has consistently required detailed budgets since the new policy was issued. Further, the November 2005 policy eliminates the requirement that Attorney's Office staff periodically compare actual and budgeted costs. Instead, the policy states that budget updates will generally be required from outside counsel as contract amendments are proposed and that the need for additional funding will result in regular budget reviews. Further, the November 2005 policy eliminates the need for outside counsel to submit quarterly reports. In the policy, the reason the Attorney's Office offers for this change is that "these reports have proven to be less practical and useful than originally envisioned." Rather than requiring quarterly reports from outside counsel, according to the new policy, the Attorney's Office will, at least twice each year, provide updates to the city council or appropriate boards on all "significant" cases being handled by outside counsel. The policy does not include a definition of significant cases. In preparation for the updates, management personnel within the Attorney's Office are to work with outside counsel on providing status reports for each case being handled. Further, the new policy calls on the managing attorneys to closely monitor outside counsel's work by maintaining regular contact with them. The language regarding case plans in the Attorney's Office's revised standard contract is permissive, stating that the Attorney's Office may request a case plan but not obligating outside counsel to prepare one in every instance.

By eliminating its quarterly reporting requirement, the Attorney's Office may be limiting its insight into outside counsel's activities.

Budgets are an important means of controlling the costs of outside counsel. The professional literature recognizes that budgeting is the most common way to contain outside counsel costs. Without budgets and periodic comparisons of budgeted amounts to actual costs, the Attorney's Office cannot proactively minimize outside counsel costs by identifying services that are not cost-effective or that might be made more efficient. By eliminating its quarterly reporting requirement and instead relying on its work with outside counsel to create status reports as preparation for updates to the city council or appropriate boards, the Attorney's Office may be limiting its insight into outside counsel's activities. Moreover, the November 2005 policy requirement of reporting only on "significant" cases could further reduce the information available to the Attorney's Office for decision making. However, it is too early to tell what the long-term effects of the policy change will be.

Finally, the professional literature encourages case plans as a means of focusing outside counsel on key issues so that it can establish priorities and function more effectively. Our testing revealed that the Attorney's Office often did not obtain case plans. Because it leaves case plans to the discretion of the managing attorneys, we question whether that element of the Attorney's Office November 2005 policy will be used to a great extent.

THE ATTORNEY'S OFFICE'S POLICIES AND PROCEDURES FOR REVIEWING OUTSIDE COUNSEL'S INVOICES ARE REASONABLE, BUT IT COULD BETTER IDENTIFY AND ELIMINATE CERTAIN QUESTIONABLE COSTS

Although its prescribed process for reviewing outside counsel's invoices for contracts paid by the General Fund and proprietary departments is reasonable, the Attorney's Office does not consistently apply its invoicing policies and procedures. In establishing comprehensive invoicing policies and implementing a review process to ensure that outside counsel follow them, the Attorney's Office has helped control outside counsel costs. Our testing of 41 invoices demonstrated that the Attorney's Office often eliminated invoiced charges that conflicted with its policies. Nevertheless, we identified certain instances in which the Attorney's Office did not apply its invoicing policies and paid outside counsel for costs that were not allowed. Those costs were primarily related to block billing—the practice of grouping tasks and invoicing for an aggregate amount of time, rather than specifying the time spent and costs associated with each task. In addition, attorneys and

paralegal staff were sometimes billed to the City without prior written approval. Although the Attorney's Office's invoicing policies seek to establish a standard for reasonable billing practices and to encourage accountability based on cost-benefit considerations, it undermines those efforts by not consistently identifying all unallowable costs. In addition, the Attorney's Office risks paying more for outside counsel than it has to or is contractually obligated to pay.

The invoicing policies and review procedures that the Attorney's Office has developed to manage outside counsel costs are reasonable.

Legal invoices generally contain two types of costs: legal fees and expenses. Legal fees consist of attorney and paralegal fees typically charged at an hourly rate, and expenses include charges for such items as copies and delivery services. The invoicing policies and review procedures the Attorney's Office has developed to manage outside counsel costs are reasonable. Specifically, the policies and procedures encompass three components: invoicing requirements outlined in its standard contract; its Guidelines for Outside Counsel (guidelines), which are included in the contract; and an established invoice review process.

In its standard contract the Attorney's Office specifies the frequency with which outside counsel must invoice the City and the form the invoices must take. For example, the standard contract states that firms are to invoice the City monthly and that the invoice must specify the compensation and expenses by assigned task and must identify the attorney or staff member performing the task and the date on which the task was performed. The contract requires outside counsel to submit invoices that are "highly specific and highly detailed" and expressly prohibits block billing. In addition, the contract describes costs that outside counsel may not invoice the City for, such as fees for hours devoted to matters other than those specified in the contract, review of junior attorneys' work, and resources not reasonably necessary for the services being contracted for.

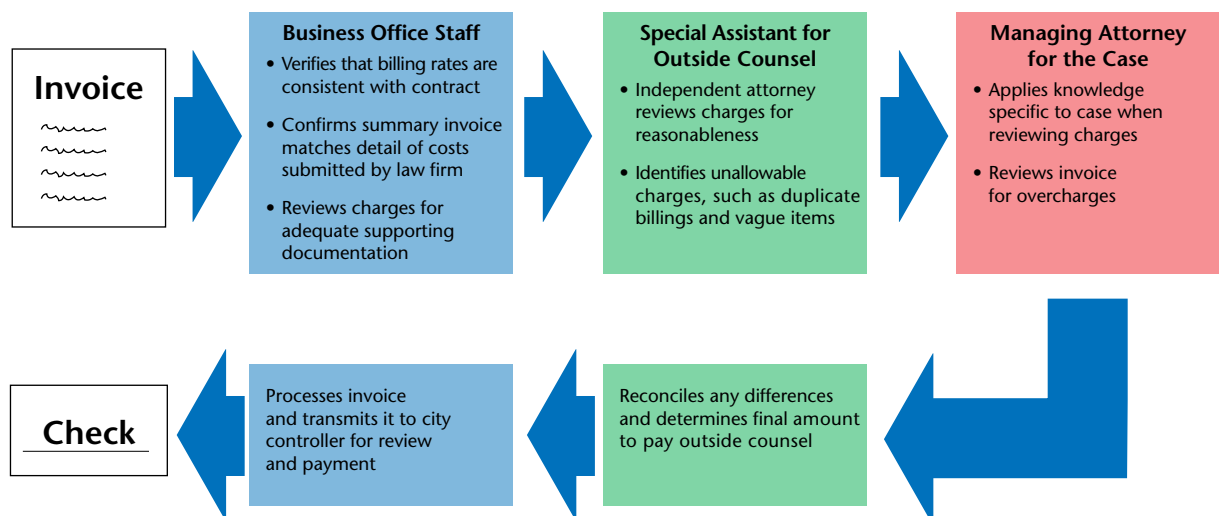
The Attorney's Office's guidelines further detail acceptable invoicing practices. The guidelines state that any rate increase must be approved in advance and in writing, require advance written approval for individual expenses in excess of \$500, and state that the City will not pay for vague services such as "research," "analysis," and "conference." With the standard contract and its guidelines, the Attorney's Office reasonably outlines the level of detail that an invoice must reflect and the types of costs for which outside counsel can and cannot invoice.

To ensure that the legal fees and expenses it is billed for are appropriate and in accordance with its invoicing policies, the Attorney's Office has a process in place for reviewing each invoice received from outside counsel. Each invoice is subject to an internal three-part review. In place for all General Fund legal contracts since October 2001 and all proprietary legal contracts since October 2004, the process incorporates a review by business office staff, the special assistant for outside counsel (special assistant), and the managing attorney assigned to the day-to-day monitoring of the specific matter for which outside counsel have been assigned. According to the CFO, no centralized invoice review existed before this process was implemented. As the Figure demonstrates, once outside counsel submit an invoice to the Attorney's Office, business office staff perform various administrative checks on the invoice. After that the special assistant and the managing attorney for the case review the invoice for reasonableness and compliance with the Attorney's Office's policies. In having multiple checks and balances, such as requiring that an invoice be reviewed by both an attorney with unique knowledge of the case and an independent attorney who reviews all invoices, the Attorney's Office helps reduce the risk that outside counsel will overcharge the City for legal work.

Through its invoicing policies and procedures, the Attorney's Office has established a mechanism that the legal community recognizes as valuable in controlling the costs of outside

FIGURE

Invoice Review Process Used for Outside Counsel



counsel. *Successful Partnering* suggests that well-planned billing procedures should address the frequency of and form in which outside counsel submit invoices—for example, requiring a description of the work performed and the names of attorneys performing the work. It also recommends that organizations require detailed invoices from outside counsel, because that detail allows inside counsel to determine whether outside counsel are adhering to billing guidelines, performing unauthorized work, replacing attorneys too frequently, exceeding the realm of reasonable paralegal work, or charging excessive amounts for expenses. The policies and procedures the Attorney's Office has in place address those best practices.

Our review of 41 invoices revealed numerous instances in which the Attorney's Office disallowed charges.

Our review of legal fees charged on 41 outside counsel invoices recorded between July 2003 and June 2005 for the General Fund and proprietary departments revealed numerous instances in which outside counsel did not comply with the invoicing policies and the Attorney's Office disallowed charges. For example, on one invoice we observed that the Attorney's Office reduced the charges by \$5,362 because the outside counsel had invoiced for the work of more than one attorney to complete the same task and because certain line items were vague. The standard contract and guidelines stipulate that the Attorney's Office will not pay for duplicate work or vague tasks. As previously mentioned, during the invoice review process, the special assistant assesses the invoice for reasonableness. We saw examples of this practice throughout the invoices we reviewed. For instance, we noted one invoice that the special assistant reduced by \$255 because the hours spent on a particular task seemed excessive. In addition, we found that nearly all the invoices dated after October 2004 that we reviewed had gone through the Attorney's Office's three-step review process.⁴

However, the Attorney's Office could improve its enforcement of two of its invoicing policies—those prohibiting block billing and billing for time spent by attorneys and paralegal staff who were not named in the contract or otherwise approved in writing. The most prevalent problem we noted was block billing. Sixteen of the 41 invoices we reviewed were submitted by outside counsel with at least one line item in a block format that the Attorney's Office did not disallow. For example, in one outside

⁴ In October 2004 the Attorney's Office centralized its review of invoices for the proprietary departments. Before October 2004 outside counsel for the proprietary departments submitted invoices directly to those departments to be reviewed by the corresponding managing attorney. Since October 2004 outside counsel for the proprietary departments have submitted invoices to the headquarters office as part of the three-step process.

counsel invoice, the firm included a block line item totaling seven hours and \$1,365. The block bill described seven activities: reviewing documents, working on a declaration, organizing documents, working on a motion for dismissal, responding to a memorandum from opposing counsel, researching certain matters, and working on a reply in support of a different motion. When tasks are grouped together into a block of time, it is not clear to the reviewer the amount of time the attorney spent on each activity. For that reason the guidelines established by the Attorney's Office specifically prohibit outside counsel from block billing. Nevertheless, our review revealed that the Attorney's Office generally did not eliminate these types of costs.

The Attorney's Office could improve its enforcement of two of its invoicing policies—those prohibiting block billing and billing for attorneys and paralegal staff who were not approved in writing.

According to the special assistant, she does not always disallow block billing if the overall amount for the grouped tasks appears reasonable. However, because she lacks information on the amount of time spent on each activity, the special assistant does not have all the information necessary to make an optimal determination whether the time spent on each task or in total was reasonable. Because the Attorney's Office did not always follow its policy by disallowing block billing, it may have paid more for outside counsel services than was appropriate. Moreover, the Attorney's Office might undermine its efforts to control outside counsel costs when it does not consistently identify costs that its invoicing policies do not allow.

During our testing we also identified instances in which the Attorney's Office paid outside counsel for the work of attorneys and paralegals who were not authorized in the contract. Typically, the Attorney's Office requires in its contracts that each attorney and paralegal be preapproved in writing. However, the Attorney's Office has not always enforced its policy. For example, for six of the 41 invoices we reviewed, we identified names of attorneys and paralegals who were not approved in writing. The attorneys we spoke with who were charged with managing the outside counsel contracts stated that the attorneys or paralegals named in the invoices were approved verbally. However, under that form of approval, the managing attorney or outside counsel could lose track of which attorneys were approved, possibly leading to a misunderstanding later. Not obtaining written approval for all attorneys invoiced under an outside counsel contract increases the risk that more attorneys than are necessary for the size of the engagement will bill the City, and that the City will pay more to outside counsel than it is contractually obligated to pay.

THE ATTORNEY'S OFFICE COULD MORE EFFICIENTLY AND EFFECTIVELY MONITOR OUTSIDE COUNSEL COSTS BY COMPARING BUDGETED TO ACTUAL COSTS FOR ACTIVITIES

The Attorney's Office could more efficiently and effectively monitor outside counsel costs if it prepared budgets detailed by activity and required outside counsel to submit invoices that had the same level of detail and could thus be compared to the budget. For cases we reviewed in which outside counsel provided budgets to the Attorney's Office, the budgets were in varying formats and showed varying levels of detail.

The Attorney's Office's December 2001 policy stated that managing attorneys should participate in the creation of a litigation budget that describes, in detail, the total estimated cost of outside counsel's assistance in a matter. The policy also directed managing attorneys to periodically compare outside counsel's actual costs against budgeted costs. However, the November 2005 revised policy states that budget updates are generally required from outside counsel as contract amendments are proposed, and managing attorneys are not required to compare budgeted costs with actual costs. Thus, it appears that reacting to the need for more funding, rather than proactive cost control, now drives budget reviews, because their use is tied to requests for supplemental funding.

Although comparing budgets against actual costs was required by the policy in effect during the period of our audit, our review of selected contracts found no evidence that Attorney's Office staff made the comparisons. Even though Attorney's Office staff ensured that total invoices did not exceed total contract costs and reviewed lengthy invoices that reflected time charged in increments as small as six minutes, the invoice review discussed in the previous section is labor intensive, and its comprehensiveness and effectiveness are limited. Comparing outside counsel costs to budgeted costs by activity within litigation or project phase should enable the Attorney's Office to better facilitate effective communication on the progress of its cases and any deviations from established budgets.

Comparing outside counsel costs to budgeted costs by activity should better facilitate effective communication on the progress of cases and deviations from established budgets.

Using a Budget as a Tool to Control Costs Has Various Benefits

Successful Partnering points out the following insights, among others, of using a budget as a tool to control costs on an engagement. One of the most important benefits of preparing a budget is that it forces inside and outside counsel to agree on the

strategy going forward. To maximize the benefits of budgeting, the process of preparing a budget should be regarded as an exercise in analyzing the scope of the engagement, assessing the likely costs, and implementing the necessary control devices to contain costs. The budgeting process should be seen as ongoing and subject to change as the engagement progresses.

A key project management control made possible by comparing costs to date with the budget is the corresponding discussion of the hours remaining to complete the activity, which would determine whether the costs to date plus the remaining costs are within the authorized budget. That discussion identifies whether the current legal strategy may need to be revised because it is not as cost-effective as initially anticipated. Without a detailed budget that identifies costs to date and estimated remaining costs for significant activities within litigation or project phases, Attorney Office staff do not have the data available to gauge the reasonableness of prior costs and anticipated remaining costs for particular efforts.

By having outside counsel's invoices list attorney hours by activity, the Attorney's Office can explore whether outside counsel are performing efficiently over the entire case.

By having outside counsel's invoices list the attorney hours by activity within a litigation or project phase, the Attorney's Office can also explore whether outside counsel are performing efficiently over the entire case, instead of limiting its analysis to a specific invoicing period, as is currently the case. For example, the Attorney's Office might be able to identify unnecessary work by detecting excessive hours spent on a relatively insignificant issue or minor task across numerous invoicing periods. When attorneys in a case are being replaced too frequently, the Attorney's Office might be able to discover charges for excessive hours for new attorneys to review background material. However, those types of problems cannot be identified efficiently and comprehensively unless the invoices are organized by activity within a litigation or project phase since the beginning of the case.

The Attorney's Office is prevented from performing this type of meaningful invoice review because it does not require its contractors to submit invoices that organize attorney time according to the nature of the work performed. The enormous volume of line-item charges by individual attorneys that can appear on invoices generally makes efforts to manually compile attorney time according to activity within a litigation or project phase impractical. Compiling attorney time in that way has become far easier since the advent of computerized invoicing

systems that generate invoices with summaries by issue and by attorney, and since the development of standardized activities applicable to various types of legal work.

Although we did not see any evidence that managing attorneys performed a routine comparison of actual to budgeted costs for specific activities, managing attorneys to whom we spoke indicated that they examined activities in the invoices for reasonableness. One managing attorney told us that, when outside counsel were performing an important or time-consuming task, he would compare actual costs to budgeted costs by estimating the actual costs through a review of individual invoices. We questioned how that was possible, considering that each invoice could have hundreds of line items during a particular billing period and that attorneys could be working on different tasks. The attorney clarified that he would typically perform that type of analysis when he knew that outside counsel were expending most of their efforts on a certain task, such as discovery or an important brief when the invoices would better lend themselves to this type of analysis. Two other attorneys indicated that they would personally comb through the invoices to determine the reasonableness of the charges. One of those attorneys stated that the reviews were “generally detailed and on occasion quite time-consuming.” By requiring outside counsel to submit invoices by activity, managing attorneys would be better equipped to conduct a systematic review of the reasonableness of each activity, both as a stand-alone item and in comparison to the budget. In addition, reviewing invoices in that format would likely take less time.

A Standardized List of Activities That Attorneys Perform Has Already Been Developed

To facilitate the effective communication of activities within litigation or project phases and contain the costs of litigation, one possible approach for the Attorney’s Office to consider is the result of a joint effort by a consortium of the American Corporate Counsel Association, the American Bar Association, and a group of law firms and clients (consortium). The consortium developed standardized lists of activities applicable to the various types of work attorneys perform. The standardized lists consist of different sets of activities for litigation, counseling, and bankruptcy work and a more generic project list of activities for other legal tasks, such as transactional work.

The activities list for litigation is grouped into five basic phases or aspects of litigation, plus expenses. The five phases are case assessment, development, and administration; pretrial pleadings and motions; discovery; trial preparation and trial; and appeal. Each phase consists of a number of tasks or activities, such as written discovery, document production, and depositions. In total, the list for litigation contains 29 activities. The intent is to provide a true picture of the labor cost of each activity. The monthly invoices would then list that month's charges by activity, which would facilitate comparing those charges, along with the cumulative totals, with the detailed budget. Monthly invoices would still contain the detailed line items that can be useful for determining whether individual charges are reasonable. However, the detail would be summarized in such a way as to afford a global view of the litigation or project.

The Attorney's Office Has Concerns About Using Activity-Based Invoices for Managing the Cost of Outside Counsel

The Attorney's Office acknowledged the challenges associated with achieving a comprehensive view of how legal dollars are spent using traditional legal invoices.

The managing assistant city attorney for the Business and Complex Litigation Division (managing assistant city attorney) within the Attorney's Office acknowledged the challenges associated with achieving a comprehensive view of how legal dollars are spent using traditional legal invoices that present detailed line-item descriptions of the time spent by each attorney on a case each day (as opposed to being organized by activity within each litigation or project phase). He stated that the Attorney's Office management would embrace a management tool that would aid in reviewing invoices from outside counsel if the tool was effective and reasonable. He further acknowledged that the outside counsel the City works with are likely able to submit invoices in a task-based format.

However, he went on to describe various reasons why the Attorney's Office would be unlikely to embrace the activities list developed by the consortium. For example, he stated that performing the initial setup and analysis at the task level might not be the best use of the City's limited resources, because information in the budget or case plan typically changes as the case develops. He commented that because invoices are always submitted after a task is done (sometimes two or three months later), comparing tasks to a modified budget or case plan (or, conversely, comparing tasks to an unmodified budget or case plan) would not provide a useful tool for comparing expectations to the reality of the case.

Effective management of contracts requires that managing attorneys think through expected resources, document an agreed-upon set of activities with outside counsel, and monitor the efficiency of execution.

However, even if the Attorney's Office's resources are limited, effective management of contracts by the managing attorneys still requires that they think through the resources they want to spend on the activities needed to execute an agreed-on strategy, document an agreed-on set of activities with outside counsel, and monitor the efficiency of execution. Unless the Attorney's Office is not currently investing time to perform those cost reduction steps in some fashion, the additional time required should be minimal. In addition, it is not possible to effectively manage contracts with outside counsel if the Attorney's Office receives invoices for services two or three months after services were performed, because an analysis of the charges for those services would likely be too late to identify the need for a change in strategy. The points raised by the managing assistant city attorney further highlight the need for timely receipt and review of invoices. Also, budget changes are typically needed in projects of any type, and separate line items make it possible to separate hours related to the initial scope of work from those related to the new scope of work and to compare each to their respective budgets.

The managing assistant city attorney was also concerned that no public entity had participated in the creation of the consortium's activities list, and he knew of no public entities that use task-based billing. However, neither concern seems relevant in addressing why a technique employed by in-house counsel in corporations to manage outside counsel contracts with private law firms may not be beneficial to public entities such as the Attorney's Office.

THE ATTORNEY CONFLICTS PANEL IS GENERALLY MANAGED APPROPRIATELY, ALTHOUGH THE SELECTION OF FIRMS FOR THE PANEL COULD BE BETTER DOCUMENTED

When the Attorney's Office has an actual or potential conflict of interest—that is, a case in which it cannot ethically represent a city employee whose interests may be adverse to those of the City—it refers the matter to the attorney conflicts panel (conflicts panel). The conflicts panel comprises law firms selected by the Attorney's Office, in conjunction with the Office of the City Administrative Officer (CAO), to provide legal services to the City in the event of a conflict of interest. The selection process culminates in a committee from the Attorney's Office (selection committee) making a recommendation to

the city council, which makes the final contracting decision. The major types of litigation for the conflicts panel are cases involving police or employment issues.

In May 2005 the Attorney's Office began administering a competitive selection for a new conflicts panel. Based on our review of the process it followed, we determined that the Attorney's Office could better document its selection of firms for the conflicts panel. The CAO, an entity that is separate from the Attorney's Office and whose primary role is chief financial adviser to the mayor and city council, is the day-to-day overseer of the conflicts panel. Thus, an adequate separation exists between the Attorney's Office and the legal matter when the Attorney's Office declares a conflict of interest.

The Attorney's Office has augmented the conflicts panel in the past, most recently through a selection process it began in 2002. Firms that were on the conflicts panel remained on, and the RFQ was used to identify additional firms for the panel. According to CAO staff, the number of cases increased, and the CAO needed additional firms to help with the conflicts panel workload. According to its policy, the Attorney's Office is to issue an RFQ for the conflicts panel on an as-needed basis or every three years. Thus, the Attorney's Office, in conjunction with the CAO, issued another RFQ in May 2005. At that time the Attorney's Office required all firms to participate in the selection, including firms that were currently on the conflicts panel. In mid-November 2005 the Attorney's Office submitted the selection committee's recommendations to the applicable committee of the city council for approval.

It was evident that the selection committee interviewed prospective firms for the conflicts panel, but it did not sufficiently document its rationale for choosing some firms over others.

In reviewing the process used to evaluate firms responding to the 2005 RFQ, which took place during our audit, we concluded that the Attorney's Office could better document how it made its decisions when selecting firms to recommend for placement on the conflicts panel. The Attorney's Office has overall responsibility for the selection process, although CAO staff were involved in the process, including participating in the selection committee. It was evident that the selection committee interviewed prospective firms, but the selection committee did not sufficiently document its rationale for choosing some firms over others. As in our review of other selection processes that the Attorney's Office conducted, we found that the RFQ that was released cited evaluation criteria, in this case focusing on

ability and experience, but that the selection committee could not provide sufficient documentation to support the decisions it made based on the criteria.

According to the deputy city attorney responsible for conducting the RFQ, the selection committee held a conference in which members shared their opinions of each firm based on the firm's performance in interviews, the proposal it submitted, and the firm's reputation, among other items. The deputy city attorney explained that after its members had reached a consensus, the selection committee chose firms to recommend for placement on the conflicts panel. The selection committee used a recommendation form to document which firms were suitable to serve on the panel. Each firm had an opportunity to apply for up to four categories of expertise, such as complex police/tort litigation and employment litigation. On the recommendation form the committee indicated by checking "yes" or "no" whether it recommended a firm to provide services for the categories for which it had applied. At our request the Attorney's Office was able to provide some interview notes from some members of the selection committee. However, the selection committee did not maintain documentation, such as rating sheets, to support its decisions. Without sufficient documentation to show why it made the selections it did, the Attorney's Office leaves itself vulnerable to criticisms that the process was not conducted in a fair and objective manner.

Without sufficient documentation to support its decisions, the Attorney's Office leaves itself vulnerable to criticisms that the conflicts panel selection process was not fair and objective.

The CAO's Invoice Review Process Appears Reasonable

As discussed earlier in this report, a valuable mechanism for controlling the costs of outside counsel is the existence of detailed invoicing guidelines. The contracts that the City enters into with outside counsel through the CAO contain the CAO's invoicing policy, which is comparable to the policies of the Attorney's Office. The contracts specify the frequency with which outside counsel must invoice the City and the form the invoices must take. The policy included in the contracts places restrictions on certain types of fees and expenses. For example, outside counsel cannot charge the CAO for the time of two or more attorneys to complete the same task unless the arrangement is approved by the CAO in advance. In addition, the CAO has established an internal process for reviewing outside counsel invoices for compliance with its invoicing policy and disallows costs that do not comply. As a result, the CAO focuses on eliminating costs for which it is not contractually obligated to pay.

Our review of invoices indicated that the CAO consistently followed its review process and applied its established invoicing policy.

Our review of 10 invoices indicated that the CAO consistently followed its review process and applied its established invoicing policy by disallowing costs that were not in accordance with its policy. For example, we noted an instance in which the CAO disallowed a charge of 2.5 hours totaling \$500 because the description provided by outside counsel on its invoice was deemed to be vague. The invoicing policy prohibits charges that are so vague that the CAO cannot understand the precise nature of the work performed. In another instance the CAO reduced charges for duplication of work, which are prohibited by its policy. Specifically, the CAO eliminated a charge of \$1,225 for seven hours from an attorney who attended the same court appearance as two other attorneys. In contrast to our review of invoices at the Attorney's Office, at the CAO we did not observe any invoices in which block billing was allowed or any invoices that charged for attorneys not previously approved in writing.

The CAO's Monitoring Policies Are Generally Appropriate, But It Could Require Budgets More Often

The CAO's policies for monitoring cases handled by outside counsel are similar to those of the Attorney's Office in that its contracts require outside counsel to submit reports that are useful for monitoring, including budgets and quarterly status reports. The CAO's procedures manual states that the CAO is responsible for ensuring that outside counsel comply with the terms and conditions of its contracts. Our review revealed that the CAO generally has performed an adequate job of monitoring outside counsel. However, we found some contracts that did not require outside counsel to submit budgets.

The CAO uses two types of contracts when working with outside counsel. One type is the CAO's standard contract, which requires outside counsel to submit budgets and quarterly reports. The CAO used a second type of contract for the Rampart cases, which stemmed from allegations of police misconduct and corruption in Los Angeles in the late 1990s. Specifically, rather than requiring budgets in all instances, the Rampart contract required outside counsel to submit budgets for matters expected to exceed \$50,000. In testing three standard contracts, we found budgets in all three instances. Because the two Rampart contracts we selected were less than \$50,000, they did not require budgets, although for one contract outside counsel submitted a budget. All five contracts required outside counsel to submit quarterly reports, and we found that outside counsel submitted them in three of the four instances in which the cases lasted long enough

for the reports to be necessary. Regarding the one instance in which the CAO did not receive quarterly reports but should have, the CAO's senior administrative analyst who oversees the conflicts panel commented that because of time constraints related to trial preparation, the firm communicated with the CAO through telephone conversations and document filings instead of quarterly reports.

We inquired why the Rampart contracts did not require budgets except for matters exceeding \$50,000. According to the CAO's senior administrative analyst, only a handful of Rampart cases exceeded the \$50,000 threshold. The senior administrative analyst said that the Rampart cases were special, and she added that outside counsel generally were asked to submit budgets for Rampart cases. In addition, the senior administrative analyst stated that other measures to control costs were used, such as the Attorney's Office making various nonconfidential legal documents like briefs, pleading, and background materials available to outside counsel so the attorneys did not have to recreate those documents.

In our review of a report summarizing Rampart case costs between June 2000 and May 2005, we found that only 12 of the 455 Rampart cases exceeded \$50,000; therefore, most of the Rampart cases did not require budgets. Our analysis also showed that the remaining 443 Rampart cases accounted for \$7.4 million of the total \$8.3 million in costs for outside counsel related to Rampart. In contrast, the three standard contracts we reviewed were all originally for \$25,000, yet the contract language required budgets for those cases. It seems inconsistent that standard cases that may be smaller in scope than a Rampart case required a budget while the Rampart cases did not. Because budgets are a recognized tool for controlling costs, and considering the sizable total dollar amounts of the Rampart cases, it seems reasonable for the CAO to have required, through its contracts, that outside counsel submit budgets.

Finally, according to the senior administrative analyst, the CAO's intent is to model its policy after that of the Attorney's Office to the extent that it is applicable. Thus, the CAO plans to review the Attorney's Office November 2005 policy to determine how its own policies may change in the future.

THE ATTORNEY'S OFFICE TAKES APPROPRIATE ACTION TO ADDRESS CONFLICTS OF INTEREST IDENTIFIED BY OUTSIDE COUNSEL

Conflicts of interest can arise between the City and a particular law firm's numerous other clients for various reasons. For example, a conflict of interest occurs when a law firm that currently represents or plans to represent the City has a contract or potential contract with another client that intends to seek a legal remedy against the City or, conversely, has been sued by the City. According to the California Rules of Professional Conduct (professional conduct rules) on conflicts of interest, outside counsel must provide written disclosure to its client of the actual or potential conflict, and the client must subsequently agree in writing that such representation can occur or continue. The Attorney's Office's policies and procedures regarding whether to waive a conflict and proceed with a contract appear appropriate. In addition, our review revealed that the Attorney's Office has followed its policies and procedures. The professional conduct rules on conflicts of interest, which regulate the conduct of members of the California State Bar, do not obligate the Attorney's Office to identify potential or actual conflicts of interest that outside counsel may have; rather, outside counsel are responsible for identifying conflicts and informing the Attorney's Office of them. All law firms, regardless of whether their contract with a client explicitly includes a conflict of interest provision, must adhere to the conflict of interest provisions in the professional conduct rules. Additionally, the professional conduct rules require that the Attorney's Office provide written consent to work with outside counsel following counsel's disclosure of any conflicts of interest, or outside counsel cannot agree to continue to represent the Attorney's Office.

The Attorney's Office has reasonably sought to address conflicts of interest.

The Attorney's Office's policies and procedures regarding whether to waive a conflict of interest demonstrate that the Attorney's Office has reasonably sought to address conflicts of interest. A January 2003 memorandum announced the formation of a conflicts analysis team (conflicts team) and set forth the steps to be followed when the Attorney's Office was notified of an actual or potential conflict of interest. The memorandum specifies that outside counsel is to provide written disclosure of the actual or potential conflict and the conflicts team is to review the matter, determine whether it believes a conflict exists, and if so, recommend whether it should be

waived. The city council or the applicable board then makes the final decision as to whether to waive the conflict, based on the recommendation of the conflicts team.

In August 2004 the Attorney's Office assigned the responsibility to review and recommend waiver of conflicts to the outside counsel committee (committee). The procedures the committee uses to review conflicts essentially remained unchanged from those used by the conflicts team. After outside counsel notifies the committee in writing of a potential or actual conflict, the committee reviews the matter and, if it determines that a conflict should be approved, recommends that the city council or board, as appropriate, grant the waiver.

We reviewed most of the waivers that the Attorney's Office recommended be granted between January 2003 and June 2005. Our work confirmed that the Attorney's Office took the appropriate actions to address conflicts of interest identified by outside counsel. Both the conflicts team and the committee essentially followed the same process for reviewing potential conflicts. Further, outside counsel provided written disclosure of actual or potential conflicts, and the city council or applicable board provided written consent to representation.

RECOMMENDATIONS

To ensure that the decisions it reaches within the outside counsel committee to retain outside counsel are justified in accordance with the policy of the Attorney's Office and to enable it to demonstrate the justification to interested parties, the Attorney's Office should ensure that the outside counsel committee follows the new policy of preparing a memo to document each of its decisions. The Attorney's Office should ensure that the memo sufficiently reflects the analysis used by the outside counsel committee in reaching its decision to recommend the retention of outside counsel.

To ensure that its recommendations for contract awards are less vulnerable to criticisms, the Attorney's Office should develop and implement comprehensive RFP and RFQ policies and procedures that specify standards for applying evaluation criteria such as the use of rating sheets and retaining documents. For instance, the Attorney's Office could use

the document retention standards established in the City's contracting manual as the basis for developing its own document retention policy and procedures.

To ensure that it can demonstrate that its decisions to select outside counsel in a noncompetitive manner are justified and in accordance with policy, the Attorney's Office should make certain that the outside counsel committee follows the new policy of drafting a memo regarding the firm it recommends for selection. The Attorney's Office should ensure that the memo sufficiently reflects the analysis used by the outside counsel committee in concluding a noncompetitive selection was necessary and appropriate.

To help control the costs of outside counsel, the Attorney's Office should require budgets and case plans. Specifically, it should ensure that contracts with outside counsel contain provisions requiring comprehensive budgets and case plans and ensure that the requirements are met.

The Attorney's Office should take steps to ensure that all its staff, regardless of the department they are serving, are following its prescribed policies and procedures. For example, Attorney's Office staff should ensure that staff at the proprietary departments use the standard contract when retaining outside counsel.

To ensure that its November 2005 policy change of eliminating quarterly reports has not limited its insight into the activities of outside counsel, the Attorney's Office should periodically evaluate its process of obtaining status updates to report to the city council or appropriate board on significant outside counsel cases and modify that approach if necessary.

To help control the costs of outside counsel, the Attorney's Office should enforce its contract requirements and billing guidelines. Specifically, the Attorney's Office should do the following:

- Disallow payment for invoices that it receives in a block-bill format and require that outside counsel resubmit the charges in the prescribed manner.
- Ensure the formal approval of attorneys and paralegals not previously listed on the contracts with outside counsel.

To achieve a comprehensive view of how legal dollars are spent and to facilitate a comparison of budgeted costs with costs to date, the Attorney's Office should require outside counsel to prepare monthly invoices and cumulative cost reports that sort charges both by attorney within activity and by activity within litigation or project phase. Further, the Attorney's Office should compare cumulative charges and estimated remaining charges to agreed-on budgets.

To help control the costs of outside counsel, the CAO should require budgets for all contracts with outside counsel that it manages.

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 government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,



ELAINE M. HOWLE
State Auditor

Date: January 26, 2006

Staff: Karen L. McKenna, CPA, Audit Principal
Sharon L. Smagala, CPA
Jessica Oliva
Claudia Orsi
Paul Philip Zahka

Agency comments provided as text only

City of Los Angeles
Office of the City Attorney

January 10, 2006

Ms. Elaine M. Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

This provides my response to your review of the City's use of outside counsel.

We appreciate the work of your staff in reviewing our policies and procedures in this area, and in recommending ways in which we can further improve our operations. While improving the oversight of outside counsel is an ongoing process, we are pleased that our progress has been noted and intend to fully explore your staff's recommendations into how we can ensure continued improvement.

Thank you for your interest in this issue and for your staff's investment of time and energy in reviewing this matter.

Sincerely,

(Signed by Rockard J. Delgadillo)

Rockard J. Delgadillo

Agency comments provided as text only

City of Los Angeles
Office of the City Administrative Officer
1500 City Hall East
Los Angeles, Calif. 90012-4190

January 10, 2006

Ms. Elaine M. Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

This provides our response to your review of the administration of the Attorney Conflict Panel by the Office of the City Administrative Officer (CAO).

We appreciate the work of your staff in reviewing our policies and procedures in this area, and in their recommendation as to how we can further improve our oversight of conflict counsel. The CAO acknowledges the importance of budgets as a mechanism for controlling outside litigation costs. Should another extraordinary circumstance such as Rampart occur, the CAO will require budgets in all cases, as is required in all other conflict of interest matters.

Thank you for your interest in this issue and for your staff's investment of time and energy in reviewing this matter.

Sincerely,

(Signed by William T Fujioka)

William T Fujioka
City Administrative Officer

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press